



ASSOCIATION INTERNATIONALE DE DROIT DES ASSURANCES

# **Transparency in Insurance Law**

Istanbul, 4 May 2012

**Joint Seminar Organized by**

**SİGORTA HUKUKU TÜRK DERNEĞİ**

**Turkish Chapter of AIDA**

**&**

**DEUTSCHER VEREIN FÜR VERSICHERUNGSWISSENSCHAFT**

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**SİGORTA HUKUKU  
TÜRK DERNEĐİ**

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**SIGORTA HUKUKU TÜRK DERNEĐİ**  
TURKISH CHAPTER OF AIDA

*Deutscher Verein für  
Versicherungswissenschaft*



**DEUTSCHER VEREIN FÜR VERSICHERUNGSWISSENSCHAFT**  
GERMAN CHAPTER OF AIDA



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## Foreword

The International Association of Insurance Law/Association Internationale de Droit des Assurances (AIDA) was formed in 1960 for the purpose of promoting and developing, at an international level, collaboration between its members with a view to increasing the study and knowledge of international and national insurance law and related matters. It is in the spirit of furthering these collective goals that the Turkish and German Insurance Law Associations as national chapters of AIDA held a joint seminar on Transparency in Insurance Law on 4<sup>th</sup> May 2012 in Istanbul. The lectures that were held during this conference are collected in the present publication. All authors share in the assessment that transparency has developed into a guiding principle of modern insurance law (contract law, insurance mediation law and supervisory law). There is an increased importance of transparency and of legal transparency requirements. The reasons are manifold and different for the single areas of insurance law. The decision for what areas by which means and to what extent transparency should be legally required is a political one. Such a decision should be taken by paying heed to its potential impact on the whole insurance system. The financial consequences of such a decision should be carefully considered as well since it is the policyholder who will finally have to bear the costs. It is insofar a crucial duty of the legislator to achieve a balance between an equitable amount of transparency and a cost efficient conduction of business in order to increase the welfare gain created by insurance.

**Samim Ünan, *Istanbul***

**Manfred Wandt, *Frankfurt***



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# Transparency as a General Principle of Insurance Law

Dr. Manfred Wandt\*

## I. Introduction

The topic „transparency and insurance“ has as many layers as there are areas of legal practice. The facet to be analysed subsequently is that of the role that transparency plays in insurance law. In a nutshell we are dealing with the question of the existence and extent of **standards of transparency** in this field of law. The main focus will be on transparency in insurance contract law, in the law of insurance mediation and in insurance supervisory law.<sup>1</sup>

The **point of reference** of legal transparency standards differs depending on the area of insurance law concerned. In insurance contract law, on the one hand, the requisite of transparency attaches mainly to the rights and duties of the contractual parties (including product and cost transparency). In the law of insurance mediation, on the other hand, it is the legal relationship between the insurer and the intermediary, the status and the legal powers and duties of the intermediary but also his professional qualification and potential conflicts of interest that trigger a demand for transparency. In insurance supervisory law it is the organisation of business, the solvency of the insurer and its business activities that need to be transparent.

It is quite a commonplace to conclude that a standard of transparency exists in all areas of contract law and that such standards are continuously enlarged in the course of the evolution of consumer protection. The question, however, remains if insurance as a legal product and the insurance market as a whole exhibit such unique features that there is a ***sui generis* insurance law principle of transparency**.<sup>2</sup>

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<sup>1</sup> Regarding insurance competition law cp. *Dreher/Kling*, Kartell- und Wettbewerbsrecht der Versicherungsunternehmen, Munich 2007.

<sup>2</sup> Concerning transparency as a principle of (insurance-) contract law cf. *Basedow* [1999] VersR 1045 et seqq.

## II. Transparency in Insurance Contract Law

### 1. Definition

In the context of an insurance contract, transparency may be defined as comprehensibility, unambiguity and certainty. These terms may not be mistaken for synonyms for transparency but merely describe different aspects of the latter concept.

**Comprehensibility** means that a legal rule is framed in a way that it is understandable for its addressee. The problem in determining the level of comprehensibility lies in the determination of the person of reference. In insurance contract law this will usually mean that the legal rule must be comprehensible for the policyholder, i.e. the average policyholder. The question of what constitutes an average policyholder may not be assessed empirically since the term refers to a legal fiction comparable to that of the reasonable person under the common law (which is considered as a *normativer Maßstab*).<sup>3</sup>

A rule is to be considered as **unambiguous**, when and if the framing of said rule (this includes the statutory elements of the provision and its legal consequences) does not invite several possible interpretations. In this sense unambiguity is to be understood as the absence of any reasonable doubt concerning the interpretation of a provision.

Whether or not a provision is (sufficiently) **clear** may not be ascertained – in this sense the concept of clarity differs from unambiguity – by interpreting the provision itself. On the contrary the point of reference for clarity is in principle to be found in legal provisions outside the rule in question. Insofar a rule that is unambiguous may, nevertheless, be considered unclear and *vice versa*.

The **objective of comprehensibility may conflict with the objective of clarity**. This (often diametrical) opposition of the two objectives has not yet been sufficiently fathomed by German jurisprudence. In the case of an insurmountable conflict between the two objectives clarity takes precedence over comprehensibility.<sup>4</sup> This practical priority of the objective of clarity is based on the fact that if an average policyholder is confronted with a deficit of comprehensibility he is often in a position to overcome such deficit by other means such as seeking legal counsel. A deficit of clarity, on the contrary, cannot be compensated.<sup>5</sup>

<sup>3</sup> The national concept of the average policyholder may, insofar, differ from the legal fiction under community law. Regarding the average policyholder under German law cp. BT-Drucks. 16/3945 p. 48 (*Leitbild des mündigen Verbrauchers*, i.e. the responsible consumer); Lorenz [1998] VersR 1086; Wandt, *Bitburger Gespräche Jahrbuch 2006/II*, Munich 2007, p. 17 at 21. For the ECJ's concept of average consumer cp. ECJ [1995] NJW 3243 at 3244; *idem* [1998] NJW 3183 at 3184; Dreher [1997] JZ 167 at 170 et seqq. Cf. also Clarke, *Policies and Perceptions of insurance law in the twenty-first century*, Oxford 2005, p. 145.

<sup>4</sup> Römer [1999] NVersZ 97 at 104; Wandt in Beckmann/Matusche-Beckmann, *VersR-Handbuch*, 2<sup>nd</sup> ed. Munich 2009, § 11 para. 122 with further references.

<sup>5</sup> Cp. Wandt (fn. 4) § 11 para. 122 with further references.

## 2. Relevance

In the insurance sector the concept of transparency has another i.e. a more profound impact than in the context of contracts regarding the exchange of goods. This difference is predicated on the fact that insurance is a **legal product**.<sup>6</sup> Up until the occurrence of an insured event we are not dealing with an exchange of physical goods for money but with the exchange of a promise of performance for money. The absence of any physical manifestation of the mere promise to perform hinders a visual inspection as it is possible under contracts for the exchange of goods. The insurance product only comprises the insurance policy and the general conditions of insurance (in German *Allgemeine Versicherungsbedingungen* [AVB]). Insurance may, nevertheless, not be described as a completely “invisible good” – as some do not tire to claim<sup>7</sup> – due to the fact that the contract is usually fixed in writing.

The **legal product**, however, **only manifests itself in paper and language**. What is worse, the (linguistic) manifestation is not limited to common language but is rather based on legal language and technical terminology. Furthermore insurance may only be perceived as a rather **complex and complicated legal product**. Even the most common product specific differentiations prescribed by primary risk description, secondary risk exclusion and tertiary risk reinclusion will pose a difficulty in comprehension for the average policyholder. Additionally insurance is not limited to a punctiform exchange of goods and services but regards a promise that spans extended periods of time, in the case of life assurance this will often mean decades. For this reason one, for example, needs to provide for a rule how the policyholder is to handle the insured risk. In life assurance, to give another example for the complexity and complication of the product, one needs to provide for a rule if and how the policyholder is to participate in the surplus of the insurance undertaking. We are, hence, dealing with the transparency of very complex legal regimes.

The nature of insurance as a complex and complicated legal product will make it difficult if not impossible for the **buyer of insurance**, i.e. the policyholder, to come to a full and comprehensive understanding of all properties of the contract in question before the conclusion of said contract. Without extensive expert advice (regarding insurance technique, financial and legal questions) a layman will never be able to fully comprehend any insurance product. This situation is, however, not entirely different to a vast variety of contracts for the exchange of goods. A person that wishes to buy a car will usually have no intricate knowledge of the precise functioning of the engine and the electronic system. He will, furthermore, be unaware how the car manufacturer calculates its distribution costs, i.e. the buyer is unaware to what extent his purchase price will serve to cover the manufacturer’s overall expenses of distribution.

Considering the above, the principle of transparency may from a legal perspective only require making **transparent such properties of the product that are essential to the purchase decision**. Understood in such a way the main purpose of the principle

<sup>6</sup> Cp. esp. *Dreher*, Die Versicherung als Rechtsprodukt, Tübingen 1991.

<sup>7</sup> Cp. *Hübner*, Festschrift Lorenz, Karlsruhe 1994, pp. 317 et seq.

of transparency in the context of a contract for the exchange of performances is to put the buyer in a position in which he is not forced to buy “a pig in a poke” but may ascertain if the product meets his reasonable expectations. Concerning insurance this intrinsic need is quite obvious since the insurance cover will often serve an existential need. This especially applies to **life assurance**, where such is taken in the form of a long-term capital accumulation instrument. Other than the transparency of the rights and duties of the contractual parties, **cost transparency** becomes utterly important for such contracts. It is paramount to inform the policyholder to what extent his premium will be used to cover the insurer’s overhead and for this reason will not be available to accumulate capital. Cost transparency is equally important in **private health insurance** since (at least German) regulation allows the insurer to alter the premium if technical bases of calculation of the premium have changed (sec. 203 VVG).

It is, insofar, reasonable to abstractly demand utmost contractual transparency (including cost transparency in the field of life and private health insurance). The difficulty with which the **legislator** is confronted is another. It needs to decide which rights and duties are essential, which are the precise requisites of transparency that the contractual fixation of these rights and duties has to meet and by which **means outside the policy and the GCI** transparency may be increased for the policyholder. Especially concerning such requisites of transparency that do not regard the transparent wording and fixation of the contractual text, the legislator needs to assess if and to what extent such information or advice is suitable to increase the policyholder’s comprehension of the product. In assessing the appropriateness of such means one needs to take into consideration, if the (average) policyholder is typically willing to make use of and/or demand such information and advice. One needs to, furthermore, pay heed to the **cost expenditure** caused by the preparation of additional information material and advice. These additional costs need to be seen in relation to the (economic) importance of the specific insurance product.

### 3. Big Regulatory Trends Concerning Contractual Transparency (European Union and German Law)

The policyholder’s clear comprehension of his insurance cover was already an important objective at the time of the coming into force of the **German Insurance Supervisory Act** (*Versicherungsaufsichtsgesetz* [VAG]) in **1901**. Sec. 9 of the 1901-version of the VAG enumerated the essential contractual elements that needed to be included in the general conditions of insurance (GCI).<sup>8</sup> Pursuant to sec. 4 subsec. 2 VAG 1901 the GCI needed to be submitted to the supervisory authority as part of the insurer’s business plan for approval. The explanatory memorandum to the VAG stated that the supervisory authority was under a duty to especially assess whether or not the GCI made sufficiently clear the policyholder’s rights and duties.<sup>9</sup> Sec. 10 subsec. 1

<sup>8</sup> This only applied if the GCI were to be made part of the contract, which was not necessarily the case at that time.

<sup>9</sup> Motive zum VAG, reprint Berlin 1963, p. 32.

VAG 1901 prescribed that a version of the GCI in question was to be transmitted to the policyholder against receipt before the contractual conclusion. This provision was abrogated during the economic crisis of 1923 in order to save printing costs<sup>10</sup> and a general duty to transmit the GCI was only reintroduced in the course of the EU-deregulation in 1994<sup>11</sup> when Germany included into its national legislation the new sec. 10a VAG 1994 and sec. 5a VVG 1994.

A different approach was taken by the legislator of the **Insurance Contract Act** (*Versicherungsvertragsgesetz* [VVG]) of **1908** for whom the clarity of insurance conditions was not a subject for regulation. This was due to the specific legislative intent of the Act. The Act assumed that all contractual insurance relationships were governed by extensive GCIs and it thus refrained from setting an extensive legislative framework. The Act was rather limited to correcting inequitable insurance conditions by implementing certain mandatory provisions into all contracts. Other than under the present Act, sec. 9 subsec. 3 VAG 1901 provided that the parties were not free to deviate from the provisions of the GCI to the disadvantage of the policyholder. This rule highlights the legal understanding of the time that the (preapproved) GCI served a legislative function.

The **supervisory authority** almost achieved material congruence between all standard terms on the market by way of its preapproval practice. The supervisory authority propagated that the thus achieved congruence was necessary in terms of **market transparency** which was regarded as a supervisory objective meant to safeguard the comparability of products for the policyholder.<sup>12</sup> Hence, transparency basically remained a supervisory and not a contractual subject due to the mandatory supervisory preapproval of GCI. This remained unaltered – *cum grano salis* – up until the last decade of the last century. For the same reason transparency was not a subject with which the **civil courts** were petitioned. The first decision – as far as can be seen – in which the Federal Court of Justice (*Bundesgerichtshof* [BGH]) examined the transparency of insurance conditions regarded the question of a policyholder's right of information concerning the policyholder's participation in the surplus in life assurance. Transparency was, however, only perceived as a problem in regard to the insurer's competition with other insurance undertakings.<sup>13</sup>

This pre-eminence of supervisory law in regard of the present question at first remained unaltered even after the move towards a **Single European Market for**

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<sup>10</sup> Gesetz zur Änderung des Gesetzes über die privaten Versicherungsunternehmen (RGeBl. I 1923, p. 684). Even after the Second World War the duty to transmit the GCI (in German *Beifügungszwang*) remained suspended for a variety of insurance types, cp. *Schmidt/Frey*, VAG, 10<sup>th</sup> ed., Munich 1989, § 10 para. 10).

<sup>11</sup> Up until then insurers were exempted from meeting the prerequisites set by Sec. 2 Unfair Terms and Conditions Act old version for the inclusion of general terms and conditions due to the fact that their GCI were the object of preapproval by the supervisory authority (cf. Sec. 23 subsec. 3 Unfair Terms and Conditions Act old version).

<sup>12</sup> Cp. Beschlusskammerentscheidung VerBAV 1966, pp. 2 et seqq.

<sup>13</sup> BGH [1983] VersR 746.

**insurance products.** The European approach in the 1970s was to harmonise the national insurance contract law – which would have meant an increased importance of contract law. This approach was, however, abandoned after a short time in favour of a harmonisation of the conflict of law regime applicable to insurance contracts. In light of the complication inherent in the conflict of law rules applicable to insurance contracts at that time this simply meant for a new field of transparency deficits to be created.<sup>14</sup>

A fundamental change only occurred with the **achievement of the Single European Market for insurance products** as realised by the **third generation insurance directives**.<sup>15</sup> Their implementation in **1994**<sup>16</sup> formed an elementary *caesura* in the evolution of insurance law, often described by the (misleading) term **deregulation**. The legislative intent was to create a broad trans-border market for insurance products and enable the policyholder to choose from a wide variety the product best suited to meet his insurance needs.<sup>17</sup> For this purpose the Member States were obligated to abrogate the system of supervisory preapproval of general conditions of insurance. This abandonment of the system of preapproval also meant the end of the material congruence between the conditions on the market as caused by the approval practice by the national supervisor. Insofar a broader product variety was achieved. The price for this increased variety was a **decreased transparency of the market** since products became less easily comparable. To grant the policyholder sufficient protection under these altered market conditions, the third generation insurance directives **increased and broadened** the minimal **requirements for transparency of individual contractual contents**.<sup>18</sup> This new approach was in line with the EU's general approach of consumer protection by implementing a **model of information**.<sup>19</sup>

Starting with the deregulation the **insurance supervisor** abandoned the control of transparency of the contractual content and started to concentrate its work on the supervision of the business operations and the solvency of the insurer. Under German law **sec. 10a VAG 1994** was enacted requiring the insurer to transmit to the policyholder a set of written consumer information before the contract was concluded (*Verbraucherinformation*). This consumer information material especially included all GCI applicable to the insurance relationship in question. Any breach of this supervisory duty was contractually sanctioned pursuant to **sec. 5a VVG 1994**. This meant that the power of revocation granted to the policyholder did not extinguish until fourteen

<sup>14</sup> Wandt in Reichert-Facilides/Schnyder (ed.), *Versicherungsrecht in Europa – Kernperspektiven am Ende des 20. Jahrhunderts*, Basel 2000, p. 85.

<sup>15</sup> Directive 92/49/ECC of 18.06.1992 (Third Indemnity Insurance Directive) OJ n° L-228 of 11.08.1992, p. 1; Directive 92/96/ECC of 10.11.1992 (Third Life Assurance Directive) OJ n° L-360 of 09.12.1992, p. 1.

<sup>16</sup> In Germany this was the Dritte Durchführungsgesetz/EWG zum VAG of 21.07.1994 (BGBl. I p. 1630).

<sup>17</sup> Cp. recitals of the third generation directives.

<sup>18</sup> Cp. artt. 31, 43 Third Indemnity Insurance Directive and art. 31 Third Life Assurance Directive.

<sup>19</sup> Cp. Reich/Micklitz, *Europäisches Verbraucherrecht*, 4<sup>th</sup> ed. Baden-Baden 2003, pp. 23 et seqq.

days after the complete transmission of all information material. This cataclysmic combination of insurance supervisory law and insurance contract law caused considerable scientific controversy. Even after the abrogation of sec. 5a VVG 1994 in the course of the 2008-reform of the VVG the question whether or not the provision was in conformity with European Union law still occupies the German courts. By court order dated 28 March 2012<sup>20</sup> the German Federal Court of Justice referred this question to the ECJ for preliminary ruling in the sense of art. 267 TFEU.<sup>21</sup>

The deregulation of 1994 implemented a change from the hitherto applicable *ex ante* approval of the terms and conditions of insurance to an *ex post* control of said terms. This alteration also meant that (contractual) transparency became a subject for the **civil courts**. Almost all of the approx. 70 decisions rendered by the chamber for insurance matters of the Federal Court of Justice dealing with transparency are dated 1994 or later. Nevertheless civil courts were well equipped to deal with these questions, since many of them had been raised in connection with unfair terms and conditions in (other) consumer contracts. Germany had known a written legal regime for the formal and material **control of general terms and conditions** since 1976. In this year the Unfair Terms and Conditions Act (the so-called AGBG) entered into force. Said act was included into the German Civil Code, the BGB, in 2002. Pursuant to its provisions a general term and condition shall be invalid if it causes a significant imbalance in the parties' rights and obligations contrary to the requirement of good faith (sec. 307 BGB; hitherto sec. 9 AGBG). Since the beginning the BGH contended that the material control of general terms and conditions included a control of transparency of all clauses,<sup>22</sup> even though this was disputed by many. The BGH's position, however, was affirmed by the **Directive on Unfair Terms in Consumer Contracts** (art. 5 phrase 1).<sup>23</sup> When the provisions of the Unfair Terms and Conditions Act were transferred into the BGB in 2002 the principle of **transparency in the realm of general terms and conditions** was made explicit by including the new sec. 307 subsec. 1 phrase 1 BGB. Pursuant to this provision a general term or condition *may* be regarded as unfair for the mere fact that it is not drafted in a clear and comprehensible manner.

After what may only be called a reform-wave regarding other insurance contract acts in a variety of European countries, the German legislator decided to submit the **German Insurance Contract Act** to an **extensive reform in 2008**. The insurer's **duties to inform** were substantially enlarged and broadened.<sup>24</sup> This meant in particular that the

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<sup>20</sup> Docket number IV ZR 76/11.

<sup>21</sup> There is an appeal on a constitutional issue (so-called *Verfassungsbeschwerde*) pending before the German Constitutional Court (Bundesverfassungsgericht, BVerfG) concerning sec. 5a VVG old version.

<sup>22</sup> Cp. e.g. BGHZ 104, 92 with further references.

<sup>23</sup> Directive 93/13/EEC of 05.04.1993 on Unfair Terms in Consumer Contracts, OJ n° L-95 of 21.04.1993 p. 29.

<sup>24</sup> Also cp. Verordnung über Informationspflichten bei Versicherungsverträgen (VVG-InfoV) of 18.12.2007, BGBl. I 3004.

duties to inform as they hitherto existed specifically for distance selling contracts<sup>25</sup> were enlarged to cover all contracts regardless of their mode of conclusion since the German legislator favoured the application of a uniform rule to all contracts.<sup>26</sup> These duties to inform were accompanied by **duties to advise and duties to document** the breach of which would subject the insurer (or the insurance intermediary) to a claim for damages. The inclusion of these duties was to mirror the Insurance Intermediary Directive in order to have the insurance undertaking and the insurance intermediary treated by the same standards.

### III. Transparency in Insurance Mediation

#### 1. Relevance

In general, insurance is not bought but sold. For the buyer to make a demand out of his own initiative is the exception. For the distribution to be organised by the insurer is the rule. There are several reasons for this rather untypical situation. For one, the majority of potential policyholders are not willing to handle and regard their risks with foresight. As human beings we rather tend to repress the thought of risks to which we are subject. Another reason for this situation is that insurance is a product which necessitates explanation and advice. Thus, leaving aside direct insurance, especially via the internet, insurance will usually be concluded by introducing an intermediary, be it an insurance broker or an insurance agent.

The **insurance intermediary** is ideally an **expert of the field**. As such he is able to evaluate the customer's insurance need and inform him about all appropriate insurance products. The introduction of an insurance intermediary may serve as an ample tool to compensate the policyholder's knowledge deficit by means of advice and information.

The introduction of an insurance intermediary, however, creates a new **specific need for information** on the policyholder's side. The policyholder should ideally be aware of the economic, professional and legal basis on which the insurance mediation is founded. The policyholder should equally be able to assess the quality of the advice and information as provided by the insurance intermediary. This especially includes knowledge of the professional and personal qualification of the intermediary, of his legal relationship with the insurer (i.e. status, function), of the type of remuneration the intermediary would receive, of potential conflicts of interest and of the material basis on which advice and information were rendered (i.e. was advice and information given based on a comparison of the whole market or only based on the products of one or a limited number of insurers).

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<sup>25</sup> Gesetz zur Änderung der Vorschriften über Fernabsatzverträge bei Finanzdienstleistungen von 02.12.2004 (BGBl. I 3102; cp. thereto BT-Drucks. 15/2946); in implementing directive 2002/65/EC of 23.09.2002 concerning the Distance Marketing of Consumer Financial Services, OJ n° L-271 of 09.10.2002, p. 16.

<sup>26</sup> *Wandt*, Versicherungsrecht, 5<sup>th</sup> ed. Munich 2010, para. 242; *Küster* [2010] VersR 730.

## 2. Big Regulatory Trends Concerning Transparency in the Law of Insurance Mediation (European Union and German Law)

Within the **Insurance Mediation Directive of 1976**<sup>27</sup> the European Community limited itself to regulating insurance mediation only in terms of the freedom to provide service and the freedom of establishment. The main intent of the directive was to overcome different national solutions concerning the activity of an insurance intermediary by establishing a system of mutual recognition.

With the achievement of the Single European Market for insurance products in sight the Community's focus moved towards the (necessary) professional qualification of insurance intermediaries. In a first instance the **Commission** made a **non-binding recommendation** in 1991.<sup>28</sup> The majority of Member States heeded the advice of this recommendation which resulted in considerable approximation of laws. Germany, however, was quite persistent in its refusal to pay heed to the Commission's recommendation.<sup>29</sup> For these reasons the national legislation of the Member States concerning insurance mediation remained quite varied.

The European Union reacted to this perceived deficit of harmonisation by passing the **Insurance Mediation Directive of 2002**.<sup>30</sup> The directive – that does not cover the insurer's (field) staff – creates a duty for every intermediary to be registered, sets (minimal) requirements of professional qualification and good repute to serve as prerequisites for registration and demands compulsory cover, typically by way of conclusion of a professional liability insurance. The directive, furthermore, institutes duties to inform, to advise and to document to which the insurance intermediary is subject.<sup>31</sup> Not being a full-harmonisation directive, the Insurance Mediation Directive to some extent allows the Member States to upkeep or to pass stricter provisions – this especially applies to the intermediary's duties to inform towards the customer – as long as such provisions are in line with Community Law (cp. art. 12 para. 5 of the directive).

At the moment the Commission is in the midst of assessing the need for a **revision of the Insurance Mediation Directive**. Since the 2002 version of the directive was but a minimum harmonisation directive there remain many areas – this is especially true for the intermediary's duties to inform – in which the legal systems of the Member States differ quite substantially. Pursuant to the Commission's opinion this situation has worsened the problem that customers are unable to correctly understand the

<sup>27</sup> Directive 77/92/EEC of 13.12.1976 OJ n° L-26 of 31.01.1977, p. 14.

<sup>28</sup> Recommendation 92/48/EEC of the commission of 18.12.1993 on insurance intermediaries, OJ n° L-19/230 of 28.01.1992.

<sup>29</sup> Cp. the references in *Müller*, *Versicherungsbinnenmarkt*, Munich 1995, para. 291.

<sup>30</sup> Directive 2002/92/EC of 09.12.2002 on Insurance Mediation, OJ n° L-9 of 15.01.2003, p. 3.

<sup>31</sup> Additionally there are provisions regarding the protection of money transmitted by the customer (to the intermediary) and the establishment of appropriate and effective procedures for complaints and out-of-court redress. Cp. e.g. *Reiff* [2001] ZVersWiss 451 et seqq.; *idem* [2004] VersR 142.

risks, costs and properties of insurance products.<sup>32</sup> The recent discussion has brought forward the following subjects: the extension of the duties to inform and to advise to distance selling products; the question, if the concrete remuneration of the intermediary must be disclosed or only that part of the remuneration that is priced into the premium as costs of conclusion and distribution (potentially with the additional information what kind of reduction in yield is caused by this); the establishment of a uniform insurance intermediary register in the English language for all Member States and the question if specific provisions are necessary for the distribution of investment products towards small investors (Packaged Retail Investment Products – PRIIP).

## IV. Transparency in Insurance Supervisory Law

### 1. Relevance

The **public supervisory law** regulates the relationship between the state and the insurance undertakings as professional operators of the insurance business. The call for transparency in this relationship seems – at least *prima vista* – rather unusual and surprising. Notwithstanding the aforementioned, transparency is and remains a subject for the insurance supervisor and for insurance supervisory law.

The principle of transparency, for one, applies **indirectly** since the insurance supervisor is charged with supervising, if the insurers meet the transparency requirements to which they are subject towards the policyholders. In this regard one can say that supervisory transparency requirements are often functionally insurance contract law.

Transparency is, however, also a subject which **directly** regards insurance supervisory law and the supervisory authority. As for any other area of the law, the provisions of insurance supervisory law should be transparent for its addressee, in order to be able to efficiently fulfil its (supervisory, control and intervention) function (i.e. regulatory transparency). From the supervisory authority's perspective the organisation and business operation of the supervised insurance undertakings needs to be transparent towards the supervisor to enable it to identify breaches of law and suppress them. The principle of transparency has gained more importance and will still grow even more important in the future in the realm of insurance supervisory law due to the movement towards a European insurance supervision and towards a convergent supervision in all Member States.

### 2. Big Regulatory Trends Concerning Transparency in Insurance Supervisory Law (European Union and German Law)

For an extended period of time the (German) insurance supervisory law was based on the premise – as has already been highlighted above in the context of contractual transparency – that transparency is best achieved by creating **market transparency** by having a uniform practice of preapproval of general terms and conditions of insurance. As an annex supervisory law demanded **contractual transparency** by implementing

<sup>32</sup> [http://ec.europa.eu/internal\\_market/insurance/mediation\\_de.htm](http://ec.europa.eu/internal_market/insurance/mediation_de.htm).

rules that were functionally of a contractual nature (at least in part). Examples for such rules were the supervisory provision on the minimal content of general terms and conditions of insurance (sec. 10 VAG old version) or on the insurer's supervisory duty to inform the policyholder (sec. 10a VAG old version). The supervisory authority was charged with monitoring that the insurer complied with all regulatory transparency requirements, including the ones set by contract law and the law on unfair contractual terms and conditions.

It was in particular the Solvency II-directive<sup>33</sup> that transformed transparency into a **subject of direct importance for insurance supervisory law**.<sup>34</sup> This already applies to the **law making procedure of Solvency II** by application of the *Lamfalussy*-process.<sup>35</sup> In order to accelerate the law making process and to allow for a quicker adjustment of existing rules to changed market environments the rule setting is divided into two levels. At the first level the Council and the European Parliament pass a legal instrument which is limited to the core values of the law, thus containing only politically motivated, essential and often principle based rules.<sup>36</sup> At the second level the Commission – being advised by EIOPA – passes implementing measures.<sup>37</sup> This subdivision of the law making procedure demands transparency concerning the criteria which rules are to be regarded as essential in the sense of EU primary law and must thus be passed at the first level by the genuine EU legislator. In line with the **EU-initiative for a better regulation**<sup>38</sup> initiated in 2002 the law making process of Solvency II was since its beginning marked by a very intensive involvement of all groups concerned, including especially all stakeholders. For this purpose almost all debates and decisions were made public and transparent.

Solvency II not only regards procedural transparency but also **material transparency**. Said project causes a fundamental readjustment of insurance supervisory law. At the centre of this readjustment stands the introduction of an economic risk-based method by which capital requirements are assessed, under which method all risks of an undertaking are to be backed by own funds while the Solvency Capital Requirement is

<sup>33</sup> Directive 2009/138/EC of 25.11.2009, OJ n° L-335/1 of 17.12.2009.

<sup>34</sup> Transparency in insurance supervision was already demanded by the Insurance Core Principles, Standards, Guidance and Assessment Methodology of the International Association of Insurance Supervisors (IAIS), available in the version of 04.10.2011 under [www.iaisweb.org](http://www.iaisweb.org).

<sup>35</sup> Cp. *Wandt/Sehrbrock*, Legal Aspects of the Solvency II Framework Directive, in: *Over Grenzen – Liber amicorum Herman Cousy*, Antwerpen and Cambridge 2011, pp. 923 at 929; and *Wandt/Sehrbrock*, Solvency II – Rechtsrahmen und Rechtssetzung, in: *Dreher/Wandt* (ed.), Solvency II in der Rechtsanwendung, Karlsruhe 2009, pp. 1 at 5.

<sup>36</sup> Cp. *Pohlmann*, Principles-based insurance regulation: lessons to be learned from a comparison of the EU and German law of risk management, in: *Research Handbook on International Insurance Law and Regulation*, Cheltenham 2011, p. 329 et seqq.

<sup>37</sup> Cp. for details art. 290 und 291 TFEU, the Solvency II-directive in the future version of the Omnibus II-directive (COM [2011] 8 of 19.1.2011) and the EIOPA-Regulation, OJ n° L-331 of 15.12.2010, p. 48.

<sup>38</sup> Cp. the Commission's brochure "Better Regulation – simply explained", p. 6, under [http://ec.europa.eu/governance/better\\_regulation/documents/brochure/br\\_brochure\\_en.pdf](http://ec.europa.eu/governance/better_regulation/documents/brochure/br_brochure_en.pdf).

calculated by taking into account the individual risk profile of the undertaking (pillar 1), the rearrangement of the business organisation and the supervisory instruments (pillar 2) and the readjustment of reporting duties towards the supervisor and towards the public (pillar 3). The new supervisory regime aims for a high level of transparency in all of these areas. In the following some of the essential elements of transparency concerning all three pillars shall be highlighted:

**Pillar 1:** The basis for the calculation of the new capital requirements is the individual risk profile of the insurance undertaking, which is economically assessed by applying the fair value method. The Minimum Capital Requirements are calculated in a clear and simple manner, in order to allow for the calculation to be audited (art. 129).

**Pillar 2:** Transparency is an essential criterion of the readjustment of the business organisation. Art. 41 demands for the governance system of the insurance undertaking to have a transparent organisational structure with a clear allocation and appropriate segregation of responsibilities. Transparency within the business organisation shall be obtained by the own risk and solvency assessment (ORSA) pursuant to which it shall become an integral part of the risk management system to monitor the overall solvency needs while taking into account the specific risk profile on a regular basis (art. 45). Procedural transparency is equally expected of the insurance supervisor. Art. 31 para. 3 of the directive obligates all Member States to implement rules that provide for a transparent procedure concerning the appointment and the dismissal of the members of the governing and managing bodies of their supervisory authorities.

**Pillar 3:** The reporting duties regulated in art. 35 and 36 intend to further **transparency towards the supervisory authority**. Information to be reported regard the governance system, the technical provisions, the capital requirements, the quality and quantity of own funds and capital investments. Pursuant to art. 35 para. 4 of the directive the aforementioned information must be reported in a transparent manner, i.e. it has to be complete, comparable, consistent over time, relevant, reliable and comprehensible.

By setting up a **reporting duty towards the public** the Solvency II-Project also aims to create **market transparency**. Art. 53 requires all insurance undertakings to generally publish an annual report on its solvency and financial condition. This report is to contain the amount of non-compliance with the Minimum Capital Requirement or of a significant non-compliance with the Solvency Capital Requirements including an explanation of their origin and consequences and any remedial measures taken (art. 53 para. 1 lit. v).

The more detailed regulation of the reporting duties towards the supervisory authority will be provided by the Commission's implementing measures on level 2 of the *Lamfalussy*-process. These implementing measures have not yet entered into effect. The insurance industry is afraid that these implementing measures might burden the insurance undertakings with excessive and disproportionate duties. These worries are seemingly not entirely unfounded. The Commission's striving after all-encompassing transparency was described by *Karel van Hulle*, Head of Unit Insurance and Pensions of the European Commission – Internal Market Directorate-General, in colourful words: "The idea is simple: insurers have to stand naked in front of the supervisors. In

front of the public they can wear swimming trunks and we decide how big they ought to be.”<sup>39</sup>

**“Trans-Pillar” Transparency:** Transparency is also a subject of European insurance supervision that transcends all pillars. It is the legislative goal to achieve convergence throughout all Member States. Such a convergence is only attainable if all provisions are uniform and transparent for those that have to apply them.<sup>40</sup> For this reason art. 31 obligates the Member States to ensure the disclosure of all supervisory legislation and regulation and certain data on key aspects of the supervision. The supervisory authorities are explicitly ordered to conduct their tasks in a transparent manner (art. 31 para. 1). Pursuant to art. 52 the national supervisory authorities are, on the one hand, obligated to send EIOPA an annual report. EIOPA, on the other hand, shall report publicly on an annual basis and report to the European Parliament, the Council and the Commission on the progress of the supervisory convergence in the European Union.

## V. Résumé and Forecast

The present overview has shown that transparency is a guiding principle of all branches of modern insurance law. The reasons for the increased importance of transparency are manifold and different for the single branches. In insurance contract law it was the abandonment of the system of preapproval of general terms and conditions of insurance that implied a move from a market transparency created by supervisory action towards a product transparency safeguarded by contractual regulation. In the field of insurance mediation law transparency has come to the forefront due to a European attempt to harmonise the Interior Market for the purposes of the activities of insurance intermediaries and due to an increased distrust of individual actors and their potential malpractice especially since the beginning of the financial crisis. In the field of insurance supervisory law transparency serves as a catalyser for the development of a European insurance supervisory law with the goal of convergent supervisory practices throughout the European Union. Transparency is also a necessary prerequisite for a supervisory regulation that wishes to assess solvency requirements by applying a fair value method based on the individual risk profile of the undertaking in question.

The increased importance of legal transparency requirements alters the whole system of insurance. Hitherto insurance had rightfully been described as a very particular credence good (in German *Vertrauensgut*).<sup>41</sup> The legal relationship between insurer and policyholder is notably characterised by the application of the principle of good faith. At least in principle, this will not change in the future. It is, however, the assessment of the present work that the legal function that the principle of good faith held will in many instances be replaced by a wide application of the principle of transparency. In light of

<sup>39</sup> Cp. <http://www.commercialriskeurope.com/cre/1001/15/Time-for-insurers-to-stand-and-deliver-on-Solvency-II-says-its-chief-architect/> (20.10.2011).

<sup>40</sup> Cp. recital n° 53 of the directive.

<sup>41</sup> *Taupitz* [1995] VersR 1125.

modern information technology transparency may now be technically achieved almost without any limitations. This should, however, not be understood to mean that utmost transparency should be achieved. The decision for what areas and to what extent transparency should be legally required is a political one. Such a decision should be taken by paying heed to the function and protective purpose of the insurance system and the potential impact of a considered measure on this system.<sup>42</sup> The financial consequences of such a decision should be carefully considered as well since it is the policyholder who will finally have to bear the costs.<sup>43</sup> It is insofar a crucial duty of the legislator to achieve a balance between an equitable amount of transparency and a cost efficient conduction of business in order to increase the welfare gain created by insurance.

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<sup>42</sup> Regarding the danger of creating an information overkill *Wandt*, *Bitburger Gespräche Jahrbuch 2006/II*, Munich 2007, p. 17 at 24; *Rosenow/Schaffelhuber* [2001] ZIP 2215; *Römer* in *Festschrift Lorenz 2004*, pp. 619 et seq.

<sup>43</sup> This does not apply equally to regulatory transparency (i.e. the transparency of legal provisions) that needs to be assessed differently for that reason.

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# Transparency in the Process of Mediation-Especially Status Transparency of the Intermediaries

by Dr. Peter Reusch

## 1. Introduction and history of legislation

First of all a brief look back at the history of legislation is required if one wants to understand the topic in the aspects which are of interest here. It is not surprising that the decisive key points of the statutory regulations, which are currently also applicable in Germany, are based on EU law, in particular the EU Insurance Mediation Directive from 2002<sup>1</sup>. This is essentially based on a recommendation which the European Commission issued in 1991 for the qualification of insurance mediators.<sup>2</sup> It is not possible to look at this recommendation in more detail at this point. It must be sufficient to state that all essential aspects, which are subsequently included in the EU Insurance Mediation Directive, were already initially mentioned in the recommendation. Apart from Germany the majority of the EU member states at the time already had authorisation or qualification rules and/or rules for professional practice rules for insurance mediators. As opposed to this the German law did not contain any corresponding professional code authorisation or practice regulations for insurance mediators before implementation of the EU Insurance Mediation Directive. There was rather the full and unlimited freedom to exercise the trade. Germany had also persistently refused to follow the recommendations.<sup>3</sup>

This it was clear that one of the essential aims of the EU, notably to create a standard Single European market for the mediation of insurance could not be realised without mandatory stipulations through an EU directive. Therefore, the Commission issued the already mentioned Insurance Mediation Directive -IMD 1-, which was per se to be implemented by 15.01.2005, however in Germany owing to certain political

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Directive 2002/92/EC of the European Parliament and of the Council of 09.December 2002 on insurance mediation, Official Journal of the European communities, 15.01.2003, L 9, p.3.

<sup>2</sup> Commission Recommendation of 18. December 1991 on insurance intermediaries 92/98 EEC, Official Journal L O 19, 28/01/1992, p.32.

<sup>3</sup> Müller, Versicherungsbinnenmarkt, Rn. 291.

turbulences was not implemented until on 22.05.2007. As evidenced by the reasons for the weighing up of the matter insurance mediators and insurance re-mediators, who are also covered by the directive, should be in the position to assert the rights to the freedom of establishment and the free service traffic guaranteed by the EU treaty.<sup>4</sup> Besides the aims to thus also ensure the smooth functioning of a standard insurance market for insurance mediators to an unlimited extent everywhere in the community, information, advice and documentation obligations for the mediators are to be seen as absolutely essential in particular through the directive without however using the word transparency. It is emphasised that it decisively depends for the consumer on whether he has to deal with a mediator, who advises him about the products of a broad range of insurance companies, meant is as insurance broker or about products of a certain number of insurance companies, meant is the “tight Agent”. As far as the information obligations are concerned the directive does not envisage any full harmonisation, but individually allows the member states to retain stricter regulations, insofar as they exist, or to envisage such.<sup>5</sup>

## 2. Transparency in the mediation as principle-oriented criterion

If one now considers the criterion of transparency from the point of view of an insurance customer or policy holder with regard to the insurance mediator confronting him then a distinction can be made between various aspects. Transparency then means that it is important for the customer from the aspects of consumer protection to find out whether the insurance mediator confronting him is entered in a register, which envisages certain pre-requisites such as expertise and personal reliability, or not. This register must, so that it can have the effect to protect the consumer, on the one hand ensure that an entry is only carried out if corresponding proof exists relating to “fit and proper”. It must further ensure that the data registered therein are accessible to the customer and finally it must be up-to-date and also guarantee that in case of breaches the mediator is removed from the register again. The restriction of this expectation from transparency from the point of view of the customer merely to the insurance mediator would however be too narrow-minded. It is obvious that corresponding regulations under supervisory law are also required for insurance companies as not each customer will tend to enquire about the details concerning the mediator with the corresponding register before conclusion of a contract. Therefore, supplementary regulations under supervisory law are required that insurance companies may only cooperate with mediators who feature sufficient expertise and personal reliability with the admission and during their mediation activity.

If we come back to the customer then with regard to the aspects of transparency he may be able to expect from the mediator that he informs him about his status, notably whether he is bound as a “tight Agent” or whether he operates as a broker without being committed. It is however also conceivable that there can be further potential conflicts of interests, because a connection exists between insurance companies

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<sup>4</sup> Directive 2002/92/EC whereas 6.

<sup>5</sup> See Directive 2002/92/EC Art. 12 Par. 5.

and the mediator in terms of capital. The customer may also expect to be informed about this too. The customer may however also expect transparency with regard to the advice which the mediator gives in addition to this information about status rights. On the one hand the customer will want to know and also have to know based upon which collection of data the provided advice is given and for which reason and by taking into consideration the specific needs of the customer the advice was given. Transparency for the customer must in this context also mean that this provided advice is documented in any form. Only then will the customer subsequently have the possibility, if it is determined that his justified expectations were not met, to if applicable assert claims for damages against the mediator. It can perhaps however also be subsumed under the term transparency still that the customer expects and can also expect information how he is secured if the mediator was authorized to collect money by the insurance company, thus collects the premium directly from the customer. If one now considers these more generally held considerations from the point of view of the Insurance Mediation Directive then it is noticed that besides ensuring a functioning Single European Market the benchmarks of the Insurance Mediation Directive clearly feature principle-oriented criteria and without however explicitly described this in this respect being able to methodically allocate these to the general principle of transparency. The principles of the Insurance Mediation Directive are the obligation to have themselves entered in a register, to take out professional liability insurance, to state information, advice and documentation obligations as well as envisage regulations concerning the protection of customer's money. Only mentioned to complete the picture and clearly not guided by aspects of transparency is the obligation to set up an arbitration board.

### **3. Implementation into German law**

We will now tackle the actual topic below and want to analyse how under the aspects of transparency the German legislator implemented the EU Insurance Mediation Directive.<sup>6</sup> Five standard areas can essentially be recognised. On the one hand regulations under supervisory law in the Insurance Supervisory Act, §§ 80, 80a and 80b VAG, which are supported by professional code regulations for insurance mediators in the trade regulations, § 34d GewO, and the essential regulations in the German Insurance Contract Act, §§ 59 – 73 VVG. In addition, there are the regulations concerning the insurance mediation and advice, insurance mediation regulations, VersVermV, as well as finally the regulations governing obligations to provide information with insurance contract, which in fact are not directly aimed at the insurance mediators, however so-to-speak as a reflexion should also provide the customer certain information under the aspects of transparency, which affect the insurance mediation and anticipate intended trends of the IMD 2 already. The following is specifically derived:

#### a) Regulations under insurance supervisory law

§§ 80 - 80 b VAG regulate the duties of insurers, which they have to comply with under supervisory law in the cooperation. The insurer may only cooperate with mediators

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<sup>6</sup> Bundestags-Drucksache 16/1935 of 23.06.2006.

who either within the meaning of § 34d GewO have a permit, are exempted from the permit or are not subject to any permit obligation. It may cooperate with those, who are subject to the permit obligation, if these have expertise and are reliable. The insurer must check the entries in the register and also ensure that the regulations concerning the protection of customer's money are complied with, §§ 80 Par. 1 and 2 VAG. It may nevertheless only cooperate with mediators, who do not require any permit or are exempted from this, if these are reliable and live in orderly financial circumstances insofar as it ensures that these mediators have a reasonable qualification which is necessary for the mediation.<sup>7</sup>

In case of customer complaints about the mediation activity these have to be answered. In case of repeated complaints, which may be relevant for the assessment of the reliability, the responsible Chamber of Commerce has to be informed, § 80a VAG.

## b) Trade law

### aa) *Commercial insurance mediators and exceptions*

It can be derived both from the location as well as the contents of § 34d GewO that the transparency regulations which are of interest here, which are the object of the professional code for insurance mediators, will only apply if the mediation activity is operated commercially.<sup>8</sup> The regulations emphasise that only a person who intends to mediate the conclusion of insurance contracts commercially as an insurance broker or insurance agent, falls in the field of application.

Thus, the occasional mediators, who do not operate commercially, are removed from the field of application, and the permanently employed field sales force employees of insurance companies as well as the insurance companies themselves, even if they work as direct insurers without a field sales force. The professional code regulations do not apply to these. Excluded from the registration are accordingly those mediators who also operate commercially and who are classified as insignificant mediators.

§ 34d Par. 9 GewO is insofar oriented to Art. 1 Par. 2 of the Insurance Mediation Directive. The professional code regulations do not apply to these mediators if the following pre-requisites exist cumulative:

It concerns insurance mediators, who only mediate insurances part-time as a secondary occupation; they exclusively mediate insurance contracts, for which only knowledge of the offered insurance cover is necessary; they do not mediate any life or liability insurances; it concerns insurance, which represents an additional service to the delivery of a good or a service; the annual premium is not higher than € 500.00 and the total term of the contract is no more than five years.

For additional services to the delivery of a good or provision of a service the substantiation of the German law mentions that credit and credit card mediators, spectacle dealers, also comprehensive insurers, mail order and retail trade, e.g.

<sup>7</sup> Bundestags-Drucksache 16/1935, p. 27,28.

<sup>8</sup> Prölss/Martin/Dörner, VVG, 28th ed. 2010, § 59 Rn. 2.

guarantee insurance in order to extend the warranty, electrical appliance dealers with guarantee and repair insurances, bicycle dealers and manufacturers, which mediate accident or theft insurances or also travel agencies, which offer travel cancellation or travel health insurances should fall under this.<sup>9</sup>

Further excluded according to § 34d Par. 9 No. 2 GewO are the building societies and the building society mediators insofar as a term life insurance is mediated as part of the building savings contract in order to protect the granted loan and according to § 34d Par. 9 No. 3 GewO also the residual debt insurance mediators if such insurances as mediated as an additional service to the delivery of a good or provision of services in connection with consumer loans and the annual premium does not exceed an amount of € 500.00. However, these exceptions of the German legislator are not envisaged in the directive and are therefore in breach of the directive.<sup>10</sup>

#### *bb) Insurance agents and brokers - § 34d Par. 1 GewO*

To be entered in the register are accordingly insurance agents. The trade regulations understand under this a person who is entrusted by an insurer or an insurance agent – as sub-mediator – to mediate or conclude insurance contracts commercially.

According to this definition an insurance broker is a person who commercially takes over the mediation or the conclusion of insurance contracts for the customer without having been entrusted with this by an insurer or an insurance agent.

It is to be stated in the permit of the responsible Chamber of Commerce whether it was granted to an insurance agent or an insurance broker.

#### *cc) Factual elements of the permit*

The Chamber of Commerce only grants the permit if it is ensured that the mediator is reliable, is living in orderly financial circumstances, provides the proof of professional liability insurance and proves by a necessary examination before the Chamber of Commerce the necessary expertise for performing the insurance mediation. Reliability means as a rule that he has not been sentenced final and binding because of a crime or an offence in the last five years before filing the application. The mediator lives in orderly financial circumstances if neither insolvency proceedings have been opened over his assets, nor has he been entered in a directory of debtors. As far as the proof about the conclusion of professional liability insurance and the proof of expertise is concerned the details in this respect are regulated in the insurance mediation regulations. The minimum sum insured of the necessary professional liability insurance is accordingly € 1.0 million for each insured event and € 1.5 million for all insured events of one year, § 9 Par. 2 VersVermV.

The proof of expertise is provided by an examination taken before the Chamber of Commerce. The details are regulated in §§ 1 – 4 of the VersVermV. A person who for

<sup>9</sup> Bundestag-Drucksache 16/1935, p. 20.

<sup>10</sup> Majority view, see: *Reiff* VersR 2007, 717, 719; *Wandt*, Versicherungsrecht, 5th ed. 2010, Rn. 379; *Langheidt/Wandt/Reiff*, Münchener Kommentar zum VVG 2010, vor § 59 Rn. 20; *Prölls/Martin/Dörner*, VVG, 28th ed. 2010, § 34 d GewO Rn. 15.

example can submit proof of a final certificate of studies of law or also a university qualification as business administrator will be treated by the regulations as if he had taken an examination regarding the expertise. In other words: It is insofar deemed equivalent.

It frequently occurs that the mediator occupies employees. One thinks here of large structural sales companies or the mediation activity of credit institutions at their counters. It is sufficient here if the proof of expertise is provided for the employees by a reasonable number of natural persons employed at the mediator. These persons must be assigned the supervision over the employees directly dealing with the mediation of insurances.

*dd) Exemption for “tight Agents”- § 34d Par. 4 GewO*

In line with the regulations in Art. 4 Paragraphs 1 to 3 of the directive the German legislator has envisaged that the exclusivity agents, the “tight Agents”, are not subject to any permit obligation. An exclusivity agent is the one-company agent, however also the group agent as well as the multiple general agent, who operates by order of one or, if the products do not compete, of several insurers. He does not require a permit if the insurer or the insurers assume the unlimited liability from his activity as mediator for him. This unlimited assumption of liability also results in the fact that the one-company agent then no longer needs any professional liability insurance. Neither does he have to prove any examination of expertise. As stated above already the insurer is however obliged according to § 80 VAG to convince itself of the reliability and it also has to check whether the one-company agents live in orderly financial circumstances. Details in this respect have also be stipulated by the supervisory authority BaFin in corresponding circulars.<sup>11</sup>

In practice it occasionally occurs that bound insurance agents have themselves entered in the register under their own responsibility. They must then specifically prove the pre-requisites according to § 34d Par. 2 GewO, in particular conclude own professional liability insurance. They thus want to counteract the risk that in the event of a dispute with their insurer, if it withdraws the declaration of assumption of liability and cancels them from the register, they can no longer perform their profession at short notice.

*ee) Product accessory mediator - § 34d Par. 3 GewO*

Mediators, who provide the insurance as a supplement to the goods delivered or services provided within the framework of their main activity, so-called product accessory mediators, can be exempted from the permit obligation at the application of the Chamber of Commerce. The pre-requisite is that the mediator performs his activity directly by order of one or several permit holders or one or several insurers. In addition, professional liability insurance must exist for him, he must be reliable, not live in disorderly financial circumstances and be qualified. The declaration of the insurance company is sufficient for the qualification.<sup>12</sup>

<sup>11</sup> For similar ruling see under § 34d Par. 6 GewO.

<sup>12</sup> Details under § 34d Par. 3 Nr. 3 GewO

The substantiation of the law emphasises the narrow interpretation of the term product accessory status and names as examples if the motor vehicle dealer mediates motor vehicle third party and comprehensive insurance to the customer with the purchase of a car or if with the conclusion of a loan agreement for example with a purchase of a house the life insurance is mediated as service of the loan.<sup>13</sup>

*ff) Register - § 34d Par. 7 GewO*

According to § 11a VersVermV each Chamber of Commerce keeps a register. A joint agency can be found at the DIHK [Association of German Chambers of Industry and Commerce]. Information from the register is provided by way of the automatic call via the Internet or in writing, § 11a Par. 2 Sentence 1 VersVermV. Each interested party can thus check whether the mediator and with which status the mediator is entered, notably as a broker, insurance agent with permit, bound or product accessory insurance agent.<sup>14</sup>

A specific German feature are the insurance advisers, who are also entered in the register, however do not mediate, but may exclusively advise, § 34e GewO.

*gg) Assessment*

If one now considers the regulations which were agreed then one can determine that the German legislator has essentially complied with the stipulations of the directive apart from the stated exception, on the other hand however has also found solutions, which one can partly criticise.

On the one hand it is noticed that on the whole irrespective of the status the same qualification is requested. However, this does not appear to be convincing to request the same qualification from an insurance broker and no more than from an insurance agent. In addition there is the fact that owing to the possibility for exemption according to § 34d GewO on the one hand and owing to the transitional regulations on the other hand the majority of the German insurance mediators do not have to take any Chamber of Commerce examination of expertise. If one assumes a total of 263,000 mediators of which approx. 200,000 work as bound mediators exclusively for one company, around 10,000 multiple company agents and approx. 42,000 insurance agents<sup>15</sup>, then only the insurance brokers and real multiple agents thus have to take the examination of expertise. It is however to be pointed out that the insurance industry has been putting a great deal of time and effort into the qualification of its mediators for many years, trains them itself or only cooperates with them if they can prove a certain professional qualification with the professional training organisation.

c) Status-related - stipulations concerning transparency under contract law

The stipulations of the EU Insurance Mediation Directive under contract law can be found in Art. 12 and Art. 13. The heading reads insofar however only "information

<sup>13</sup> Bundestags-Drucksache 16/1935, p. 19.

<sup>14</sup> For examples see under [www.vermittlerregister.org](http://www.vermittlerregister.org) or [www.vermittlerregister.info](http://www.vermittlerregister.info).

<sup>15</sup> Figures after GDV Yearbook 2011, 65

obligations of the mediators.” In fact the regulation character is further regulated by the fact that particularly not just status-related information and notification obligations are regulated, but also advice and documentation obligations are contained in the regulations. The German legislator has implemented the details envisaged in Art. 12 Par. 1 letters a) to e) as status-related and transformed them into German law as first information as a regulation under trade law in § 11 VersVermV. With the first establishment of the business contact the mediator must inform the customer or policy holder in a clear and understanding manner in a text form:

His name and if applicable the company name (No. 1), his company address (No. 2) and his status whether he is registered and entered (No. 3) as an insurance broker, as an insurance agent with permit according to § 34d Par. 1 GewO, as bound insurance agent according to § 34d Par. 4 GewO or as product accessory insurance agent with exemption from the permit according to § 34d Par. 3 GewO. He must state his register number, the address and telephone number and Internet address of the DIHK (No. 4). In order to disclose conflicts of interest he must also state the direct or indirect participation of more than 10 % in an insurer, which will be rare, or vice versa, which occurs more frequently, the direct or indirect participation of an insurer in the amount of more than 10 % in the mediator (No. 6). The last requirement is the detail of a mediation board. In Germany this means that the address of the ombudsman is to be stated (No. 7).

Not explicitly included in the directive is the requirement in No. 3 concerning to explicitly inform about the status of the mediator. Whether one therefore can speak of a surplus implementation appears doubtful, because the mediator must also disclose according to the directive whether he is bound to a company or can only offer its products or whether he is at liberty in his choice of products.<sup>16</sup> This is to be welcomed as with regard to the conflict of interests and the different liability of the mediator this is very important information and very significant under aspects of transparency.<sup>17</sup> It is important for the customer to know whether the mediator is an independent broker or part of an exclusivity organisation of an insurer.

The call of the customer alone with the request for a visit does not trigger any obligation for information.<sup>18</sup> However, if there is a concrete activity of the mediator during the telephone conversation the information can be given orally if the policy holder agrees with this or if the mediator grants provisional cover. The necessary information must then be subsequently carried out with the insurance policy. However, this does not apply if for example with the motor vehicle third party insurance a provisional cover is granted.

In practice the so-called business card solution has asserted itself as the requested information can be accommodated on a business card without any problems.

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<sup>16</sup> Directive 2002/92/EC Art. 12 Par. 1e, i) - iii).

<sup>17</sup> On the findings of actual studies will be referred at the end.

<sup>18</sup> Bundesrats-Drucksache 207/07 of 26.03.2007 zur Versicherungsvermittlervordnung, p. 30.

Exceptions are to be observed with multiple general agents. Here it can be reported from practice that such multiple general agents partly cooperate with up to 20 or 30 insurance companies. For obvious reasons they then waive – in breach of the law – providing the corresponding details.

It is to be noted that the information only has to be provided once by the mediator, notably with the first business contact. This means in reverse that in case of changes during the current contractual relationship and with renewed contacts the policy holder does not have to be informed thereof. This is not convincing, because Art. 12 Par. 1 of the Insurance Mediation Directive envisages that the information “if necessary also has to be provided with a mere extension or amendment to the contract”. It is important that according to § 11 Par. 2 VersVermV the business owner as mediator has to pay attention that the status-related information also has to be provided by his employees, who are not traders and therefore do not have to provide the information, about him as the business owner.

As § 11 VersVermV is not regulated in the VVG, which would also have been possible, an independent sanction had to be envisaged in the trade regulations. According to § 18 VersVermV in conjunction with §§ 144 ff. GewO breaches as sanctioned as an administrative offence.

d) Obligations under contract law, which are to be complied with during the insurance mediation according to the Insurance Contract Act - § 59 ff. VVG

*aa) Fields of application directive and basis for advice - § 60 VVG*

Even if the directive insofar is not particularly well structured however various fields of application can be recognised. On the one hand it can be seen from Art. 12 Abs. 1 letters i) to ii) that from aspects of transparency the customer has to be informed whether the mediator confronts him as insurance broker or as an insurance agent and accordingly whether he as broker supports his advice on a balanced examination (i) or whether he as insurance agent exclusively works for a company. As far as letter ii) is concerned it is disputed whether the multiple general agents are covered by this<sup>19</sup> or whether it concerns brokers, who only have a limited selection of products or a limited overview of the market and have to point this out<sup>20</sup>.

The duties of a mediator are regulated in Art. 12 Par. 2. The last obligation which is envisaged by the Insurance Mediation Directive is envisaged in Art. 12 Par. 3. The reasons for the advice which is given are to be stated “precisely.”

The German legislator has implemented these regulations in §§ 59, 60 VVG. According to § 60 Par. 1 VVG the broker must base his advice on a sufficient number of insurances offered on the market and by insurers in order to give a recommendation, based on specialist criteria, which insurance contract is suitable for satisfying the needs of the policy holder. If he cannot or does not want to do this, because he is for example

<sup>19</sup> For example *Werber ZfV* 2004, 419, 420; *Müller ZfV* 2003, 98, 102.

<sup>20</sup> So *Langheid/Wandt/Reiff*, *Münchener Kommentar zum VVG* 2010, vor § 59 Rn. 36.

a specialist broker, he must explicitly point out the limited selection of insurers and contracts to the customer from aspects of transparency. The sense and purpose of the regulation is to point out to the policy holder, before he files an application, on which information basis he is advised. § 60 Par. 2 VVG determines that the broker, who only advises owing to a limited information basis, must inform the policy holder hereof. He must then disclose to him the concrete market and information basis by stating the products and insurers included in this.

This shall also apply to the insurance agent. Insofar the regulation only has a declaratory importance as if he satisfies his status-related obligation the policy holder knows already that he merely can mediate insurance products of one insurance company or one group or of several insurance companies as a multiple agent. If he informs of this he has thus also satisfied his obligation, notably on which market and information basis he provides his service, already.

As known the obligations of insurance brokers are very high so that the question is raised in this context how far the market knowledge of the insurance broker extends. The obligations required from the brokers may not be overstretched. It cannot be expected from an average insurance broker that he for example knows the products of all insurers throughout Europe or worldwide. However, also to be taken into consideration are the specific needs and the specific product which the customer is looking for. In an individual case it may then also be necessary to conduct a pan-European market analysis at a specialist broker. No exaggerated demands which cannot be satisfied may be made on the completeness either. However, higher demands are to be made on large brokers than clearly “small brokers” for the policy holder.

The question is also frequently discussed in Germany whether a broker is for example obliged to also include the direct insurers in his selection of contracts. This is to be negated, because the broker receives a brokerage fee from the insurer and direct insurers do not pay any brokerage fee. This would otherwise mean that the broker has to work for free.

#### *bb) Possibility for waiver*

According to § 60 Par. 3 VVG the policy holder can waive this information. The directive does not contain an explicitly possibility for waiver so that doubts were reported whether § 60 Par. 3 VVG is in breach of European law<sup>21</sup> It would speak in favour of this that the EU Insurance Mediation Directive stipulates certain minimum standards which may not be fallen short of. The counter-argument is that on the one hand the Insurance Mediation Directive only envisages a right to information of the policy holder and on the other hand according to the principles of the autonomy of private rights no-one has to allow himself to be pressed to accept information, if he declares that he does not want it<sup>22</sup>.

<sup>21</sup> So in specific Bruck/Möller/Schwintowski, VVG 9th ed. 2010, § 60 Rn. 22; Pröls/Martin/Dörner, VVG 28th ed. 2010, § 60 Rn. 22.

<sup>22</sup> So the dissenting opinions, Reiff VersR 2007, 725; Langheid/Wandt/Reiff, Münchener Kommentar zum VVG 2010, § 60 Rn. 37; Looschelders/Pohlmann/Baumann, VVG, 2nd ed. 2011, Rn. 34.

In addition there is the fact that pre-formulated declarations on the one hand are subject to a General Business Terms control according to § 307 ff. BGB [Civil Code], because the legislator requests for the protection of the policy holder that the waiver must be submitted in a separate declaration. The waiver can therefore not be pre-formulated as a standard in the form application of the insurer or for example in General Business Terms of brokers.

*cc) Advice and documentation obligations of the insurance mediator - § 61 VVG*

(1) Reason-related advice and documentation

Art. 12 Par. 3 of the EU Insurance Mediation Directive should be implemented with this regulation. Whereas the directive merely requires that the insurance mediator, based on the details provided by the customer, at least has to precisely “state” his wishes and needs as well as the reasons § 61 VVG envisages in addition reason-related obligations to ask questions and more comprehensive documentation obligations.

The mediator must ask questions, he must provide advice and he must document notes.

According to § 61 VVG an insurance mediator has to **ask** his customer **questions**, insofar as according to the difficulty to assess the offered insurance or the person of the policy holder and his situation there is a reason for this, about his wishes and needs and also by taking into consideration a reasonable ratio between the work required for advice and the premiums to be paid by the policy holder, **to advise** him as well as state the reasons for each advice give concerning a certain insurance.

He must further document his advice and the reasons for this in a text form by taking into consideration the complexity of the offered insurance contract.

With regard to the contents the aim is to determine the adequate insurance need for the customer.

The mediator is however not obliged without a reason to conduct a general risk analysis, nor the broker. The obligation to ask questions is related to a reason.

To be taken into consideration is the product, the knowledge of the policy holder, the individual needs and the circumstances of the individual case. If the customer wants travel luggage insurance for a holiday the situation is to be assessed differently than in the case in which a self-employed person asks about comprehensive protection and more comprehensive contingency care.

As far as the scope of the obligation to provide advice is concerned the law does not make a distinction between insurance agent and broker. Nevertheless with regard to the obligation to ask questions and provide advice a distinction must be made between the types of mediators. The obligation of a broker to give advice goes substantially further than that of an exclusivity agent and multiple agent. This is also owed to the transparency. Finally he must have a more comprehensive overview of the market for insurance products than the agent, who can only offer the products of the insurers represented by him.

Based on the details for which questions are asked the insurance mediator must advise the customer. The German legislator has explicitly envisaged that the scope of the obligation to provide advice may also be in a reasonable proportion between the required work for advice and the premium which is subsequently to be paid by the policy holder. Even if this is not unproblematic so far in any case greater practical problems have not become known in this respect.

The mediator must state the reasons for each advice provided relating to certain insurance and he must substantiate this. All of this must be documented by taking into consideration the complexity of the offered insurance contract according to § 61 Par. 1 Sentence 2 VVG.

#### (2) Possibility for waiver

The policy holder can also waive the advice or the documentation here by a separate written declaration, § 61 Par. 2 VVG. The legislator additionally requires here that with a waiver of the customer it has to be explicitly pointed out by the insurance mediator that such a waiver can have a disadvantageous implication on the possibility to assert a claim for damages against the insurance mediator owing to deficient advice. The question is raised here again whether this possibility breaches the directive and is in breach of European law<sup>23</sup>.

That the law with regard to the waiver of advice envisages stricter regulations than with the waiver of information, is obvious. A false advice of the mediator has far more serious consequences for the policy holder and will more lead to a claim for damages than a breach of the information obligations.

The documentation obligation must be carried out in a text form. In practice the GDV (German Insurance Association) has developed sample forms for the exclusivity agents. The association of brokers has also presented forms. Whether these forms also take into account the intentions of the legislator, as they are necessarily standardised and are intended for a multitude of cases, only remains to be seen still. Court decisions have not yet been pronounced in this respect so far.

#### *dd) Form and time*

As stated above already the status-related information must be notified to the customer with the first business contact. § 62 VVG envisages that the mediator must send the policy holder the contract-related information of § 60 Par. 2 before the submission of his contractual declaration, the advice-related information according to § 61 Par. 1 on the other hand only before the conclusion of the contract. It is further envisaged that this information has to be sent in a clear and understandable manner in a text form.

It can be given orally if the policy holder requests this or if and insofar as the insurer grants provisional cover. The information is then to be made available to the policy holder in a text form immediately after conclusion of the contract, by no later than with the insurance policy unless it concerns a contract for provisional cover with a mandatory insurance.

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<sup>23</sup> The arguments are similar to those which were discussed earlier on behalf of § 60 VVG. In so far it can be referred thereon.

The regulation that the advice-related information, thus the reasons for the advice given only has to be made available to the customer together with the policy, has been rightly criticised.<sup>24</sup>

However, the procedure is different in practice. The mediator would as a rule like to reach a conclusion during a visit. In addition, he wishes to have the signature of the customer under the documentation. If this is missing namely in possible proceedings for damages it will be presumed up to a reversal of the burden of proof that the owed advice was missing. It is notably assumed for the burden of the mediator that with proper advice and explanations for the policy holder a correct advice would have been assumed and consequently the occurred damages would not have happened. For this reason the mediators pay attention that on the one hand documentation is carried out and on the other hand the policy holder confirms the completeness and accuracy with a signature. § 63 VVG accordingly regulates a corresponding obligation for damages of the insurance mediator if the policy holder suffers damages through a breach of the information, advice and documentation obligations. § 63 Par. 1 Sentence 2 VVG explicitly envisages that this will then not apply if the insurance mediator is not responsible for the breach of obligation which means the consequence of a real reversal of the burden of proof. The mediator must prove that the damages would also have occurred with dutiful conduct, which as a rule he cannot.

#### *ee) Field of application*

Art. 12 Par. 4 of the Insurance Mediation Directive envisages that the information, advice and documentation obligations should not apply to major risks. The German legislator has implemented this in § 65 VVG according to which §§ 63 – 66 do not apply to the major risks. The reinsurance and the maritime insurance are also excluded, § 209 VVG. This is useful.

As one can see from Art. 1 Par. 2 of the Insurance Mediation Directive this does not require that all commercially operating mediators have to be covered by the regulations. Accordingly the German legislator has excluded the so-called insignificant mediators. This is on the one hand regulated in § 34d Par. 9 GewO. § 66 refers hereto.

#### e) VVG information obligation regulations

With the regulations concerning information obligations with insurance contracts the legislator has determined regulations which information obligations the insurer has to satisfy in all branches of insurance. The associated link is § 7 Par. 2 Sentence 1 No. 1 VVG. Implemented are stipulations from Art. 3 of the directive 2002/65 EC, from Art. 31 of the directive 92/49 EEC as well as from Art. 36 and Appendix 3 of the directive 22/83 EC.

However, without an example and without stipulations of EU law the obligation envisaged in § 2 Par. 1 No. 1 and in § 3 Par. 1 No. 1 for the life and health insurance to provide details concerning the amount of the conclusion costs included in the

<sup>24</sup> Abram, r+s 2005, 137, 147; Langheid/Wandt/Reiff, Münchener Kommentar zum VVG 2010. § 63 Rn. 9, 10.

calculation of the premium whereby the conclusion costs included in the calculation are to be disclosed as a standard total amount and the other calculated costs as a share of the annual premium by stating the respective term. The policy holder thus finds out – at least partly –, which commission or brokerage fee the mediator receives. The legislator substantiates this with the fact that the transparency in the field of life and health insurance is to be improved and a decision of the Federal Constitutional Court of 15 February 2006 (I BVR 131796) makes this implementation necessary. The Federal Constitutional Court determined, that if the type and amount of the conclusion costs which are to be settled and the settlement mode remain unknown to the policy holders, an own-determined decision is not possible for them in this respect whether they want to conclude a contract at the concrete costs.<sup>25</sup>

#### 4. Assessment

The approach of the EU directive and of the German legislator to set up a registration obligation, a proof of expertise and reliability of the insurance mediators as well as the publicity of the register as well as the introduction of information, advice and documentation obligations is to be welcomed without limitation. The thus associated hope in particular that the so-called pseudo-brokers, thus persons, who are not even brokers, however to appear towards the customer as such, would disappear, has not been satisfied in full. The same shall also apply to the non-regulated occasional mediators and the people who give tips.

It is just being reported in Germany about a survey of the University of Applied Sciences in Dortmund, which informs about substantial divergences between actual status of brokers and their entry in the register. Random samples, which were carried out by the University of Applied Sciences, showed that merely 48 % of the persons who are registered can be certainly identified as brokers. 30 % on the other hand cannot be allocated.<sup>26</sup> One problem of the German market was and is apparently still that mediators present themselves towards the customer as supposedly independent and competent brokers, however they are not actually, but mostly operate as bound multiple general agents. This shows that the hopes that there would be an adjustment of the market for the pseudo-brokers, have not been satisfied.<sup>27</sup>

#### 5. Outlook

The EU Commission has published a consultation paper of 26 November 2010 concerning the revision of the EU Directive 2002/92 EC of 9 December 2002 about

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<sup>25</sup> BVerfG VersR 2006, 489, 493. Earlier also BVerfG VersR 2005, 1127, 1134; *Präve* VersR 2008, 151, 156. Amtliche Begründung des Gesetzentwurfs der Bundesregierung zur VVG-Informationspflichtenverordnung, Bundesanzeiger 2008, S. 98, printed also in VersR 2008, 183 f.

<sup>26</sup> *Beenken/Gottschalk/Ludwig*, Versicherungswirtschaft 2012, 442.

<sup>27</sup> Langheid/Wandt/Reiff, Münchener Kommentar zum VVG 2010, § 59 Rn. 45 ff.; *Deckers*, S. 38 ff.

the insurance mediation IMD 2.<sup>28</sup> CEIOPS has published an instructive report in which information is given about the implementation of the benchmarks of the Insurance Mediation Directive in the EU states.<sup>29</sup> Besides the consultation regarding IMD 2 the EU Commission has almost parallel carried out consultations regarding the revision of the MiFID and the initiative concerning so-called investment products for small investors - Packaged Retail Investment Products (PRIIPs).

It is noticeable that the EU Commission therefore apparently thinks in particular from the perspective of financial service mediation. A certain harmonisation is certainly desirable, however there are also misgivings in this respect, because the different nature of the sales channels and the products may not be disregarded.

Aimed at is in any case an application of the regulations from the Insurance Mediation Directive also to the direct sales. However, it should be taken into consideration here that policy holders, who intend to conclude contracts by electronic means for the Internet or by including the telephone do not necessarily expect individual advice. It cannot be ensured through these media either without further ado. It must be sufficient if insofar standardised product information is given. A determination of the concrete needs together with advice and documentation can hardly be carried out here.

A full harmonisation incidentally does not appear desirable. With regard to the different nature of the sales channels and the specific national features merely a minimum harmonisation should also be envisaged for IMD 2.

Considerations are also being made to envisage standards for a qualification level throughout the EU. No objections are to be filed against this per se. However, a possible full harmonisation may not lead to a fall in the quality standard in the countries, which have high or higher standards.

The Commission is apparently of the opinion that the current regulations concerning the remuneration are not particularly transparent in order to disclose or to avoid conflicts of interest. A ban for example to the extent that the mediator receives commission or a brokerage fee from the insurance company as so far, but exclusively is to be remunerated for his mediation and advice service by the customer, is in no way better than the previous system. It is to be feared that the consumer will tend to save costs and will waive the necessary advice in full.

A disclosure of conclusion and sales costs included in the calculation in line with the German model in the field of life and health insurance appears therefore sufficient. One could possibly supplement still to which reduction in yield these costs lead with long term life insurance contracts - Reduction in Yield. Special transparency regulations in the indemnity and accident insurance do not appear necessary in this context. The disclosure of a concrete remuneration is incidentally not even possible, because

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<sup>28</sup> Consultation document on the Review of the Insurance Mediation Directive (IMD), Commission Staff Working Paper, ec.europa.eu.internal\_market/consultations/docs/2010/insurance\_mediation/consultation\_document\_eu.pdf

<sup>29</sup> <http://www.ceiops.eu/media/files/publications/submissionstotheec/CEIOPS-DOC-09-07IMDReport.pdf>

this has not yet been determined as a rule at the conclusion of the mediation. The remuneration systems are very differentiated, include super commission, performance-based participations, etc.<sup>30</sup>

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<sup>30</sup> Very detailed the statement of GDV under [www.gdv.de/2011/02/gdv-stellungnahme-zur-evaluation-der-eu-richtlinie-ueber-versicherungsvermittlung-imd2/](http://www.gdv.de/2011/02/gdv-stellungnahme-zur-evaluation-der-eu-richtlinie-ueber-versicherungsvermittlung-imd2/)

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# Transparency Concerning On-Line Insurance

*Omnia mutantur nos et mutamur in illis.*<sup>1</sup>

**Şebnem Ulusoy**<sup>2</sup>

## CHAPTER ONE

### Overview of the key issues

- I. Transparency;** by definition implies openness, communication and accountability; it suggests to operate in such a way that is visible and accessible for others to detect what actions are performed. Transparency concerning on-line insurance should read as “readily understood” and be characterized by visibility or accessibility of information.

As the main drive for ensuring transparency is to guarantee the protection of consumer interests, insurance industry purporting to benefit from the new era of e-commerce will need to ensure the transparency amongst other notions. In our context transparency is envisaged as clarity, comprehensibility and exhaustiveness of a contractual text.

Traditionally, insurers sell their products either directly or through a variety of distribution channels, of which the most familiar are brokers, agents and bancassurance. However, in the aftermath of the recent financial crisis and subsequent economic recession, rapidly changing and innovative technologies, along with the accelerated changes in the regulations paved the way for reversing the methods of distribution of insurance products.

- II. New channel for distribution;** Now, there is an urge for the market players to generate more premiums, do cost-cuttings regarding their operation expenses and, retention of the customers with high acquisition costs already paid, encouragement for cross-selling.<sup>3</sup> Even though the distribution of insurance products has evolved significantly and the insurance industry is increasingly benefiting from the

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<sup>1</sup> *All things change, and we change with them, translation of the Latin phrase.*

<sup>2</sup> Assistant General Manager in Groupama Turkey.

<sup>3</sup> See “Consumer Protection, Insurance”, Rodney Lester, Primer Series on insurance, Issue 7, *the World Bank*, [www.worldbank.org/nbfi](http://www.worldbank.org/nbfi), August 2009. Cross-selling that constitutes bundling or tying is reviewed; despite the positive sides of the matter, it is concluded that it may reduce market transparency.

technological developments (notably the internet and mobile phones); yet, the evolution of low-cost distribution channel as on-line insurance is at a slow pace. This new form of competition and the threat of losing sales to it started to prompt the technologically reticent insurance industry to use Internet as a sales channel.<sup>4</sup> Albeit Internet and globalised social networks have transformed rapidly the sales channels and methods in other industries, insurance industry did not keep the same pace with the trend. Nevertheless, many customers changed their pattern to buy insurance and increasingly started to use the Internet to conduct research on the providers' or the third parties' comparison websites prior to buying insurance products and they go offline to make purchases. Hence, the trends in the customer behaviour are changing to a certain extent towards so-called biased advice received from the insurance intermediaries to neutral information sites that enable the customers to get quotes and information. According to a survey, the importance of online channels for research and their expected continued growth are clear with 32% of European customers currently using a range of on-line channels, including comparison websites and blogs.<sup>5</sup>

Contrary to the general presumption of the insurers, the information seeking customers does not centre on the premiums or the products primarily. Figures show that along with the price and the product, customers appreciate "transparent and clear documentation" both in insurance quotes and the contract details of the insurance policy. They require clear and brief information that is comprehensible for them rather than excessive legalese and the insurance industry jargon. More and more the customers perceived the claims handling procedures, responsiveness, and trustworthiness of insurance companies as vital for the purchase. Hence, apart from the best value for the money, it will be appropriate to conclude that honesty, trust, transparency and lastly technology will be the key drivers that influence customer expectations vis-à-vis insurers.<sup>6</sup>

**III. Transparency is on the rise;** and, the demands for transparency are increasing in large part because of globalization. The global integration of economies has a huge impact on not only the economies but also on the people. The people highly exposed to the changing concepts due to globalisation asked for involvement in the processes which led to broadened scope of disclosure and improved the accuracy and use of information.<sup>7</sup> This is the reason why throughout the world emphasis is made on the demand for more transparency in the ongoing discussions of financial services regulation regarding the consumer protection and rights. Transparency

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<sup>4</sup> "Internet Slowly Transforms Staid World Of Insurance"; Charles Waltner, <http://www.informationweek.com/777/insure.htm>.

<sup>5</sup> "Time For Insurers to Rethink Their Relationships"; Ernst & Young, *Global Consumer Insurance Survey 2012*.

<sup>6</sup> "Trust, Transparency and Technology- European customers' perspectives on insurance and innovation"; IBM Institute for Business Value, 2008.

<sup>7</sup> "Does the Invisible Hand Need a Transparent Glove? The Politics of Transparency"; Ann M. Florini, *Annual World Bank Conference on Development Economics 1999* (The World Bank, 2000)

has gained prominence as policy makers have seen the shortcomings of more conventional regulation, searched for approaches to problems that do not lend themselves to standardized rules, and recognized the potential of information technology to make complex data accessible to broad audiences.<sup>8</sup> Information technology enables the clients to make more informed decisions enabling them to have access to existing conditions, decisions and actions which are visible and understandable.<sup>9</sup>

**IV. Information, Disclosure and Transparency;** ICP No. 19, “Conduct of Business” states that the supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.<sup>10</sup> Pursuant to this rule, supervisors should ensure that the principles of transparency and disclosure applied to internet insurance activities are equivalent to those applied to insurance activities through traditional means. In addition, supervisors should require that insurers and intermediaries over which they exercise jurisdiction and which offer insurance products over the internet should disclose certain information on their internet site.<sup>11</sup> This information entails, *inter alia*, the contact details of the insurer’s head office and its supervisor, the insurer’s claims handling procedures; and information on the dispute resolution mechanisms or consumer complaints. Hence, the policyholders will be furnished with a clear view of the business activities and the financial position of their insurer and will reach to a better understanding of the risks to which they are exposed.

In order to keep up with the needs of the information society era the insurers need to abolish the asymmetry of information which often places the consumers at a disadvantage and maintain adequate consumer protection mechanisms to address this market failure. To that end, as a good practice for consumer protection, a financial sector should provide consumers with;

- Transparency by providing full, plain, adequate and comparable information about the prices, terms and conditions (and inherent risks);
- Choice, by ensuring fair and reasonable practices during the sale, post- sale and collection of payments;

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<sup>8</sup> “The Political Economy of Transparency: What Makes Disclosure Policies Sustainable?,” Archon Fung, Mary Graham, Elena Fagotto and David Weil *Harvard University*, <http://www.ashinstitute.harvard.edu>, 2004.

<sup>9</sup> See “Policy Framework for Effective and Efficient Financial Regulation- General Guidance and High-level Checklist”, *OECD* 2010. It is argued that establishing transparency will elucidate the actual functioning of the financial system given the value of high-quality and accurate information for its functioning.

<sup>10</sup> Insurance Core Principles, Standards, Guidance and Assessment Methodology, *IAIS*, <http://www.iaisweb.org>, October 2011, p. 276.

<sup>11</sup> ICP No 19, Guidance 19.5.17, p. 286.

- Redress, by providing inexpensive and speedy mechanisms for addressing the complaints and dispute resolution mechanisms;
- Privacy, by ensuring the protection of the personal financial information.<sup>12</sup>

**V. Trust, Transparency and Technology:** Having underlined the growing need for transformation, it will also be crucial to establish the way ahead of the insurance industry to meet this end. Traditionally insurers maintain product centricity, where product characteristics and the price were the main drives for marketing of the product, in tomorrow's customer-centric environment it is envisaged that flexibility, personalization and experimentation (to think "out of the box") will be the main drivers. In addition, overcoming the perception that the insurance industry has an image problem, social computing to allow information flow with the customers is also highly recommended. To conclude, being non-traditional means not relying on conventional wisdom, but listening to the market which results in mastering trust, transparency and technology.<sup>13</sup> New generation of customers that are seeking independent (*i.e.* unbiased) and transparent information are reverting to the Internet which might also result in shifting balance of power to customers from distributors.<sup>14</sup>

It is becoming increasingly important to highlight how a combination of increased expectations and accessible technology mean that the insurance industry is now facing a far more demanding customer and that those and failing to proceed with a rapid move to a more consumer-friendly business model risk will be lagging behind. It is appropriate to conclude that greater transparency and simpler products will be a deal breaker in the future. The need for clarity and transparency in the buying process is not driven purely by customer preferences. As a result of the financial crisis, all the regulators are focusing on protecting consumer interests more, with major new regulations being introduced in the EU and many other markets around the world. Insurers that align themselves to a truly customer centric model will adapt themselves to the transition to the new regulatory environment and will gain competitive advantage.<sup>15</sup>

**VI. Insurance on-line:** The usage of Internet as means for promoting and distributing insurance products implies to comply with an original legal framework composed of a very wide range of rules.

To be more precise, below mentioned categories of regulations have to be mentioned:

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<sup>12</sup> Supra footnote 3.

<sup>13</sup> Supra footnote 6.

<sup>14</sup> "What the future holds, Insurance 2020", PwC, June 2011.

<sup>15</sup> Ernst & Young's Global Insurance Customer Survey, <http://www.ey.com/GL/en/Newsroom/News-releases/Insurers-are-left-playing-catch-up-globally-as-consumer-expectations-soar>, London, 20 February 2012.

- **Insurance regulations** are subordinating the promotion and distribution of insurance products to some conditions regardless of means used for those activities.
- **Economic law** has three objectives: To ease the freedom of trade, to protect the insurers from abuses of their competitors and to protect the customer using the Internet to buy insurance.
- **IT and new technologies** influences modalities and efficiency of this new type of commercialization.

As a part of the financial sector, insurance products are intangible and thus in principle suited to trade over the Internet. However, it is a highly regulated sector as all the other financial sectors and the distribution from Internet has a “borderless” dimension which makes the rules to trade over the Internet cumbersome legally. Therefore, applicable rules to the insurance distribution by Internet have to be organized usually by taking into account different jurisdictions.

In the variety of legal sources applicable for the distribution of insurance products by Internet, various approaches exist for regulating this area. Surely, none of the jurisdictions may be exhaustive to cover all approaches in its entirety. On the other hand, EU regulations governing various national legislations should be taken into the scope of a study on law of insurance distribution from Internet.

## CHAPTER TWO

### ON-LINE INSURANCE REGULATIONS IN EU AND TURKEY

#### I. EU *Acquis* Regarding On-line Insurance:

The Insurance Directives, E-Commerce Directive, Distance Selling Directive, Insurance Mediation Directive together form the instruments of the EU *acquis* as successive steps towards the completion of a single market for insurance services within the EU. However, their provisions reflect different stages in the harmonisation of the relevant national rules, as well as the gradual accommodation of technological developments, such as electronic networks, and the policy considerations, such as the increasing focus on retail/consumer issues.

##### 1. Insurance Directives

To start with, it is noteworthy to acknowledge that the third generation directives on non-life and life insurance of the EU *acquis* (Insurance Directives) were not designed to address insurance business carried out over the Internet.<sup>16</sup> By all means, they fail to eliminate the queries with regard to the implementation of on-line insurance at the EU level, especially for the cross-border development to

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<sup>16</sup> Directives 92/49/EEC (OJ L 228, 11.8.1992) and 92/96/EEC (OJ L 360, 9.12.1992), as amended and codified. The life directives have been codified and recast as Directive 2002/83/EC concerning life insurance (recast version) (OJ L 345, 19.12.2002).

ensure a level-playing field for insurers in the Single Market; and, may require adaptation to the needs in the aftermath of the adoption of E- Commerce Directive explained below. All in all, Insurance Directives continue to apply to electronic insurance transactions carried out in the Single Market under EC Treaty rules on the freedom to provide services (Article 49).<sup>17</sup>

## 2. E- Commerce Directive

E-commerce is a term which signifies the sale of any goods or services on the Internet. Be that as it may, the E-Commerce Directive (hereafter ECD), which was adopted in 2000 and transposed by most EU Member States in 2002, aimed at guaranteeing the freedom to provide information society services in accordance with the freedom to provide services and sets out the general legal framework for business carried out over the Internet.<sup>18</sup> It also aimed to harmonise core marketing rules that are relevant in the context of the selling of all financial services, for example, so-called 'cold calling' (i.e. unsolicited phone calls) or the provision of information about the product or service.

As a horizontal and catch-all Directive, it was not tailored to meet all the requirements of particular sectors, such as financial services. The EU Communication which sets out a new policy framework for financial services, aimed to build on the ECD paving the country of origin philosophy to operate, in practice, across all financial services and distance trading modes.<sup>19</sup> In this Communication the need for a clear and coherent policy for cross-border trade in financial services is maintained. The strategy was built around the same principles with the ECD to establish a fully functioning internal market for financial services and moreover to secure coherence between on-line and off-line provision of financial services.

The ECD provides that Member States have to ensure that service providers established on their territory comply with the national requirements applicable to them, which fall within the Directive's coordinated field. In turn, Member States have been obliged to lift provisions prohibiting/impeding the offer/conclusion of insurance products over the Internet, be it internally or on a cross-border basis unless such measures are covered by one of the derogations provided in the ECD.

The ECD provides derogations specified in its Annex, *inter alia*, relating to certain provisions in insurance field mainly due to the application of country of origin principle.<sup>20</sup> The specific requirements of the Insurance Directives conflicted with

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<sup>17</sup> Article 49 para. 1 (ex Article 43 TEC) of the Consolidated version of the Treaty on the Functioning of the European Union.

<sup>18</sup> Directive 2000/31/EC (OJ L 178, 17.7.2000).

<sup>19</sup> "Electronic Commerce and Insurance", *Discussion Paper for the working group meeting*, MARKT/2541/03, [http://ec.europa.eu/internal\\_market](http://ec.europa.eu/internal_market), December 2003.

<sup>20</sup> The ECD Article 3(3) and its Annex fourth indent provides for a derogation from Article 3 of the Directive for insurance activities falling under Article 30 and Title IV of Directive 92/49/EEC, Title IV of Directive 92/96/EEC, Articles 7 and 8 of Directive 88/357/EEC and Article 4 of Directive 90/619/EEC.

the country of origin clause of the ECD. Nevertheless, as the insurance sector falls under the scope of the said directive, it is possible to conclude insurance contract by electronic means like Internet.

**2.1. General implications of the ECD on insurance activities** throughout the EU are briefly as follows;

- **Prudential supervision:** There is no specific requirement for prior authorisation to provide insurance services on-line other than a general requirement to be authorised in the insurance undertaking's home Member State, *i.e.* the Member State of establishment of the head office, pursuant to the principles laid down in the Insurance Directives. One exception is Article 41 of Directive 2002/83/EC concerning life insurance which necessitates the prior notification to the home Member State regarding the intention to carry on business for the first time in one or more Member States indicating the nature of the commitments it proposes to cover.<sup>21</sup> The host Member State is entitled for requirement of ex-post and non-systematic notification of policy conditions.
- **Applicable law:** The Insurance Directives apply given the derogation in the ECD.
- **Advertising:** It should be noted that albeit the consideration to be adopted in the interest of general good, introduction of the commercial activities is considered as admissible along with advertising of their services through all available means of communication in the Member State of the provision of services.<sup>22</sup>
- **Insurance Intermediaries:** Even though the ECD does not apply fully to all aspects of insurance, derogation concerns only the activities of the insurance undertakings but not the activities of insurance intermediaries are covered by the "internal market clause" (*i.e.* "the country of origin regime") of the ECD with respect to their on-line activities.<sup>23</sup> ECD introduced a specific liability regime for three categories of services as per the Articles 12 to 14 in the said Directive where the liability for intermediary service providers were defined and limited where they act as mere conduit operators, "caching" providers and hosting services.
- **Pre-contractual information:** The derogation does not cover the provisions of Insurance Directives referring to provision of pre-contractual information to policyholders.<sup>24</sup> Thus, insurance companies carrying out business over the Internet are subject to differing pre-contractual information requirements stemming from not only from the Insurance Directives, but also from the ECD and the Distance Marketing Directive which will be explained further on.

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<sup>21</sup> Lamy Assurances, 2011, p. 2215.

<sup>22</sup> Article 47 of Directive 2002/83/EC.

<sup>23</sup> Supra footnote 18.

<sup>24</sup> See Directive 92/49/EEC, Article 31 and Directive 2002/83/EC Article 36 and Annex 3.

Article 5 of the ECD established transparency as a requirement in addition to other information requirements established by the EU *acquis*, by stating that Member States shall ensure that the service provider renders easily, directly and permanently accessible to the recipients of the service and competent authorities. Furthermore, pursuant to the second paragraph of Article 5, Member States are required to at least ensure that, where information society services refer to prices, these are to be indicated clearly and unambiguously and, in particular must indicate whether they are inclusive of tax and delivery costs. The on-line service providers are obliged to provide the general information as set out in the directive to meet this end also. The information requirements do not prevent Member States from imposing additional information requirements but these are either harmonised or unified at EU-level. The new Consumer Rights Directive, which completes Article 5 of the ECD by fully harmonising the information requirements for business-to-consumer distance contracts.<sup>25</sup>

According to the ECD, the on-line service providers are in principle need to comply with rules of their home Member State in particular with the information requirements and contractual rules; yet there are also numerous obligations imposed on the on-line service providers. The rules that apply for on-line service providers that are simply “transmitting” and that “host” the content on the Internet differ in the imposed duties upon the on-line service providers; the latter has the obligation to remove the illegal content or to block the access to it immediately (*i.e.* “notice-and-takedown” procedure). Nonetheless, both types of the on-line service providers cannot be held liable for illegal content that is uploaded by third parties and the Member States may not impose a general obligation on the on-line service providers to monitor the content that they transmit or host.

- **E-contracts:** Article 9 paragraph 1 of the ECD obliges the Member States to ensure that their legal system allows contracts to be concluded by electronic; hence, will carry the legal effectiveness and validity as the accustomed contracts.

**2.2. E- Commerce Directive revisited-** Since the adoption of the ECD more than a decade ago, law on e-commerce has significantly evolved however e-commerce has still not reached its full potential. There is an urge for better co-operation in the application and implementation, *i.e.* governance of the ECD. To this end, the Transparency Directive is intended to help avoid the creation

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<sup>25</sup> Directive 2011/83/EU, on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, OJ L304/64, 28.09.2011. This so-called ‘Consumer Rights Directive’ obliges the trader to provide the consumer with the following information: the trader’s geographical address, telephone number, fax number and e-mail address, where available, to enable the consumer to contact the trader quickly and communicate with him efficiently and, where applicable, the geographical address and identity of the trader on whose behalf he is acting, <http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:304:0064:01:EN:HTML>.

of new barriers to trade within the EU.<sup>26</sup> The Transparency Directive requires prior notification of the Member States about their draft rules on information society services, and generally observes a standstill period of at least three months before formal adoption, in order to allow other Member States and the Commission to raise concerns about potential barriers to trade.

Hence, more administrative cooperation, improved enforcement and greater clarification in the liability regime of internet intermediaries are required to increase its impact.<sup>27</sup> As such, in the aftermath of the adoption of the ECD, several directives had also been enacted to complete the regime; namely;

- Unfair Commercial Practices Directive<sup>28</sup>;
- the new Consumer Rights Directive<sup>29</sup>;
- e- Privacy Directive (Directive on privacy and electronic communications)<sup>30</sup>
- Electronic Signatures Directive.<sup>31</sup>

Upon the request of the European Council of June 2011 to submit a roadmap for achieving an internal digital market by 2015, the efforts are underway for the attainment of a Digital Single Market and the European Commission adopted the Communication on e-commerce and other on-line services.<sup>32</sup> Furthermore, a “European Consumer Agenda” in 2012 including digital issues will be adopted, which proposes actions to guarantee an appropriate level of information and customer care on-line; *i.e.* transparency will be ensured efficiently.

Despite the enormous potential of e-commerce within the EU, the fact that this source has not been exploited to the fullest extent is due to certain obstacles; be it lack of adequate information, legal cross-border constraints, or inadequate consumer protection rules. Be that as it may, since the ECD laid the foundations for cross-border on-line services, however in a technologically neutral manner, it is recognised to be a cornerstone of the Digital Single Market also, which will result in certain additions rather than an amendment to the directive.<sup>33</sup>

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<sup>26</sup> Directive 98/34/EC (as amended by Directive 98/48/EC) laying down a procedure for the provision of information in the field of technical standards and regulations, OJ L 204/37, 31.07.1998.

<sup>27</sup> “Online services, including e-commerce, in the Single Market,” Commission Staff Working Paper, [http://ec.europa.eu/internal\\_market/e-commerce/docs/communication2012/SEC2011\\_1641\\_en.pdf](http://ec.europa.eu/internal_market/e-commerce/docs/communication2012/SEC2011_1641_en.pdf) SEC(2011) 1641. In this paper, the evolution of the ECD along with the EU jurisprudence is studied.

<sup>28</sup> OJ L 149/22, 11.06.2005.

<sup>29</sup> Supra footnote 25.

<sup>30</sup> Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector, OJ L 201/37, 31.07.2002; as revised by Directive 2009/136/EC 25.11.2009.

<sup>31</sup> Directive 1999/93/EC on a Community framework for electronic signatures, OJ L 013/12, 19.01.2000.

<sup>32</sup> Communication on e-commerce – frequently asked questions, *European Commission, MEMO/12/5*, January 2012.

<sup>33</sup> “Stimulating growth and employment: an action plan for doubling the volume of e-commerce in Europe in 2015”, *European Commission, Press release*, 11.1.2012.

### 3. Distance Marketing of Financial Services Directive

Recital 5 of the Distance Marketing Directive states that, because of their intangible nature, financial services are particularly suited to distance selling and the establishment of a legal framework governing the distance marketing of financial services should increase consumer confidence in the use of new techniques for the distance marketing of financial services, such as electronic commerce.<sup>34</sup> The basic provision of this Directive is to provide the consumer with some specified information about the supplier and the service or product and, in some cases, allow the consumer to cancel the contract within a prescribed period.<sup>35</sup> Provision of comprehensive information before the purchase of the products is needed to be respected.

Pursuant to Article 6 (1), the right of withdrawal of the consumers from the contract without penalty and without giving any reason is set out as a period of 14 calendar days. This period is extended to 30 calendar days in distance contracts relating to life insurance covered by Directive 90/619/EEC and personal pension operations whereas the EU Life Insurance Consolidated Directive specifies a cooling off period of between 14 and 30 days after the 'contract has been concluded'. In addition, where a distance contract is concluded by electronic means, e.g. Internet, the information requirements imposed by the ECD will also apply. Thus, it is right to conclude that the implementation of the Distance Marketing Directive will require firms to operate separate compliance regime for products sold at a distance.<sup>36</sup>

### 4. Insurance Mediation Directive<sup>37</sup>

This Directive has been adopted to set up a legal framework which along the single passport rules ensures a high level of professionalism and competence among insurance intermediaries whilst guaranteeing, *inter alia*, the "minimum" information which insurance intermediaries have to provide to customers. The aim of establishing a genuine level playing field for all insurance intermediaries at EU level requires taking up of a coherent approach for insurance mediation. Form and content of the pre-contractual information, incentives for distributors that may influence the advice to consumers, assessment of the suitability of the financial product for the consumer may be the key areas for alignment of the rules.

The EU Commission intends to address cross-sectoral inconsistencies regarding the marketing of investment products through its Packaged Retail Investment Products (PRIPs) initiative. It is noteworthy to emphasise the underlying rationale of the two texts; PRIPs concerns the regulation of packaged retail investment

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<sup>34</sup> Directive 2002/65/EC concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, of 23 September 2002.

<sup>35</sup> "Implementing the Distance Marketing Directive: another compliance regime," *Freshfields Bruckhaus Deringer*, October 2003.

<sup>36</sup> *Ibid.*

<sup>37</sup> Directive 2002/92/EC on insurance mediation, 9 December 2002.

products and is expected to include e.g. pre-contractual disclosure to ensure product transparency before the sale of an investment product, whereas Insurance Mediation Directive concerns insurance mediators and is expected to include e.g. information to be given to consumers to ensure that the insurance mediator acts independently from the insurance seller.

In a Communication, the EU Commission concluded that legislative changes at EU level were necessary to ensure a more consistent and coherent horizontal approach to the regulation of product disclosure and sales practices. Therefore, the regulation of selling practices in relation to insurance PRIPs should be covered by the revision of the Insurance Mediation Directive, *i.e.* IMD2. In this context, two regimes would appear to be necessary in the Insurance Mediation Directive, one for the sale of general insurance products and one for insurance PRIPs (investments packaged as life insurance policies).<sup>38</sup> Under the proposed review of the Insurance Mediation Directive, these products would become subject to regulation of insurance PRIPs through the Markets in Financial Instruments Directive (MiFID).<sup>39</sup>

## II. Legislation with a Turkish flavour

As in nearly all jurisdictions, as well as EU, an important remark for Turkish insurance mediation is that the direct sales through employees or distance-selling are less developed in life than in non-life insurance.<sup>40</sup> The old rhetoric about the life insurance products goes as “Life insurance is sold, not bought!” in Turkey also. In light of these similarities the rules of Turkish insurance industry with regard to the on-line insurance and e-commerce will be briefly presented.

Transparency is treated within the Turkish Insurance Law as a secondary contractual obligation of the insurer which is the duty to inform the policyholders about the content of the insurance agreement.

The E-Signature Law<sup>41</sup> is aimed at extending the application area of e-commerce in Turkey. Nevertheless, on-line insurance is still a new concept for the Turkish insurance industry and given the lack of secondary legislation there is a road ahead of the industry and all the market players. The transparency in on-line insurance under Turkish Insurance Law is also not elaborated in detail. Therefore the general rules governing the duty of information also applies in on-line insurance.

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<sup>38</sup> Study on the impact of the revision of the Insurance Mediation Directive (ETD/2007/IM/B2/51) Final Report, [http://ec.europa.eu/internal\\_market/insurance/docs/mediation/imd\\_final\\_en.pdf](http://ec.europa.eu/internal_market/insurance/docs/mediation/imd_final_en.pdf), prepared for the European Commission DG Internal Market and Services.

<sup>39</sup> Directive on 2004/39/EC (known as “MiFID” as subsequently amended is a European Union law that provides harmonised regulation for investment services with the main objectives to increase competition and consumer protection in investment services. As of the effective date, 1 November 2007, it replaced the Investment Services Directive Directive (93/22/EEC of 10/05/1993, OJ N.L.141 of 11/06/1993).

<sup>40</sup> <http://www.insuranceeurope.eu/uploads/Modules/Publications/key-facts-2011.pdf>.

<sup>41</sup> Law No: 5070, entered into force on July 23, 2004. The secondary rules were adapted by the E-signature Regulation and Communiqué, published in the Official Gazette and entered into force on January 6, 2005.

## **1. Turkish Code of Commerce**

According to the article 1290 of the Turkish Commercial Code, the policyholder must share necessary information regarding the object of the insurance with the insurer. However, such obligation has not been stipulated for the insurer; the obligation of the insurer to inform was introduced by virtue of the Insurance Law.<sup>42</sup>

## **2. Insurance Law**

According to the article 11/3, the Insurance Law governs the issues related to information to be provided by the insurance companies and insurance agents to the policyholder, beneficiary and the insured during the pre-contractual period (before issuance of the policy) and within the insurance term.

## **3. Regulation Concerning the Liability of Disclosure Regarding Insurance Contracts (Regulation)**

The regulation mentioned in the article 11.3 of the Insurance law entered in force on March 1<sup>st</sup>, 2008. According to the regulation the insurer or its agent shall disclose all necessary explanation to the policyholder and notify a disclosure form before the issuance of the policy.

- “Disclosure form” is as a document containing brief information on insurance coverage, exemptions, processes, dispute resolution mechanisms along with the rules on indemnification which needs to be disclosed by the insurer and the competent intermediaries to the policyholder before the issuance of insurance contract.
- The policyholder is entitled to terminate the insurance contract and claim indemnification of the damages incurred if any, upon failure to properly fulfil the obligation to inform or upon provision of misleading information about the insurer or failure to deliver the disclosure form duly or upon misrepresentation of information in the form and upon any one of such cases being effective in the decision-making of the policyholder.
- In principle, the disclosure should be in “in writing”, whereas a derogation is maintained for the policies concluded via distance marketing methods such as telephone, call centre, Internet. However, the insurer continues to bear the burden of proof concerning the notification of the minimum obligatory information.

## **4. The New Turkish Commercial Code:**

The new Turkish commercial Code (hereafter NTCC) will enter into force as of July 1<sup>st</sup>, 2012. According to the article 1423 of the NTCC entitled “Disclosure Obligation” which will enter in force as of July 1<sup>st</sup>, 2012, the insurer and its agencies shall notify the policyholder in writing all important information about his/her rights before the issuance of the insurance contract.

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<sup>42</sup> Turkish Insurance Law, Law No: 5684, published on June 14, 2007.

In case of failure to disclose, the policyholder is entitled to object to execution of the insurance contract within 14 days, otherwise the policy issued shall become valid.

The insurer bears the burden of proof regarding the evidence of explanatory disclosure. The insurance regulator of Turkey is empowered to determine the structure and content of the disclosure to the consumer, in light of the regulations of various countries and especially European Union.

## 5. On-line Insurance under Turkish Insurance Law

- According to the article 5 of the E-Signature Law a secure digital signature will bear all the legal consequences of signature made by hand. The act provides that an e-signature cannot be used for transactions involving guarantee contracts or for transactions required to be executed by special official form or procedure. Therefore e-signatures may not be used to execute the sale of real estate or a marriage ceremony.
- According to the first paragraph the article 1526 of the NTCC;  
*“Bill, bond, check, receipt, interest warrant and other instruments that are similar with bill of exchange cannot be issued by means of secure electronic signature. The transactions to be conducted on the bill such as request, acceptance and aval cannot be implemented by secure electronic signature”*
- However according to the second paragraph of the 1526;  
*“The signature on the consignment, bill of loading and **insurance policy** can be affixed by hand writing, facsimile print, stapler, stamp or any **other electronic vehicle**. The records on these bills can be written, created and sent by means of hand writing, telegraph, fax and **other electronic vehicles** to the extent that it is allowed by the laws of the country in which the bill is issued”.*

## III. Concluding Remarks:

In a nutshell, the evolving nature of the Turkish legislation is in line with that of the EU *acquis*. All these efforts are to secure that the consumer protection rules are respected and a level playing field for the insurance market players are maintained by virtue of imposition of transparency, whilst keeping up with the pace of the technological changes.

In an era where we have observed the continuous innovations in electronic means; we will soon be closing the file of e-commerce and passing on the new file on m-commerce.<sup>43</sup> These challenges will pave the way to change the business patterns of

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<sup>43</sup> M-commerce (mobile commerce) is the buying and selling of goods and services through wireless handheld devices such as cellular telephone and personal digital assistants (PDAs). Known as next-generation e-commerce, m-commerce enables users to access the Internet without needing to find a place to plug in. Citation from <http://searchmobilecomputing.techtarget.com/definition/m-commerce>.

the insurance market players and will result in switching to the customer than product centricity.<sup>44</sup> The success of the market players in adapting themselves to the changes in the pattern of their business and struggling with the legal impediments to reach these goals remains to be seen. ***All things change, and we change with them.***

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<sup>44</sup> "Insurance 2020-Innovating beyond old models", *IBM Institute for Business Value*, 2006.

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# Requirements Regarding the Transparency of Standard Terms

Oliver Brand\*

## I. Introduction

Insurance contracts have been labelled as “**contracts of adhesion**”, i.e. agreements in which one of the parties – the policyholder – has no option other than to adhere to the terms dictated by the other party – the insurer – or reject the conclusion of the contract.<sup>1</sup> The power of the insurer in determining the rights and obligations of the insurance contract derives from the fact that most of its terms are standard terms, pre-formulated by him. This situation is aggravated by the fact that in insurance contracts – as opposed to other agreements containing standard terms – even the core terms, most notably the extent of coverage, are determined by the “small print”.<sup>2</sup>

As a basic means of policyholder protection, most legal systems have devised mechanisms that limit the authority of insurers concerning the drafting of standard terms. Among these mechanisms, the supervision of transparency by courts and authorities stands out as a nearly universally accepted<sup>3</sup> limiting factor. This paper examines the requirements regarding the transparency of standards terms in insurance contracts. The analysis will focus on the law of European jurisdictions with a particular emphasis on English and German law. It is split into **five parts**. After briefly outlining the functions of transparency (II.), the legal framework of the transparency rule that governs insurance contracts will be discussed (III). Subsequently, the three main prerequisites of transparency will be examined in detail and illustrated by cases from various jurisdictions (IV.). After that, the paper will turn to the consequences of infringing the transparency rule; this will include a short survey of complementary

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<sup>1</sup> *Fontaine*, Droit de assurances, 14<sup>th</sup> edition, Bruxelles 2010, no. 395; *Fischer*, 24 Ariz. St. L.J. 995, 1001 f. (1992); *Kimball/Pfennigstorf*, 39 Ind. L.J. 675, 676 (1963-1964); more generally on adhesion contracts: *Kessler*, 43 Colum. L. Rev. 629, 641 ff. (1943); *Rakoff*, 96 Harv. L. Rev. 1173, 1284 (1983).

<sup>2</sup> *Looschelders/Pohlmann/Pohlmann*, Versicherungsvertragsgesetz – Kommentar, 2<sup>nd</sup> edition, Cologne 2011, Vorbemerkung B, no. 45; *Langheid/Wandt/Reiff*, Münchener Kommentar zum Versicherungsvertragsgesetz (commentary), Munich 2009, AVB, no. 2 f.; *E. Lorenz* in: *Beckmann/Matusche-Beckmann* (eds.), Handbuch des Versicherungsrechts, 2<sup>nd</sup> edition, Munich 2009, § 1 no. 23; *Martin*, VersR 1984, 1107, 1108; *Terno*, r+s 2004, 45.

<sup>3</sup> See *Möller*, ZVersWiss 1975, 271, 288.

principles like the ambiguity doctrine (V). The paper will finish with a few concluding remarks (VI).

## II. Functions of transparency

While there is no generally accepted definition of the transparency rule governing standard terms, a “common core” of this rule can be detected which is widely used in statutes and regulations. According to this “core rule”, standard terms need to be drafted in a “plain, intelligible language” (“klar und verständlich”). Along these lines, transparency is meant to enable policyholders to **assess their rights and obligations correctly** and to take a well-informed decision when entering into a contract with the insurer.<sup>4</sup> In a contract dominated by standard terms a test of “plain, intelligible language” is needed in order to at least mitigate imbalances in the bargaining process. Whereas an individually negotiated contract generally involves a certain “guarantee of correctness” due to the negotiation process, the use of standard terms causes a functional imbalance between the contracting parties. Unilateral pre-formulation of the relevant conditions of contract by one party typically harbours the risk that they are excessively tailored to the user’s interests, shift risks (disproportionately) to the customer’s detriment and do not (sufficiently) consider the legitimate concerns and interests of the other contracting party.<sup>5</sup>

Under these circumstances, transparency helps to enforce **market discipline**. The greater the section of policyholders (active margin) who can gain a proper understanding of the terms of an insurance contract and their implications, the greater is the pressure on insurers to offer policies the terms of which are more substantively balanced between the parties and/or that there is improved choice.<sup>6</sup>

In insurance contracts, clauses are only regarded as transparent when the reasonable policyholder cannot only understand their meaning but can also comprehend the basic **economic consequences** of respective provision.<sup>7</sup> Only if this standard is met, it can be assumed that the policyholder has been provided with an appropriate level of information in order to be able to evaluate the product offered, e.g. concerning its price/coverage ratio, and to reasonably compare it with competing products.

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<sup>4</sup> See ECJ, 10.5.2001, C-144/99 - Commission v Kingdom of the Netherlands [2001] ECR I-03541, para. 17 (“it is essential that the legal position under national law is sufficiently precise and clear that individuals are made fully aware of their rights”); for similar statements see ECJ 7.5.2002, C-478/99 - Commission of the European Communities v. Kingdom of Sweden [2002] ECR I-04147, para. 18; ECJ 9.9.2004, C-70/03 -Commission v. Kingdom of Spain [2004] ECR I-0799, para. 15.

<sup>5</sup> BGHZ 70, 304, 310; BGHZ 126, 326, 332; Ulmer/Brandner/Hensen/*Fuchs*, AGB-Recht – Kommentar, 11<sup>th</sup> edition, 2011, Vorb. v. § 307 BGB no. 26; Palandt/*Grüneberg*, BGB – Kommentar, 70th edition, Munich 2011, Überbl. v. § 305 BGB, no. 8; *Schäfer*, JBLR 2011, 484, 490;

<sup>6</sup> *Trebilcock*, in: Reiter/Swann, (eds), Studies in Contract Law, Toronto 1980, p. 379; *Willet*, ICLQ 2011, 355, 375.

<sup>7</sup> BGH VersR 2001, 841, 844; BGHZ 136, 401 = VersR 1997, 1517, 1519; *Wandt*, Versicherungsrecht, 5<sup>th</sup> edition, Cologne and Munich 2010, no. 200; for a (non exhaustive) list of instances where clauses have found to be intransparent under German law see *Schaer*, Modernes Versicherungsrecht, Berne 2007, p. 260 ff.

### III. Legal framework of the transparency rule

The legal framework of the transparency rule has two different aspects: On the one hand, it consists of the outer framework which is formed by the substantive provisions of contract law and – in some jurisdictions – additionally of the law of insurance regulation (1). On the other hand there is an inner framework created by the different effects, which the transparency rule has on different groups of standard terms in insurance contracts (2).

#### 1. Outer framework: contract law and law on insurance regulation

In European Union law, Art. 5 of the Unfair Contract Terms Directive 93/13/EEC<sup>8</sup> requires the member states to afford rules that force insurers and other users of standard terms to draft documents which are provided to consumer customers in “**plain, intelligible language**” in order to promote transparency of documents. Similar provisions can be found in Art. 3 para. 2 of the Distance Marketing Directive 2002/65/EC<sup>9</sup> and Annex III of the Life Assurance Consolidation Directive 2002/83/EC.<sup>10</sup> Recently, transparency of documents has been promoted to a general principle of insurance law by being accepted as a basic rule of interpretation in Art. 1:203 of the Principles of European Insurance Contract Law (PEICL).

But even before transparency became attractive to Brussels legislators, it was accepted as a principle of contract law in most member states of the Union.<sup>11</sup> This can be traced back to two traditional doctrines of law, the doctrine of unconscionability in Common Law countries and the doctrine of abusive clauses within the Civil law tradition which have supported the transparency rule. Concerning insurance contracts in particular, the transparency of documents provided by the insurer can also be seen an aspect of the general principle of good faith which governs insurance contracts. Surprisingly, **Switzerland** has not found its place within this Pan-European tradition. As a **notable exception** in Europe, it does not provide a transparency rule for standard terms in either its general contract law or in its special rules on insurance contracts. However, Swiss policyholders can regularly reckon to be protected against misleading provisions in their contracts, which are caught by the transparency rule elsewhere, under Swiss law against unfair competition.<sup>12</sup>

Among those jurisdictions which embrace the transparency rule, the technical means of implementing it and the reach of the rule differ significantly. Some legal systems

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<sup>8</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, O.J. L 095, 21.4.1993, p. 29.

<sup>9</sup> Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services, O.J. L 271, 9.10.2002 p. 16.

<sup>10</sup> Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, O.J. L 345, 19.12.2002 p. 1.

<sup>11</sup> With the exception of the Netherlands, where the courts seem to rely on the general rules of construing contracts and the ambiguity doctrine; see Basedow/Fock/Fock, *Europäisches Versicherungsvertragsrecht*, Tübingen 2000, vol. II, p. 835.

<sup>12</sup> Basedow/Fock/Bälz (supra n. 11), vol. II, P. 1218.

have made the transparency rule part of separate regulations, as it is the case in the UK,<sup>13</sup> others have decided to make it a part of the rules of general contract law, as it is the case in Germany (sec. 307 para. 1 subs. 2 BGB). More importantly, the transparency rules governing insurance contracts can be distinguished by the group of policyholders they apply to. Under the **narrower approach**, which is followed, for example, by English law, the transparency rule **only applies to consumer policyholders**, as it is expected by directive 93/13/EEC. It only affects policies issued to policyholders who are natural persons and are acting in obtaining insurance for purposes which are out their trade, business or profession.<sup>14</sup> Other policyholders are merely protected by the ambiguity doctrine (*infra* V 2).

Other legal systems, like Germany, have given the transparency rule **effect for all policyholders**, irrespective of whether they are consumers or not. The only requirement of applying the transparency rule in a non-consumer context is that one of the contracting parties imposes on the other party conditions of contract that are pre-formulated for a large number of contracts.<sup>15</sup> The decision to expand the scope of the rule can be explained with pre-existing German law on protection against standard terms, which provided protection regardless of whether the contracting partner of the drafter was a consumer, and with a recent general trend in German insurance law not to distinguish between consumer and non-consumer policyholders, because they are regarded as similarly in need of protection vis-à-vis the intricacies of insurance contracts.<sup>16</sup>

Some jurisdictions, including Belgium, the United Kingdom and Germany, have enshrined the transparency rule not only in their (insurance) contract laws, but also in their **rules on insurance regulation**. In Germany, for example, sec. 10a para. 2 VAG subjects standard terms in insurance contracts to particular requirements concerning clarity, intelligibility and unambiguity because they form part of the relevant pieces of information which the insurer needs to distribute to the policyholder prior to conclusion of the contract.<sup>17</sup>

## 2. Inner framework: Core terms and ancillary terms

Concerning the effects of the transparency rule on standard terms in insurance contracts, European legal systems distinguish between **two different categories** of terms: core terms and ancillary terms. This distinction can be traced back to Art. 4 para. 2 of the Unfair Contract Terms Directive 93/13/EEC. According to the national laws based upon this provision, core terms of an insurance contract will not be scrutinized

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<sup>13</sup> Unfair Terms in Consumer Contracts Regulations 1999, SI 1999/2083.

<sup>14</sup> Reg. 3 (1) Unfair Terms in Consumer Contracts Regulations 1999, SI 1999/2083; MacGillivray on Insurance Law, xth edition, London 2011, no. 10-017; this approach is substantially narrower than that of older policyholder protection rules in the United Kingdom, e.g. s. 6 (7) Policyholder's Protection Act 1976.

<sup>15</sup> See *Schäfer*, JIBLR 2011, 484, 485.

<sup>16</sup> See *Brand*, in: E. Lorenz (ed.), *Karlsruher Forum 2011*, Karlsruhe 2012, p. 55, 59 seq.

<sup>17</sup> *Präve*, *Versicherungsbedingungen und AGB-Gesetz*, Munich 1998, no. 425; *Reich*, *VuR* 1995, 1, 5; *Biagoschi/Scherer*, *VW* 1995, 429 f.

for unfairness, as long as they are drafted in plain and intelligible language.<sup>18</sup> That means that the policyholder can, for example, not challenge the fairness of a clause in his policy concerning the cover or exceptions from cover by asserting that the premium charged is too high, unless the wording of the relevant clause is shrouded in obscurity or complexity.<sup>19</sup> Transparency, accordingly, is of particular relevance for core (standard) terms, as it is the only legal instrument for scrutinising the content of such terms. The reason for this exemption in favour of core terms in insurance contracts is that it is assumed that contractual freedom and competition in domestic markets are sufficient to bring about adequate results to the market. The market, however, will not be able to produce efficient results in the absence of transparency as the persons seeking insurance cannot take rational decisions under such circumstances (see *supra* II.).

**Core terms** in insurance policies will include terms which stipulate premium, describe the perils insured against and excluded,<sup>20</sup> and specify the measure of indemnity afforded by the cover.<sup>21</sup> Among ancillary terms courts have found clauses on default interest,<sup>22</sup> stipulating time limits and procedures of making claims<sup>23</sup> and resolving disputes under the policy as well as forfeiture clauses.<sup>24</sup>

## IV. Requirements regarding transparency in insurance contracts

### 1. General remarks

Transparency is assessed across the legal systems in Europe largely according to a similar standard: the **reasonable policyholder** or *Durchschnittsversicherungsnehmer*.<sup>25</sup> It is him whom the insurer needs to put into a position to assess the legal and economic consequences of the policy, in particular his rights and obligations on the legal side and potential expenses on the economic side. The reasonable policyholder test is an objective standard with little if any doctrinal differences across the legal systems. This can be explained by the fact that even in legal systems that generally subscribe to a subjectivist approach to contract interpretation (e.g. France and Germany) it is a well-established rule that standard contracts, such as the ordinary insurance policy, have

<sup>18</sup> Germany: sec. 307 para. 3 subs. 1 BGB; BGHZ 123, 83, 84 = VersR 1993, 957; BGH VersR 2004, 1037, 1038; United Kingdom: Reg. 6 (2) Unfair Terms in Consumer Contracts Regulations 1999, SI 1999/2083; MacGillivray on Insurance Law, 11<sup>th</sup> edition, London 2011, no. 10–019.

<sup>19</sup> Collinvaux on Insurance Law 8<sup>th</sup> edition, London 2007, no. 3–20.

<sup>20</sup> Germany: Looschelders/Pohlmann/Pohlmann (*supra* n. 2), Vorbemerkung B, no. 47; United Kingdom: *Bankers Ins. Co. v South* [2004] Lloyd's Rep. I.R. 1.

<sup>21</sup> Recital 20 of the Unfair Contract Terms Directive 93/13/EEC; MacGillivray on Insurance Law (*supra* n. 18), no. 10–020 and 11–036.

<sup>22</sup> United Kingdom: *Director General of Fair Trading v First National Bank Plc.* [2002] 1 A.C. 481.

<sup>23</sup> United Kingdom: *Bankers Ins. Co. v South* [2004] Lloyd's Rep. I.R. 1.

<sup>24</sup> MacGillivray on Insurance Law (*supra* n. 18), no. 10–021.

<sup>25</sup> Germany: BGHZ 112, 115, 118 f.; *Präve* (*supra* n. 17), no. 428; but cf. *Schwintowski* VuR 1997, 265, 266.

to be construed objectively.<sup>26</sup> As insurance is still a predominantly national business, the reasonable policyholder needs to be imagined as a national of the region where the respective insurance contract is made, and not so much as a policyholder with a European (transnational) background. This rule of thumb, however, does not apply to cross-border contracts.

In order to present standard terms to the reasonable policyholder in a plain and intelligible fashion, **three requirements** need to be met: the terms will have to pass the tests of intelligibility (2), determinateness (3) and correctness (4).<sup>27</sup> In some jurisdictions, like Germany, these requirements have been formally established as criteria for assessing the transparency of standard terms.<sup>28</sup> In other jurisdictions like the United Kingdom, courts and authorities, in particular the OFT, have come to substantively similar conclusions, as can be demonstrated by examples, without formally referring to distinctive sub-criteria of transparency. For this paper, the formal German approach will be adopted, because German law as the “founding system”<sup>29</sup> of transparency control has developed a particularly clear approach towards the precise requirements that insurers have to meet when drafting their standard terms.

## 2. Intelligibility

The first requirement of the transparency rule is that standard terms in insurance contracts need to be intelligible to the reasonable policyholder. Since the transparency rule in all European jurisdictions is designed for protecting the consumer policyholder – in some jurisdictions with surplus protection for non-consumer policyholders –, standard terms accordingly will have to be devised in a way that they can readily be read and understood by consumers. From this it follows that, so far as possible, legal (and other) jargon must be avoided.<sup>30</sup> The rationale supporting this approach is that the reasonable policyholder according to whose comprehension the meaning of terms is to be determined, is on a general basis ignorant of the exact meaning of legal and technical terms, which are predominantly attributed their strict technical meaning by courts in Europe, even if the consequences for the policyholder are harsh.<sup>31</sup> Intelligibility, in other words, requires as far as possible the use of everyday words, used in their familiar sense.

<sup>26</sup> *Grabau*, Über die Normen zur Gesetzes- und Vertragsinterpretation, Berlin 1993, p. 114; *Präve* (supra n. 17), no. 268; *Sonnenberger*, Verkehrssitten im Schuldvertrag, Munich 1970, p. 8.

<sup>27</sup> Looschelders/Pohlmann/Pohlmann (supra n. 2), Vorbemerkung B, no. 51; *Präve*, VW 2000, 450, 451.

<sup>28</sup> Though the courts at times fail to address the criteria properly: see Looschelders/Pohlmann/Pohlmann (supra n. 2), Vorbemerkung B, no. 51.

<sup>29</sup> *Kath*, Rechtsfragen bei der Anwendung Allgemeiner Versicherungsbedingungen, Vienna 2007, p. 209.

<sup>30</sup> *Präve* (supra n. 17), no. 429.

<sup>31</sup> Germany: BGH VersR 2007, 535; BGH VersR 2003, 236; BGH NJW 2000, 1194, 1196; BGHZ 123, 83, 85 = NJW 1993, 2369; *Beckmann*, in: *Beckmann/Matusche-Beckmann* (supra n. 2), § 10 no. 170; *Wandt* (supra n. 7), no. 192; but cf. *Roth*, WM 1991, 2125, 2129 seq.; United Kingdom: *Deutsche Genossenschaftsbank v Burnhope* [1995] 4 All ER 717; see also *Grundy (Teddington) Ltd v Fulton* [1981] 2 Lloyd's Rep 666, 670; MacGillivray on Insurance Law (supra n. 18), no. 11-13; for an overview see *Brand*, in: *Burling/Lazarus* (eds.), *Research Handbook on International Insurance Law and Regulation*, Cheltenham 2012, p. 93, 100.

The transparency rule, however, does not mean that the insurer can no longer resort to terms that have acquired technical meanings (**terms of art**) when used in insurance policies.<sup>32</sup> It would be too much a burden for the insurance business if such terms would have to be supplanted by terms of ordinary usage, because the use of terms of art is at times unavoidable. Proper examples are the use of the term “theft” in coverage clauses or the term “riot” in exclusion clauses.<sup>33</sup> Where terms of art are unavoidable, they must be clearly defined – even if that means using more words than would otherwise be necessary.<sup>34</sup> The transparency of terms of art can be enhanced by providing examples. On the other hand, the transparency rule does not go so far as to require the insurer to add detailed comments to standard terms, which contain terms of art, elucidating the precise meaning and risk with regard to every single term of contract.

Mere **references to statutes** and to policyholder rights under them are on a regular basis not intelligible because it cannot be assumed the reasonable policyholder is familiar with the relevant provisions.<sup>35</sup> Therefore uncommented references to statutes and statutory instruments are potentially unfair where policyholders need to understand the reference to know where their rights and interests lie.<sup>36</sup> The insurer can, however, establish intelligibility by reiterating the statutes referred to word by word.<sup>37</sup> Under German Law, for example, the Landgericht Berlin<sup>38</sup> even exempted a standard term from control under the transparency rule as it properly reiterated the relevant provisions of the German Act on Insurance Contract Law (Versicherungsvertragsgesetz, VVG).

So far, concerning intelligibility, **exception clauses** have attracted attention of the courts most of all.<sup>39</sup> This has been particularly prevalent where several parallel sets of standard terms (more general and more specific ones) are governing a particular insurance contract, as it often is the case in liability insurance contracts.<sup>40</sup> Also, standard terms concerning the duration of the contracts have raised intelligibility problems in the past where the insurer did not resort to specific dates in the contract.<sup>41</sup>

Intelligibility of standard terms in insurance contracts, however, is more than a matter of wording. The insurer needs also to give consideration to the **style and structure** of

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<sup>32</sup> Merkin/Rodger, *European Community Insurance Law*, London 1996, p. 48 f.; Lowry/Rawlings, *Insurance Law: Doctrines and Principles*, 2<sup>nd</sup> edition, Dublin 2005, p. 219; *Präve* (supra n. 17), no. 425.

<sup>33</sup> See *Brand*, in: Burling/Lazarus (eds.), *Research Handbook on International Insurance Law and Regulation*, Cheltenham 2012, p. 93, 100.

<sup>34</sup> United Kingdom : OFT Bulletin no. 4, p. 15.

<sup>35</sup> OLG Schleswig NJW-RR 1995, 2858, 2859; OLG Hamm NJW-RR 1987, 311, 313.

<sup>36</sup> United Kingdom: OFT Bulletin no. 4, p. 15.

<sup>37</sup> *Präve* (supra n. 17), no. 429.

<sup>38</sup> LG Stuttgart VersR 1998, 1406.

<sup>39</sup> Germany: BGH VersR 1996, 651, 652.

<sup>40</sup> OLG Frankfurt a.M. NJW-RR 1995, 283, 284.

<sup>41</sup> OLG Stuttgart NJW-RR 1992, 887, 888 f.

the contract as a whole. Accordingly, he is required to resort to an acceptable font size for his standard terms. Under French law, this requirement is laid down specifically in the Code of Insurance Contracts (Art. L.112-3 Code de assurances: *caractères apparents*). For some clauses in insurance contracts there are even stricter rules concerning the way they need to be presented (e.g. highlighted or as part of a separate document). Under French law this is true for exception clauses (Art. L.112-3 Code de assurances), under German law for clauses laying out substantial rights of the policyholder (e.g. sec. 8 para. 2 item 1 VVG; sec. 19 para. 5 VVG). Furthermore, the insurer has to use short sentences whenever possible and – where lengthy clauses are unavoidable – he must try to itemise them by dealing with one issue at a time. Also, the number of cross-references and the use of terms that are defined elsewhere in the policy need to be minimised; finally, a plain and intelligible contract will be organised in a way that related terms are brought together under explicit sub-headings, which reflect as a kind of keyword the content of the clauses provided in the relevant part of the contract and which are accessible through a table of contents.<sup>42</sup> Only this enables the policyholders to find what is relevant to them.

The intelligibility requirement of the transparency rule also extends to the realm of **language**. Documents are only intelligible if they are issued in a language that the policyholder can understand.<sup>43</sup> Annex III of the Life Assurance Consolidation Directive 2002/83/EC accordingly requires the Member States to establish rules of law according to which information by the insurer must be provided in an official language of the Member State in which the policyholder has his habitual residence. The policyholder may, however, choose any official language of another Member State. This rule does not necessarily meet the requirements of insurance transactions, in particular in a cross-border context.<sup>44</sup> If a prospective policyholder approaches an insurer, who does not do business in the country of the policyholder's habitual residence and does not use the respective language in his commercial conversation, cover may be refused, because the insurer is not prepared to have all relevant documents translated. The transparency requirements of the European directives therefore might have the unwanted side effect of denying the policyholder access to foreign insurance markets.

### 3. Determinateness

In order to meet the requirements of the transparency rule, standard terms in insurance contracts must not only be intelligible but also determinate (*Bestimmtheitsgebot*). The rights and obligations of the policyholder need to be specified in a way that does not leave excessive discretion to the insurer. The graver the consequences of applying a clause to a policyholder are, the clearer the respective clause needs to be drafted. Under German law, premium adjustment clauses which take effect automatically have raised particular concern of the courts in this respect, as often their economic

<sup>42</sup> BGH NJW 1969, 230; *Präve* (supra n. 17), no. 432.

<sup>43</sup> France: Cass. civ 1re, 24.11.1993, RGAT 1994, 87 seq.

<sup>44</sup> *Basedow et al.*, PEICL, Munich 2010, Art. 1:203, Comment C 6.

consequences cannot be readily detected by policyholders.<sup>45</sup> The same is true for so-called „Zillmerungsklauseln“ in life insurance policies.<sup>46</sup>

A standard term in an insurance contract only meets the requirements of the determinateness test, if its **scope can be readily understood** by the reasonable policyholder. This is most probably not the case if the respective clause contains phrases like “as far as this is permitted by the law” because the insurer has failed to precisely delineate the rights and obligations of the policyholder by using this phrase. In Germany, the regime against drafting insurance contracts indeterminately is particularly strict. Descriptions of cover have come time and again under close scrutiny. Under this strict approach, the Bundesgerichtshof has regarded the definition of “unintentional unemployment” as “having occurred due to reasons outside the person of the policyholder” in an unemployment policy as non-transparent in 1999.<sup>47</sup> Earlier, the court had found that the term “for each day of the calendar spent in hospital” in a health insurance policy lacked transparency, because it remained unclear, how the relevant clause would apply to days not fully spent in hospital, such as the day of arrival or the day of departure.<sup>48</sup>

Whether this strict approach is still justified under the rules of the reformed German Insurance Contracts Act 2008 is doubtful. The insurer is now burdened with substantial pre-contractual **information and counselling duties** (Sec. 6, 7 VVG). These duties should modify the requirements concerning the transparency of terms in insurance contracts. The particularly strict German approach can, however, be explained historically. In this country, the transparency rule was developed by courts in the field of insurance in the late 19<sup>th</sup> century, even before a general regime of supervising standard terms came into existence.<sup>49</sup> During this time, insurance contracts were seen with great scepticism by courts because they were largely framed by the discretion of the insurers, because they allegedly were of “aleatory” nature and because the subject matter of the contract was immaterial.<sup>50</sup> This scepticism never fully left the German judiciary.

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<sup>45</sup> BGHZ 136, 394, 401 f. = NJW 1998, 494, 456; BGHZ 141, 153, 157 = NJW 1999, 1865; BGHZ 119, 55, 59; also OLG Hamm, NJW-RR 1993, p. 1501; OLG Celle, VersR 1993, p. 1343; *Römer*, NVersZ 1999, 97, 103; critically Langheid/Wandt/*Bruns* (supra n. 2), § 307 BGB, no. 93 ff.

<sup>46</sup> “Zillmerung” is named after the mathematician *August Zillmer* and refers to contracts of life insurance. By this method of calculation, the acquisition costs – mainly brokerage and administrative expenses – are amortised with the premiums paid by the policyholder within the first few years. The consequence of this is that premium reserves can only be accumulated after all administrative expenses are covered. If the policyholder terminates the contract within the first years, the surrender value is very low.

<sup>47</sup> BGHZ 141, 137, 143 f. = NJW 1999, 2279, 2280.

<sup>48</sup> BGH NJW 1984, 1818, 1819.

<sup>49</sup> ROGHE IV, 60; ROGHE V, 121 und 243 f.; ROGHE VIII, 72; sowie RGZ 10, 160; RG JW 1897, 244; *Ehrenberg*, p. 86.

<sup>50</sup> *Ewald*, *Der Vorsorgestaat*, Frankfurt a.M. 1993, p. 210 f.; *Ebel*, *ZVersWiss* 1962, 53, 59.

#### 4. Correctness

A third aspect of the transparency rule is the principle of correctness. This principle requires the insurer on the one hand to describe the rights and obligations of the policyholder in the standard terms precisely. References to provisions outside the policy need to be correct and up to date. That can be troublesome for the insurer in times of legal reform, as it has been experienced in Germany during the 2008 reform of the insurance contract law. On the other hand, standard terms have to be complete in order to fulfil the requirement of correctness. That basically means that standard terms in insurance contracts have to contain all the relevant clauses governing the contract. In some jurisdictions, like Germany, the (sub-) principle of completeness is supported by the law of insurance regulation (e.g. § 10 VAG). This sub-principle does, however, have its limits. The insurer is, for example, not required to inform the policyholder about even the remotest legal implications, because this might lead to new non-transparencies in turn.<sup>51</sup>

### V. Consequences of infringing the transparency rule

#### 1. General remarks

The consequences of infringing the transparency rule by using improper standard terms in insurance contracts vary to some extent across the jurisdictions of the European Union. This is due to the fact that the wording of Art. 5 of the Unfair Contract Terms Directive 93/13/EEC does not specify consequences of a breach. As a common starting point, however, it can be said that a non-transparent term is considered in most Member States to be unfair – and unfair terms are not binding on the contracting partner – at least if he is a consumer (see supra III 1).<sup>52</sup> There is some debate about whether this is an automatic effect of a term's intransparency or whether a detriment to the policyholder needs to be demonstrated in addition. Because intransparent standard terms may impair the policyholder in exercising his rights, the better view seems to be the latter is not the case.<sup>53</sup>

In some jurisdictions, like Italy, the result of non-transparent clauses being non-binding needs to be established by the courts, as the relevant code does not provide for a sanction for infringing the transparency rule.<sup>54</sup> German law, in contrast, once more presents a particular strict regime on intransparent standard terms in insurance contracts, which has largely been followed by jurisdictions like Austria and Latvia. Under German law,

<sup>51</sup> Looschelders/Pohlmann/Pohlmann (supra n. 2), Vorbemerkung B, no. 51; *Präve*, VW 2000, 450, 451; but cf. *Klimke*, VersR 2010, 290, 295.

<sup>52</sup> For an overview on the position of individual European jurisdictions see *v.Bar/Clive*, DCFR, Munich, 2010, Art. 9:402 no. 5 -12; further: *Schuhmacher*, ZSR 118 (1999), 361, 368

<sup>53</sup> Germany: Looschelders/Pohlmann/Pohlmann (supra n. 2), Vorbemerkung B, no. 52; *Pilz*, Missverständliche AGB, Karlsruhe 2010, S. 2007; but cf. *Langheid*, NVersZ 2000, 65, 67; United Kingdom: Law Commission, Report no. 292: UnfairContract Terms.

<sup>54</sup> Basedow/Fock/Brunetta d'Usseaux (supra n. 11), vol. I, p. 678; *v.Bar/Clive*, DCFR, Munich, 2010, Art. 9:402 no. 8.

a standard term that lacks transparency will be subject to an irrefutable assumption of unreasonable discrimination (*unwiderlegbare Vermutung einer unangemessenen Benachteiligung*) against the contractual partner. Such discriminatory standard terms are null and void under sec. 307 para. 1 BGB. The remainder of the contract will be binding only if it is capable of continuing in the absence of the unfair term. The loophole in the contract - as a consequence of the non-validity of the non-transparent standard term - has to be filled by way of dispositive law or by way of supplementary interpretation of the contract.<sup>55</sup> In insurance cases, the latter is often the case as for many branches of insurance there is no statutory law in Germany (e.g. fire insurance). In case the entirety of the insurance contract is contravening the transparency rule, the contract is void under German law according to sec. 138 para. 1 BGB.<sup>56</sup>

Among the European legal systems, Belgian law follows a somewhat unique approach. It provides that clauses or terms which have been found to be intransparent are supplanted with a transparent rule. There seems, however, some debate about how this result can be reached in a dogmatically convincing manner.

## 2. The ambiguity doctrine

The transparency rule is complemented by the ambiguity doctrine. As the transparency rule is contained in the same Article of the Unfair Contract Terms Directive 93/13/EEC as the ambiguity doctrine or “*contra proferentem* rule,” it is sometimes maintained that the latter is another sanction for not-plain or unintelligible language. But it has been convincingly suggested by academic commentators that this is not the case.<sup>57</sup> Ambiguity is only one kind of non-transparency. It encompasses cases where the policy is reasonably susceptible to more than one interpretation when viewed in a common sense, non-technical manner, and construing the policy as a whole after the usual methods of contract Interpretation have failed.<sup>58</sup> Another case of intransparency would be unambiguous terms in (too) small print or in unwarranted use of technical language (see supra IV 2). As far as instances of intransparency caused by ambiguous terms are concerned, however, the ambiguity doctrine is a minimum standard for all member states of the European Union concerning consumer insurance contracts. Scholars working in the law and economics tradition advocate the doctrine as an instrument to incentivize the drafting of contracts in an optimally clear language.<sup>59</sup>

The doctrine says, in brief, that whenever a written contract is susceptible to two or more reasonable interpretations after the usual methods of contract interpretation

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<sup>55</sup> Ulmer/Brandner/Hensen/*Fuchs* (supra n. 5), Vorb. v. § 307 BGB, no. 98; *Schäfer*, JIBLR 2011, 484, 490.

<sup>56</sup> LG Hamburg NJW-RR 1995, 1078, 1080.

<sup>57</sup> MacGillivray on Insurance Law (supra n. 18), 11–33.

<sup>58</sup> *Krampe*, Die Unklarheitenregel, Bürgerliches und Römisches Recht, Berlin 1983, p. 15; *Grabau* (supra n. 26), p. 145; United Kingdom: *Kirby*, Stat. L.R. 2003, 95, 104; France: Art. 1162 CC; Montpellier, 27.6.1990, RGAT, 1991.118; *Bigot*, p. 409 ff.; Switzerland: *Koenig*, p. 84.

<sup>59</sup> *Brand*, in: Burling/Lazarus (eds.), Research Handbook on International Insurance Law and Regulation, Cheltenham 2012, p. 93, 105 seq.; *Posner*, 33 Fla. St. U. L. Rev., 563, 579 (2006).

have been exhausted,<sup>60</sup> ambiguities in the language should be construed strictly against the drafter of the unclear contract clause.<sup>61</sup> Applied to insurance contracts this means that in general the interpretation most favourable to the policyholder prevails. Yet, under certain circumstances, the ambiguity doctrine might also strike against the policyholder.<sup>62</sup> In the past, lists of insured risks and exclusion clauses have been exposed rather frequently to judicial scrutiny under the ambiguity doctrine. German courts, for example, have used the ambiguity doctrine in order to interpret a standard term in a health insurance contract (Sec. 1 para. 1 MB/KK 94) which provided for coverage for inpatient medical treatment in such a way that the insurer was obliged to pay for treatment which only partially took place in hospital.<sup>63</sup> In a case dealt with by the OFT in the United Kingdom in 1997, the policy excluded theft cover unless entry or exit had been gained by “breakage.”<sup>64</sup> The OFT found the term “breakage” to be ambiguous, because it was not clear whether it applied if a lock had been sprung by the use of plastic material. Accordingly, cover was granted to the policyholder.

## VI. Concluding remarks

Intransparent terms are considered to be unfair and unfair terms are not binding on either the consumer (according to the English approach) or any contracting partner (according to the German approach). Transparency has therefore been an important tool for courts to monitor the core provisions of insurance contracts, which are otherwise not scrutinised for fairness. The intensity of transparency control varies very much from jurisdiction to jurisdictions. German courts find themselves among the strictest guardians of transparency in Europe, whereas their counterparts in as different jurisdictions as the United Kingdom and Austria have taken a less strict approach.

Among the standard terms which were challenged so far, in particular coverage clauses and exception clauses have raised concerns regarding transparency. The focus of transparency tests has been on intelligibility of the respective clauses. Completeness and Determinateness have played, however, a vital supporting role. The transparency rule as a whole is complemented by the ambiguity doctrine.

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<sup>60</sup> *Krampe* (supra n. 58), p. 15; *Grabau* (supra n. 26), p. 145; United Kingdom: *Kirby*, Stat. L.R. 2003, 95, 104; France: Art. 1162 CC; Montpellier, 27.6.1990, RGAT, 1991.118; *Bigot*, *Traité de droit des assurances*, volume 3, Paris 2002, p. 409 seq.; Switzerland: *Koenig*, *Schweizerisches Privatversicherungsrecht*, 3<sup>rd</sup> edition, Berne 1963, p. 84.

<sup>61</sup> Corbin on Contracts V, § 24.27 at 282.

<sup>62</sup> *Brand*, in: Burling/Lazarus (eds.), *Research Handbook on International Insurance Law and Regulation*, Cheltenham 2012, p. 93, 106; see also with a view to general contract law *Krampe* (supra n. 58), p. 60; *Grabau* (supra n. 26), p. 142.

<sup>63</sup> OLG Hamm VersR 1986, 883; VersR 1990, 843; Langheid/Wandt/*Reiff* (supra n. 2), AVB no. 99; but cf. *Bach/Moser*, *Private Krankenversicherung: MB/KK und MB/KT* (commentary), 4<sup>th</sup> edition, Munich 2010, § 4 MBKK no. 74.

<sup>64</sup> United Kingdom: OFT Bulletin no. 4, p. 53.

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# Control of General and Special Conditions of Insurance Under Turkish Law with Special Regard to the Transparency Requirement

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## A. INTRODUCTION

General Conditions of Contract (GCC)<sup>1</sup> are necessary for a system of mass distribution. They bring rapidity and security<sup>2</sup>. But they are dangerous for the contractual partner of the user who adheres to the contract without being aware of all the clauses but having trust in the user. He is then under the risk of being disappointed. This risk has its source in the fact that these contractual terms mostly favour their user. In a contract formulated beforehand, the consent of the parties is not equally “strong.” The user of the GCC knows well the clauses he inserts in the contract he offers, whereas the other contractual partner may not be aware of those clauses or may have understood them mistakenly. The imbalance between the parties requires on the one hand the determination of the possible unfair clauses and on the other hand the sanctioning of these clauses that are inserted in a contract.

Under Turkish law there are following sets of rules, which concern the control of GCC:

- First, there are the statutory rules about consumer protection: The Consumer Protection Act of 1995 was revised in 2003 and a provision for the control of GCC was introduced in Art. 6. Based on this new article the Parliament also issued a Regulation on Unfair Terms in Consumer Contracts (2003 Regulation), which is basically a translation of the Unfair Terms Directive of the EU<sup>3</sup>.

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<sup>1</sup> PECL (Principles of European Contract Law) Article 2:209 (3): “General conditions of contract are terms which have been formulated in advance for an indefinite number of contracts of a certain nature, and which have not been individually negotiated between the parties”

<sup>2</sup> CALAIS-AULOIS/TEMPLE, Droit de la consommation, 8ieme edition, 2010, no. 163.

<sup>3</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, Official Journal 21.04.1993, L 95/29

- Second, the new Turkish Code of Obligations (enacted in 2011, entry into force July 2012, TCO) regulates the issue in Art. 20-25 without having regard as to whether the contracting party of the user is a consumer or not<sup>4</sup>. Here it was the German provisions on GCC, which have inspired the Turkish legislator. But this inspiration was not sufficient and in respect of many particular issues the Turkish CO has insufficient legal provisions.
- Thirdly, the new Turkish Commercial Code (enacted in 2011, entry into force July 2012, TCC) defines in Art. 55 (1) (f) among the rules on unfair competition that the use of GCC contrary to the good faith requirement constitutes a violation of fair competition. Article 55 Turkish Code of Commerce underlines that GCC departing substantially from the legal rules directly or indirectly applicable or providing a repartition of rights and obligations substantially contrary to the nature of the contract would amount to the violation of the good faith principle.<sup>5</sup>

The three major aspects regarding the control of GCC, that is their inclusion into the contract, their interpretation and their judicial review is provided for in the Turkish CO, whereas the Consumer Code, parallel to the Directive 93/13, just provides for the interpretation rules of GCC and the possibility of judicial review. Although the broader regulation of the CO comprising also the merchants (B2B and P2P contracts) is highly appreciated, the two sets of rules are not identical and the discrepancies may engender some problems of application.<sup>6</sup> How the newly introduced provision on unfair competition will be applied remains unclear for the time being.<sup>7</sup> Given the rules in the CO and the Consumer Code a wide application should not be expected.

Below we will try to explain the provisions regarding control of GCC and how they might apply to insurance contracts.

## **B. TERMS RELATED TO INSURANCE CONTRACTS AND THEIR QUALIFICATION AS GENERAL CONDITIONS OF CONTRACT (GCC)**

### **1. Insurance Contract Terms**

There are two major types of insurance contract terms under Turkish law: the “General Conditions of Insurance” (GCI) and the “Special Conditions of Insurance” (SCI). Both of these are contractual provisions formulated beforehand and used by insurers in insurance contracts.

<sup>4</sup> For a detailed analysis of the Turkish rules on GCC see ATAMER, Y.M., Yeni Türk Borçlar Kanunu Hükümleri Uyarınca Genel İşlem Koşullarının Denetlenmesi – TKHK m. 6 ve TTK m. 55 (1) (f) ile Karşılaştırmalı Olarak (Control of General Conditions of Contract pursuant to the provisions of the New Turkish Code of Obligations – in comparison with article 6 of the Turkish Consumer Protection Act and article 55 (1) (f) of the New Turkish Code of Commerce), Türk Hukukunda Genel İşlem Şartları, BATİHAE, 2012, 9-73.

<sup>5</sup> This rule is based on Art. 8 of the Swiss Code on Unfair Competition.

<sup>6</sup> Cf. ATAMER, p. 59 et seq.

<sup>7</sup> Cf. ATAMER, p. 67-70.

The “General Conditions of Insurance” are contractual texts prepared and published by the Regulator<sup>8</sup> for different kinds of insurances such as “Theft General Conditions” or “Motor Vehicles (Casco) General Conditions” or “Motor Third Party Liability General Conditions” etc. Turkish insurers are *ex lege* obliged to use the GCI prepared by the Regulator. The general conditions of insurance are shaped following the sole discretion of the Regulator who takes into account the interests of the concerned parties (insurer, policyholder/insured, third party victim etc.). The Turkish Insurance Activities Act (IAA)<sup>9</sup> (Insurance Control Act = *Versicherungsaufsichtsgesetz*) requires that the main content of the insurance contracts be conform to general conditions of insurance (Art. 11(1) IAA). The meaning of this rule is not very clear. However there is a widespread understanding in Turkey that general conditions of insurance may be contractually altered only if the alterations are not detrimental to the policyholder (as if we face semi-compulsory legal rules protecting the policyholder). In the prevailing circumstances, the Regulator *de facto* uses the power of the Parliament and imposes compulsorily applicable rules. It is submitted that this is not an acceptable solution since it is a direct intervention to the contractual freedom guaranteed by the Constitution and also into the principle of free market economy which in fact should be regulated solely by free competition.

Nevertheless, Turkish insurers are also allowed to use “special conditions” when the circumstances of the concrete case so require. The SCI are contractual terms used by the insurer in its contracts of insurance in addition to the general conditions. In Turkey following types of special conditions may be distinguished:

- Clauses complementary to GCI (endorsements) prepared and published again by the Turkish Regulator as exhibits of the general conditions. These are for example Medical Doctors Liability clause attached to the Professional Indemnity General Conditions or clauses annexed to Fire Insurance General Conditions such as flood, earthquake, internal water, contact of sea crafts etc.
- Clauses complementary to GCI but prepared either by an institution other than the Turkish Regulator or by the insurer himself, that is clauses like Institute Cargo or Hull or Yacht or War Clauses.

## 2. Qualification of Insurance Contract Terms as GCC

In order to decide whether or not the GCI and the SCI qualify as GCC one has to look at the definition provided in Art. 20(1) TCO. According to this provision GCC are “contractual provisions which are drafted unilaterally in advance with the aim of using them in similar contracts in the future and which are presented to the other party at contract conclusion.” Even though the lawmaker did not mention expressly the requirement of not being negotiated in this definition, it is beyond doubt that this is

<sup>8</sup> General Directorate of Insurance of the Undersecretary of Treasury is the competent public authority in Turkey to control and regulate the insurance sector.

<sup>9</sup> Sigortacılık Kanunu, Resmi Gazete 14 Haziran 2007, Sayı: 26552.

also one of the major criteria for being qualified as GCC.<sup>10</sup> In fact this can be deduced also from Art. 20 (3) TCO, which provides that a clause in the GCC stating that the contract terms were accepted by the parties after negotiation cannot by itself suffice to qualify all the contract terms as being individual terms. It has to be proven by other means that there was actual negotiation.<sup>11</sup>

The same is true for Art. 6 of the Consumer Code, which only qualifies pre-drafted terms as unfair, if they were not negotiated at contract conclusion. Parallel to Directive 93/13, Art. 6 also clarifies that a term shall always be regarded as not individually negotiated in the context of a pre-formulated standard contract. The fact that certain aspects of a standard contract have been individually negotiated does not lift the burden of proof from the user of the GCC. The rest of the contract is still judged as a pre-formulated, non-negotiated standard contract (Art. 6 (4)). Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him. This division regarding the burden of proof seems to be fair also in regard of B2B contracts and should be applied under the Turkish CO.

Looking at the special Conditions of Insurance from this angle they certainly fall under this definition of GCC. They are formulated in advance in order to be used multiple times; they are generally not negotiated with the (prospective) policyholder and are included into the contract unilaterally. It would make no difference by whom they are prepared in advance. It may be the insurer himself, the concerned reinsurer or another institution. They will qualify as GCC.<sup>12</sup>

But it might raise doubts whether or not General Conditions of Insurance can also be labelled the same. Given that the GCI are prepared by the Regulator and are compulsorily used by the insurer one could be inclined to say that they have to be judged as mandatory rules which fall outside the scope of control. Turkish law is silent on the issue. The EU Directive on Unfair Contract Terms states in its Recitals that "...

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<sup>10</sup> See ATAMER, p. 20 et seq.

<sup>11</sup> The question whether one should accept that negotiation has taken place where the contracting partner had only a choice between specific alternatives offered by the user of the GCC seems open to discussion. The German High Court (BGH) has answered negatively in its decision of 3 December 1991. According to the BGH, a term shall be regarded as a standard term if the customer only has a choice between particular alternatives offered by the user without having regard to the manner in which this choice is expressed: The use of a separate form for each of the alternatives, the printing of all the alternatives onto one form, choice of the contracting partner given by filling out by hand or typing in the blank spaces are not decisive. In *Bryen & Langley Ltd v Martin Boyston*, the Judge expressed the view that (in selecting particular terms from a choice of standard terms) it was at least arguable that the client has been able to influence the substance of a term and that this term can be regarded as individually negotiated. (cf. Cases Materials and Text on Consumer Law (General editors: MICKLITZ/STUYCK/TERRY; Coordinating editor: DROSHOUT), 2010, p.288-289). Under Turkish law, the choice between alternatives would be interpreted rather in the same way as in Germany since the user by way of offering alternatives is pushing his customer into a narrow space and allows him to play in the borders as he thinks fit. This is not negotiation but "faire semblant" (as if negotiating).

<sup>12</sup> ATAMER, p. 15-16.

the wording ‘mandatory statutory or regulatory provisions’ in Article 1 (2) also covers rules which, according to the law, shall apply between the contracting parties provided that no other arrangements have been established” and in Article 1 (2) that “...the contractual terms which reflect mandatory statutory or regulatory provisions shall not be subject to the provisions of this Directive.” But it is submitted that even though the GCI are prepared by the Regulator and the insurer is under the duty to use these terms they should still be qualified as GCC and be controlled by the courts.<sup>13</sup> One should not forget that what the General Directorate is issuing is not supposed to be law rules but standard form contracts. Therefore these rules should not be interpreted to fall under the term ‘mandatory statutory or regulatory provisions’ of Directive 93/13. It never can be guaranteed that the General Directorate of Insurance of the Undersecretary will always judge the contractual equilibrium in the best possible way and protect the insured adequately. A revision of these contract provisions by courts should be allowed for.

## C. INCORPORATION OF GCC AND OF INSURANCE CONTRACT TERMS

### 1. General Principles of Incorporation According to Turkish CO

Article 21 of the Turkish Code of Obligations (2011) defines under which circumstances GCC are included into the contract.<sup>14</sup> The provision reads as follows: “GCC detrimental to the contractual partner of the user shall become part of the contract only if the other party was informed about their existence and was given the opportunity to learn their content and upon acceptance of the other party.”<sup>15</sup> It would for example not suffice that the contract includes a mere reference to the GCC. Also the text must be made available to the other party. In one of its decisions the Turkish Court of Cassation did not find the allegation convincing that the signed declaration of the client on the front page (confirming the reading of all the conditions of the contract printed on the reverse page) was unfair<sup>16</sup>. In the concrete case the client had also signed the reverse page. He subsequently had withdrawn from the contract because of his financial situation without alleging the unfairness. Regarding the “reverse side clauses” the problem always consists to know whether the contractual partner of the user was

<sup>13</sup> Cf. for German law H. SCHMIDT, in: Beck’scher Online-Kommentar BGB, Bamberger/Roth (eds.), 22nd ed., BeckOK BGB § 307, para 7.

<sup>14</sup> A parallel rule can be found in the Principles of European Contract Law (PECL) which states the following in Art. 2:104 (Terms not individually negotiated): “(1) Contract terms which have not been individually negotiated may be invoked against a party who did not know of them only if the party invoking them took reasonable steps to bring them to the other party’s attention before or when the contract was concluded. (2) Terms are not brought appropriately to a party’s attention by a mere reference to them in a contract document, even if that party signs the document.”

<sup>15</sup> Cf. on the details ATAMER, p. 26 *et seq.* Whether or not it was a good choice to define the rules on incorporation focusing on GCC “detrimental to the partner” is very doubtful. Even if the GCC are not detrimental for the other party they will still not be included into the contract if the user does not inform the other party of his will to do so. This result is backed up by a fundamental rule: What is not comprised by offer and acceptance is not part of the contract.

<sup>16</sup> 13<sup>th</sup> Civil Chamber, 14.12.2004, decision no. E. 2004/9747 K.2004/18207.

sufficiently aware. It should be accepted that unsigned documents can in principle also be regarded as incorporated if reasonable steps are taken to draw the attention of the other party to the existence of the terms.<sup>17</sup>

Neither the Consumer Code nor the 2003 Regulation includes any parallel provision; consequently Art. 21 TCO finds application for B2B as well as B2C relations. Accordingly the user of GCC has to give the other party a fair chance to read and think about the GCC, which certainly is paralleled by the idea underlying all kinds of information duties. The other party shall at least hypothetically be given the chance of bargaining even though he will not be able to make use of it in most of the cases.<sup>18</sup>

Art. 21(2) TCO in fact is also based on the assumption that the other party just gives its “global” consent to the GCC without ever reading them. This provision excludes “unusual terms” from the contract content. It is presumed that a global consent can only cover those provisions which a reasonable person in the position of the other party would expect to be included in the contract. Surprising terms cannot be deemed to have been accepted by a reasonable person. Whether or not the so-called “red ink rule,” according to which onerous clauses can be incorporated only if they have been pointed out to the contracting partner in the most explicit way, should be introduced to Turkish law is open to discussion.<sup>19</sup> Given that Turkish law opens the way to judicial control of GCC it must be submitted that an argument about whether or not a certain term was included into the contract seems to be superfluous. Any provision which is onerous will anyhow be under scrutiny by the court.

As a result, whenever the other party is not given the chance to learn about the GCC or where it includes absolutely surprising terms the consequence is that they are regarded as “not written” (*reputées non écrites*). The contract is valid but either without including the GCC as a whole or just the surprising terms (Art. 22 TCO).

## 2. Incorporation of Insurance Contract Terms

Incorporation of insurance contract terms as a rule is subject to the same provisions as all other GCC. Therefore, all Special Conditions of Insurance can only become part of the contract if the requirements of Art. 21 are met, which means that the conditions have to be handed over to the insured and he must be given the opportunity of reading them. Otherwise they would not become part of the contract. But there are some

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<sup>17</sup> Cf. for comparative information: Cases Materials and Text on Consumer Law (General editors: MICKLITZ/STUYCK/TERRYIN; Coordinating editor: DROSHOUT), 2010, p. 283.

<sup>18</sup> The contractual partner of the user generally omits to read the GCC. This is particularly true in the field of insurance. The policyholder rarely examines the GCI (see CALAIS-AULOY/TEMPLE, no. 171).

<sup>19</sup> In *Thornton v. Shoe Lane Parking*, the High Court of England decided that an exoneration clause stated in the conditions displayed in a panel near the ticket machine to which the ticket of a new automatic car park refers was not incorporated. The clause was aimed at relieving from liability the garage for any injury to the customer while his car was on the premises. The term was found to be so wide and so destructive of rights that for having a binding effect it should be printed in red ink with a red hand pointing to it –or something equally startling, see MICKLITZ/STUYCK/TERRYIN, p. 286.

specific questions regarding the conclusion of insurance contracts which need to be elaborated on.

### **a. Incorporation of General Conditions of Insurance**

Given that the GCI are issued by the Regulator and have to be included into the Contract according to Art. 11 of the Turkish Insurance Activities Act it must be admitted that the requirements of Art. 21 TCO cannot find application in this case. The special provisions of insurance law have priority. That means that the GCI can be applied to this contract without the policyholder ever having had the possibility to acknowledge or read them. This consequence can be based on several different legal arguments: either it is assumed that the parties' fictitious will leads to an inclusion of the GCI or that they will be included due to the silence of the insured regarding an insurance policy which includes the GCI, or they are not incorporated but still the Judge makes use of them to fill in the gaps of the contract. Obviously all arguments will lead to the same result.

Given that in Turkey the Regulator generally takes care in safeguarding the interests of the policyholders and/or insured in preparing the general conditions of insurance, it would not be realistic to assume that the insured would have any objection against an inclusion of them. The policyholder would desire rather to be under the protection of the terms shaped by the Regulator more advantageous for him compared to statutory provisions<sup>20</sup>. Therefore it can be assumed that in the area of insurance contracts both parties' (common) wish to be bound on the basis of GCI policyholders' is realistic<sup>21</sup>. A relatively old decision rendered by the Court of Cassation states also that "*the oral conclusion of the insurance contract is sufficient for the incorporation of the CGI into the insurance contract. Express reference to the GCI is not needed. Otherwise the insurance contract would be a 'quasi-empty' agreement.*"<sup>22</sup>

The second way of incorporation may be based on the silence of the insured regarding the insurance policy delivered after the conclusion of the insurance contract: The insurance policy established by the insurer must include the GCI and in practice it contains at least a clear reference to them. If the policyholder does not object to the policy handed over to him, this fact can be interpreted as the (subsequent) inclusion

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<sup>20</sup> In Turkey the insurance contract will be subject to the provisions of the Turkish Code of Commerce of 1956 until July 2012 and then to the new Code of Commerce (enacted in 2011). The provisions of the Turkish Code of Commerce of 1956 are old and in many instances reflect the approach –nowadays abandoned– that the insurer must be protected against the bad-faith policyholders. For example the provisions about the duties to be accomplished towards the insurer are shaped mainly on the basis of "all or nothing" (*alles oder nichts*) principle. The GCI in many respects modify the old legal solutions to create a climate more favourable to the policyholders. After the entry into force of the new statutory provisions the existing GCI will have to be revised in order to ensure compliance with the new law.

<sup>21</sup> However this fact will not lift the need of control by the Judge since even if the GCI can be deemed as incorporated into the insurance contract on the grounds cited above, the non-negotiated terms may be detrimental to the policyholder in some instances.

<sup>22</sup> 11th Civil Chamber, decision E.1982/74; K.1982/1125 of 26.01.1982.

of the GCI into the insurance contract<sup>23</sup>. This issue will be dealt with also below under (b).

Finally the GCI may be included into the insurance contract as a result of the Judge's decision: The Turkish Code of Obligations article 2(2) stipulates that if the parties do not agree on the "secondary points" (*accidentalialia negotii*), the judge shall decide this controversy by taking into account the particularities of the case. If the Judge fills the gaps of the agreement by referring to CGI those conditions will be a component of the insurance contract <sup>(24)</sup> <sup>(25)</sup>.

### **b. Incorporation of Insurance Terms by way of Reference in the Insurance Policy**

According to Article 1423(1) TCC 2011 the insurer and his agent are under the duty to provide the prospective policyholder in a timely manner prior to contract conclusion with the necessary information regarding the insurance contract, the rights of the insured and the notification duties. In case the insurer does not comply with his duty of information and does only disclose the contract terms in the insurance policy which is issued and sent to the policyholder at a later point, the question will arise whether or not these terms are included into the contract. If Art. 21 TCO would be applicable we would conclude that these terms are not included since the policyholder was never informed of the applicable GCI or SCI rules. But article 1423 (2) TCC 2011 provides that if the policyholder does not object to the conclusion of the contract within 14 days, the contract will be deemed to be concluded on the basis of the conditions stated in it. If e.g. the parties have not specifically addressed the issue of inclusion of GCI or SCI and the insurer refers to them in its insurance policy they will become part of the contract if the policyholder does not refuse this contract. If he objects the contract will be invalid. During the 14 days the invalidity is pending.<sup>26</sup>

The rule is pretty similar to the old § 5a of the German *Versicherungsvertragsgesetz* (VVG) which was changed in November 2007. As it was also accepted among German scholars at that time, this provision is an exception to the rules of incorporation of

<sup>23</sup> If the risk is materialized before the GCI are deemed to have become part of the insurance contract by way of non-objection to the policy delivered by the insurer, the GCI will not be binding for that risk. This is the weakness of that interpretation.

<sup>24</sup> The judicial decision will have retroactive effect and the weakness stated in the previous footnote will not appear here. However it will be rare to have a contract referred to the Judge for the filling up of secondary points.

<sup>25</sup> At first glance it is surprising to think that GCC are equitable enough to establish a fair balance between the concerned parties. In Turkish practice it is due to the fact that the GCI are prepared by the Regulator taking into account the interests of the policyholders/insureds.

<sup>26</sup> The issue of the preliminary cover is not regulated at all in Turkish law. However the German rule contained in VVG § 49 (2) about the preliminary cover can serve as model, we believe, for a future legislative work. According to VVG § 49 (2) if the GCI are not given to the policyholder at the conclusion of the contract aimed at preliminary cover, the GCI used by the insurer for preliminary cover contracts or in the absence of such conditions, the GCI used by the insurer for the main insurance contract (of which the preliminary cover would constitute the "prelude") shall be deemed to have been incorporated even if specific reference to them are omitted.

GCC.<sup>27</sup> The burden of objection is on the side of the policyholder which is certainly a privilege for the insurers. They can always rely on the possibility of incorporation by way of a late reference to insurance terms.

### **c. Insurance Policy Inconsistent with Previous Agreement**

Article 1425(2) TCC 2011 deals with the eventuality that the insurer hands over an insurance policy containing terms different from the agreement or the policyholder's application. Other than in the case of Article 1423(2) the application of Article 1425 (2) requires a prior oral agreement of the parties or at least an application made by the insured where the contract terms have already been defined to a certain extent. If the insurance policy issued later differs from the application made by the prospective policyholder or the previous agreement of the parties to the detriment of the policyholder these provisions are null and void. The contract stays alive without these clauses. But, given that the GCI have to be incorporated into the contract anyhow this provision seems to be applicable only to SCI and other provisions included later by the insurer into the policy in deviation from the previous agreement.

The issue is specifically regulated also under German law (VVG § 5). According to VVG § 5 however, if the insurance policy contains new terms or deviates from the application made by the policyholder, the policyholder would be bound by those terms if an express reference is made by the insurer to the changes and the insured did not make use of its right to object within a period of one month.

## **D. INTERPRETATION OF GCC AND INSURANCE CONTRACTS**

It is a generally recognized principle that "doubt about the interpretation of general conditions of business will be resolved to the disadvantage of the user"<sup>28</sup> ("*in dubio contra stipulatorem*" or "*contra proferentem*" rule). This is exactly also what Art. 23 TCO and also Art. 6 (4) of the 2003 Regulation on Unfair Terms in Consumer Contracts reflect. If there are two different interpretations available, and if none of them legally must have precedence over the other, the interpretation most favourable to the weak party will be compulsorily chosen.<sup>29</sup> In cases where all the possible interpretations would not pass the subsequent control of content, it is needless to lose time with interpretation and it is better to proceed directly to judicial control. If one available interpretation would pass judicial control and the other would not, we must opt for the alternative that would be most to the advantage of the weak party. In any case, individual contractual arrangements shall always have priority over general conditions of contract.<sup>30</sup>

Obviously the provisions regarding interpretation of GCC will also find application

<sup>27</sup> Reiff in: WOLF/LINDACHER/PFEIFFER, AGB-Recht Kommentar, 5. Aufl., 2009, Klausel V 105-106.

<sup>28</sup> CALAIS-AULOY/TEMPLE, no. 172.

<sup>29</sup> Cf. ATAMER, p. 36-38.

<sup>30</sup> Cf. ATAMER, p. 38-41.

for GCI and SCI. The clauses will be interpreted according to the principle of trust, which would refer to the “horizon” (i.e. comprehension) of the average contract partner<sup>31</sup>. Therefore the terms used in the contract would be attributed the meaning that an average policyholder would normally attribute to them (depending also on the insurance class to which the contract belongs). Special consideration has to be given to a uniform interpretation based on the fact that insurance contracts are mainly related to “mass risks”. The technical particularities of the insurance require that the same rule of interpretation be applied in similar contracts of a large number.<sup>32</sup>

## E. JUDICIAL CONTROL OF GCC AND INSURANCE CONTRACTS

### 1. General Principles

The user of the GCC will easily overcome the incorporation and interpretation requirements by simply formulating the GCC in a clear and comprehensible way, by providing a copy of them duly in advance to the prospective contract partner and by explaining each of the surprising provisions. The GCC will become a component of the contract and no possibility of interpretation will be left. However, a clause in GCC clearly written and brought to the attention of the other contracting party can still be detrimental to the other party and therefore needs to be controlled. The only means of duly protecting the other party is the judicial review of the contract content.

As already explained above under heading (A) as of July 2012 there are three different provisions in Turkish law, which give the Judge the power to interfere into the contract. Art. 25 TCO provides that “it is prohibited to include in the GCC, provisions detrimental to the contract partner, in a manner contrary to the requirement of good faith (unfairness)”<sup>33</sup>. Although good faith is the only control criteria, the provision is silent as to what constitutes a violation of the good faith principle in the context of GCC. Furthermore the provision does not include any reference to “contractual equilibrium”. In a very dangerous way the decision on the invalidity of a clause in GCC is absolutely left to the discretion of the judge without giving him any precise means of control. Obviously this lacuna has to be filled by resorting to other provisions regarding the control of GCC.

The second rule is Art. 6 (1) of the Turkish Consumer Code, which defines the control criteria for consumer contracts and pretty much reflects what Directive 93/13 states in Art. 3 (1): A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer. Although this provision too seems to leave everything to

<sup>31</sup> BRULHART, *Droit des assurances privées*, Berne 2008, p.127 no.282-284; ULMER/BRANDNER/HENSEN, *AGB – Recht*, 11th ed. 2011, *Spez. AGB Werke*, Teil 4 (7) *Versicherungsbedingungen*, para 4.

<sup>32</sup> Cf. Reiff in: WOLF/LINDACHER/PFEIFFER, *AGB-Recht Kommentar*, 5th ed. 2009, *Klausel V 121*.

<sup>33</sup> On unfair clauses see RAYMOND, *Droit de la consommation*, 2ieme edition, no.444 ss.; PICOD/DAVO, *Droit de la consommation*, 2ieme edition, 2010, no.213 ss.

the judge, the 2003 Regulation on Unfair Terms fills in the blanks. Being a translation of Directive 93/13, this Regulation especially covers in Art. 6 (1) the need for to be drafted in plain and intelligible language (Directive Art. 5); in Art. 6 (2) the detailed instructions regarding the assessment of unfairness (Directive Art. 4(1)); in Art. 6(3) the exclusion of price and remuneration clauses from control; and in the Annex the list of several exemplary clauses, which may be declared void according to the circumstances of the contract. All in all, the consumer legislation seems to describe in much more detail how GCC have to be controlled by the judiciary. In the authors' view these provisions may also be used per analogy for filling the gap in Article 25 Turkish CO. Although at first sight consumer protection rules might not be judged to suit B2B contracts (which are also covered by Art. 25 TCO) Directive 93/13 and its parallel in Turkish law, the Unfair Terms Regulation, seem to reflect a balanced approach to the control of contract terms.<sup>34</sup> It has to be submitted that the risks attached to a mere judicial control based on the "unfairness" principles outweigh the concern of appropriateness of consumer provisions for B2B transactions.<sup>35</sup>

On the other hand, the provision in Article 55 (f) of the Turkish Commercial Code (2011) may also be consulted to give the judge guidelines for the review of GCC according to Art. 25 TCO. As stressed above under heading (A), the function of Article 55 (f) TCC in the field of unfair competition remains to be seen. But it is certainly worth looking at this provision when concretizing the unfairness criteria of Article 25 TCO. According to this provision "GCC departing i. substantially from the legal rules directly or indirectly applicable or ii. providing a repartition of rights and obligations substantially contrary to the nature of the contract would amount to the violation of the good faith principle." In fact these two criteria are major reference points used for the control of abusive clauses.<sup>36</sup> The same should be valid under Turkish law.

<sup>34</sup> In fact, PEICL Article 2:304 (Abusive Clauses) follows also the approach of Art.3-4 of Directive 93/13: "Terms that are not individually negotiated shall not be binding if they cause a significant imbalance to the detriment of the policyholder contrary to the requirements of good faith and fair dealing taking into account the nature of the insurance contract, all the other terms of the contract and the circumstances at the time the contract was concluded." The Principles of European Insurance Contract Law (PEICL) were prepared by the Project Group Restatement of European Insurance Contract Law, Chaired by Helmut HEISS and edited by the Drafting Committee BASEDOW/BIRDS/CLARKE/COUSY/HEISS, 2009.

<sup>35</sup> Even though the 2003 Regulation gives the judge several criteria for control the judiciary until today has mainly just evaluated whether or not negotiation prior to the contract was conducted. Any clause accepted without negotiation is *per se* considered to be unfair, which is certainly against the wording of the 2003 Regulation. Cf. e.g. Turkish Court of Cassation 13<sup>th</sup> Civil Chamber, decision no. E.2009/14991; K. 2010/5048 of 14.4.2010 ([www.kazanci.com](http://www.kazanci.com)). Here the Court declared a term contained in a bank services agreement invalid which granted a pledge in favour of the bank on the bank account of the client. The sole explanation was that the clause had not been negotiated. According to the bank service agreement a bank account was created in the name of the client where his salaries would be monthly deposited. The bank granted a credit card to the client who largely used it but did not pay back. Based on the agreement the bank emptied the client's account as a self-help remedy. The client sued the bank. The lower Court rejected the claim and the client (claimant) appealed. Turkish Court of Cassation allowed the appeal on the grounds that the term establishing a pledge to the benefit of the bank on the client's account was ineffective due to non-negotiation.

<sup>36</sup> Cf. e.g. for the German provision § 307 German Civil Code (BGB).

In conclusion of these considerations we categorize the criteria for the judicial review of GCC according to Art. 25 TCO under three headings:

- Non-mandatory provisions of law which would apply if the GCC would not have been contracted for (in analogy to Art. 55(f) TCC);
- Distribution of rights and obligations which would be adequate to the nature of the contract (in analogy to Art. 55(f) TCC);
- Requirement of Transparency (in analogy to Art. 6(1) 2003 Regulation)

If a clause in GCC deviates from one of these principles this deviation might be considered a violation of the good faith principle. Below we will first elaborate on the criteria and then on the good faith issue.

## **2. Criteria Applied for Controlling the Content of the GCC**

### **a. Non-Mandatory Provisions of Law**

In order to decide whether GCC are creating an imbalance to the detriment of the contract partner, the appropriate frame of reference is the law in force. GCC deviate from non-mandatory legal rules which would have otherwise been applied. As a principle, the legal rules regulating the contracts are apt to establish equilibrium between the contract partners. Therefore, departure from those rules in favour of the user would mean creation of an imbalance. In any contract where the parties really bargained and found their contractual equilibrium a deviation would not be judged unfair. In fact, non-mandatory provisions are in the Code only for being applied whenever there is a lacuna in a contract. But in case of GCC one of the parties by himself eliminates all legal provisions and in a way rewrites the law only in his favour. Exactly this makes GCC unfair and leads us to the conclusion that for GCC the non-mandatory rules become mandatory criteria of control.

Speaking of non-mandatory provisions of law we refer to rules regulating special types of contracts as well as rules applicable to all contracts (general provisions). In case a special legal provision cannot be defined, provisions in respect of a similar contract can be applied per analogy. However, it seems not conceivable to find a type of contract that would supplement the contract of insurance which is perhaps the most broadly regulated contractual relationship.

### **b. Repartition of Rights and Obligations Most Appropriate to the Nature of the Contract**

Where a contract is not legally regulated and there is no provision applicable *mutatis mutandis*, the judge will use his power of law making (Art. 1 Turkish Civil Code) and will determine, as if he were legislator (*modo legislatoris*), the rules that should govern the contract in question. The aim of the contract will be of special relevance in that respect. The most appropriate way of reconciling the respective conflicting interests of the contracting parties is to take into account the aim they pursue in entering into this contract.

In the field of insurance contracts, the judge will not be often obliged to act as legislator since these contracts are regulated in details in the law. However, taking into account the diversity of insurance contracts, there might be rare cases in which the judge's intervention is necessary.

### c. Transparency

Unfairness can also appear as a formal or a substantive element<sup>37</sup>. Unfairness in the formal sense is the result of the violation of the transparency requirement. The imbalance between the parties may be due not only to the content of non-negotiated GCC detrimental to the contracting party but very often to the manner in which they are formulated. If for example the rights (or obligations or duties) of the contracting party are mentioned in many different places in a complicated style not easily comprehensible the contracting party (policyholder) will be restricted in benefiting from the insurance. The user of the GCC is therefore under the obligation of preferring a clear and understandable language.

In fact, according to Art. 6(1) of the 2003 Regulation consumer GCC terms must always be drafted in plain and intelligible language.<sup>38</sup> Where the language is not clear and understandable, the judge will decide on the invalidity of the GCC provision without even being required to determine first whether or not the other control criteria were met. Obviously the judge first has to try to interpret the rule. If there is any chance of interpreting it to the benefit of the insured this interpretation can be sustained. If there is no possibility to give the rule any meaning it will be invalid for the sole reason of being intransparent. Although until today no Turkish court has made use of the transparency rule, it should be interpreted the same way as in the European context and as broadly as to cover also B2B transactions.

In this context Turkish Insurance Activities (Control) Act Article 11(4) and (5) merit special attention:

- Article 11 (4) IAA imposes on the insurer the obligation to define clearly what is covered by the insurance but does not stop there and imposes also the duty to mention what is "not" covered. Therefore, the insurer must state what is not under the scope of cover, otherwise all his omissions will be deemed under the insurance umbrella. Although at first glance this rule does not seem to be logic –as it provides a mission "impossible" since there is no way to complete the list of what is not covered- it can be said that it leads to the ban of "named perils" type covers and allows only "all risks" policies, more "policyholder friendly"<sup>39</sup>.

<sup>37</sup> MICKLITZ/REICH/ROTT, Understanding EU Consumer Law, 2009, p. 135.

<sup>38</sup> Cf. also PEICL Article 1:203 (Language and Interpretation of Documents) "(1) All documents provided by the insurer shall be plain and intelligible and in the language in which the contract is negotiated."

<sup>39</sup> Whether this provision should be deemed as "tacitly repealed" by the new Turkish Commercial Code (2011) Article 1409 (1) seems open to discussion. Article 1409 (1) stipulates that the insurer is only liable for losses caused by the materialization of a risk provided in the insurance contract. In our opinion those two provisions are compatible: Article 11 (4) Insurance Activities (Control) Act deals with the "exclusions" (*sekundäre Risikobeschränkungen*) whereas article 1409(1) TCC concerns

- Article 11 (5) IAA stipulates that the insurer should refrain from using “foreign” words. It must instead use the equivalent as might be created by the Turkish Language Institution. In practice this legal provision (reactionary regulation) is totally disregarded.

Another Turkish law not applied is the Law no. 805 (of 1926) imposing the use of Turkish language on Turkish financial institutions in their records, correspondence and contracts. The legal sanction to be applied in case of violation of this law is among others the “invalidity” of the contractual term. The Turkish Court of Cassation has ruled that contractual stipulations written in a foreign language or foreign words used in a contract would be valid if the business in question so requires. In insurance practice, it happens that sophisticated (rare) contracts such as BBB cover are at least partly written in English (i.e. clauses in English sent by the international broker or reinsurer are simply inserted). Where a Turkish translation is annexed, errors are frequent and insurers don’t omit to stipulate that in case of conflict between the original text and the Turkish translation, the former shall prevail.

It is submitted that the following principles prevailing within the EU are valid also under Turkish Law and Turkish Courts should apply them without reservation in the future:

- Transparency must exist from the start. Therefore the user of the GCC is required
  - to draft his contract terms in a plain and intelligible language.
  - to grant to his contracting partner the opportunity to be informed sufficiently before making his decision<sup>40</sup>.
- The core terms of the contract will be reviewed only if they are opaque.

“Plainness” and “intelligibility” are not defined in Turkish law. So far there is no court ruling neither. Looking at comparative comments, plainness relates to the legal effect of the clause. The contracting partner of the user should be given the opportunity to understand the consequences that will arise as a result of the insertion of the clause in question into the contract.

Intelligibility means at first glance the “legibility” but is a far reaching concept. Under “legibility” we must understand the elimination of small prints in order to ease the comprehensibility. A relatively old French decision shows that the said principle was already adopted decades ago<sup>41</sup>: “A jurisdiction clause (deviating from the general rules) must have been accepted. Such acceptance may be tacit but must nevertheless be certain. In casu the term was printed in characters that were not very noticeable...”

Turkish Consumer Protection Act provides in various articles that consumer contracts

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the risk covered (*primäre Risikobeschränkungen*). Under the article 1409 (1) TCC, the insurer who granted cover for fire shall not be deemed to have also granted cover for theft and this is not incompatible with IAA Article 11 (4). But anything imaginable within the scope of fire insurance would be included if they are not excluded properly in accordance with IAA Article 11 (4).

<sup>40</sup> MICKLITZ/REICH/ROTT, p. 136.

<sup>41</sup> Cases Materials and Text on Consumer Law (General editors: MICKLITZ/STUYCK/TERRY; Co-ordinating editor: DROSHOUT), 2010, p.283.

must be written in bold print and not less than 12 points. The constant ruling of the Turkish Court of Cassation (in disputes between a professional and a consumer) is that contract terms not respecting this requirement shall not be valid. To give an example:

*“Article 6 (E) of the contract ... between the parties stipulates that in case of non-payment of the instalments a default interest of monthly 10 % shall be added to the total amounts due and ..... also 25 % of the debt amount shall be paid as indemnity .....The contract is prepared as a standard contract but is not written in bold black print of at least 12 points.... Besides the Claimant has not proven that this contract term was negotiated...The term in question is an unfair term”<sup>42</sup>*

Furthermore intelligibility refers to information. The contracting partner should not be induced to mistakes and must deduct correctly the extent of his rights and duties from the contract text.<sup>43</sup> He must weigh with accuracy with the help of information provided to him whether he would conclude the contract (transparency prior to the conclusion). Whether intelligibility entails also a linguistic element can be debated<sup>44</sup>. The Unfair Contract Terms Directive 93/13/EEC does not contain any rule in that respect. In Germany, the Courts admit as a general rule that contracts concluded in that country can be in German even if the contracting partner has not enough knowledge of that language<sup>45</sup>.

In Turkey, the intelligibility requirement may also be violated by reason of provisions containing “gaps” (or “black holes”). As an example we can refer to the Institute Clauses annexed as SCI to marine insurance policies. They are tailored in accordance with English law and for what they do not expressly regulate they refer to the provisions in force or practice prevailing in England<sup>46</sup>. However sometimes this leads to unacceptable situations since the policyholders are completely ignorant about English law rules.

<sup>42</sup> Turkish Court of Cassation 13<sup>th</sup> Civil Chamber, decision no. E.2008/3546; K.2008/10759 of 18.9.2008 ([www.kazanci.com](http://www.kazanci.com)).

<sup>43</sup> The Medical Doctors Third Party Liability (Malpractice) GCI (article C.4) might serve as an example. According to this provision: “The obligations and duties imposed on the policyholder or on the insured as the case may be shall be deemed accomplished when obligations or duties imposed on the policyholder are performed by the insured or when the obligation or duties imposed on the insured are performed by the policyholder. But the insurer’s right to object on the ground that his situation has been worsened by this sole cause is reserved”. The insurer’s right to reject does not seem to make sense at all given that the insurer’s situation can never be worsened by third party involvement anyhow.

<sup>44</sup> MICKLITZ/REICH/ROTT, p.137. Micklitz underlines that if the user of the GCC is or should have been aware of the fact that the terms are not linguistically intelligible for the contract partner, the user should provide a translation or ensure otherwise the intelligibility.

<sup>45</sup> Cases Materials and Text on Consumer Law (General editors: MICKLITZ/STUYCK/TERRYN; Coordinating editor: DROSHOUT), 2010, p.285.

<sup>46</sup> Almost on every Institute Clause there is the mention “this insurance is subject to English Law and practice”.

### **3. Departure from the Criteria Applied Must Amount to Violation of the Good Faith Principle**

#### **a. In General**

If the judge determines an imbalance due to the departure from the control criteria applied he must thereafter evaluate whether this imbalance is against the good faith principle. The degree of the departure is of relevance. Only imbalances of some degree will give rise to invalidity. Where the equilibrium judged fair by the legislator is broken because of an important departure from the legal provisions and instead no other equivalent equilibrium is put in place, the GCC become against good faith.

The newly introduced provisions in the Turkish Code of Obligations unfortunately do not include examples of unfair contracts, but for one “black rule”: TCO Art. 24 with the heading “prohibition to alter” provides that “terms conferring to the user the right to alter or replace the GCC to the detriment of the other party shall be regarded as not written.” It is beyond doubt that the user of GCC should not be granted the faculty of altering or replacing GCC provisions at his sole discretion. However, this option may be authorized under certain circumstances: The contract may provide the cases where an alteration or replacement can be made or a reasonable cause may arise after the conclusion of the contract. “Adjustment” reveals itself to be a true need in the field of long-term contractual relationships. The only requirement is the existence of a just cause. Therefore, it is quite debatable whether it would not have been better if the lawmaker had left the issue to the discretion of the judge instead of introducing such an inflexible rule in the TCO.

In fact, the EU Directive as well as the 2003 Regulation seem to have followed a much more balanced approach in their annexes, where examples of unfair contract clauses in consumer contracts are provided for. Given that the list is a “grey list” using terms like “excessive;”, “without just cause;”, “unreasonably” it gives the judge the chance to use his discretion. For example, only clauses giving the user of GCC excessive discretionary rights<sup>47</sup>, or arbitrary rights to end a contract or to claim excessive amounts of compensation are found invalid or clauses which give the user rights to modify the contract without valid reason or without giving the other party the chance to dissolve

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<sup>47</sup> In a relatively recent decision the Turkish Court of Cassation declared unfair and thus invalid a clause providing for the application of the currency rate of the day when the loan amount was drawn down in case the currency rate of the repayment date is less favourable to the lender. In the concrete case, the lender granted a loan expressed in Japanese Yen but actually paid in Turkish money. At the day of repayment it was determined that the currency rate was smaller and the borrower had to repay the sums due according to currency rate applicable at the day of drawdown. The borrower later sued the lender and claimed the difference. Turkish Court of Cassation pointed out that under the disputed clause the lender was benefiting from the increase of the currency rate but the borrower was not benefiting from its decrease. Such a term ought to be considered unfair. Turkish Court of Cassation 13<sup>th</sup> Civil Chamber, decision no. E.2010/13371; K.2011/4123 of 21.3.2011 ([www.kazanci.com](http://www.kazanci.com)).

the contract.<sup>48</sup> It has to be submitted that this list can also have an indicative function for the fairness of B2B contracts given that it mostly aims at striking the balance between the parties.

However, in order to decide about the unfairness of a clause the judge always has to evaluate the contract as a whole. As is underlined in Art. 6(2) of the 2003 Regulation, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent. These criteria should certainly be also applied when judging on a B2B contracts. It is of special importance e.g. whether or not the parties may have established the balance otherwise despite obvious departure from the legal regulation. The contract must be examined as a whole. A provision detrimental to the contracting party might have been neutralized by a favouring provision in counterpart. The provisions in favour and against the contracting party should be functionally linked and regarded as being part of the same problem. Such a link would be accepted for example in an exoneration clause from liability arising out of culpa levis but at the same time provision of insurance cover to the contracting party. But the scope of the insurance would be decisive: If the cover granted is too narrow, the balance would not be re-established.

### **b. Examples of insurance clauses against the good faith principle**

As put forward above, the authors are of the opinion that SCI as well as GCI qualify as GCC and must be subject to judicial control. It is not conceivable that the GCI represent the perfect equilibrium between the insurer and policyholder (If such an assertion were correct, we could think that each and every derogation of the GCI constitutes a violation of the good faith requirement). Although it is true that many provisions of the GCI establish a good balance, it is impossible to conclude that all the GCI are divine words. This is certainly also valid for SCI. In some cases the special conditions are advantageous to the policyholder (for instance the archaic Turkish Cargo Insurance Conditions remaining without any alteration for more than 50 years now are more restrictive than the Institute Cargo Clauses [A]) whereas in some other they are detrimental to him (for instance Institute Cargo Clauses [C] are less advantageous than Turkish Cargo Conditions). Indeed the SCI globally approved by the policyholder may be for various reasons detrimental to him and he may deserve special protection.<sup>49</sup>

Looking first at the Annex of the 2003 Regulation and of Directive 93/13 one comes

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<sup>48</sup> Article 1414 of the Turkish Commercial Code of 2011 includes a parallel clause: "If the insurer without changing the coverage of the insurance contract increases the premium based on an adjustment clause in the contract the policyholder may terminate the contract in a one month time." This mandatory rule also shows that the law maker was not against adjustment clauses but wanted to have the equilibrium assured by giving the insured the chance of getting out of the contract.

<sup>49</sup> But it must be underlined that the Regulator takes care in inserting regularly into the GCI a "protective clause" to the benefit of the policyholders. According to the said clause "the parties concerned can agree on special clauses provided these are not detrimental to the policyholder".

to the conclusion that this “indicative” list (grey list) may be of relevance for insurance contracts in some cases.<sup>50</sup> In fact, the Principles of European Insurance Contract Law (PEICL) enumerate clauses frequently inserted in insurance contracts that may be regarded as unfair<sup>51</sup> which will be summarized below (examples are given in brackets):

- Terms capable of misleading the contractual partner of the insurer;
- Hidden terms (*a reference to a legal term not quoted in the contract, small print*);
- Entire agreement clauses (*exoneration from acts of the agents, clauses stating that the insurance agent would represent the policyholder when filling the application form*);
- Terms excusing improper performance (*exclusion of liability for delayed payment of insurance money*);
- Terms hindering redress (*notice of loss within an unduly short period of time*);
- Terms allowing the insurer to cancel the insurance contract, especially when the policyholder is deprived of such right (*cancellation period so short that the policyholder has not enough time to find alternative insurance cover – cancellation without return of the premium*);
- Terms allowing the insurer to modify the contract unilaterally (*premium increase or assignment of the contract to another insurer*);
- Terms allowing disproportionate penalties for breach by the policyholder.

Other examples from insurance policies might be as follows:

- *Land Motor Vehicle (Casco) GCI: “If at the conclusion of the contract or during insurance period the value of the motor vehicle is determined by experts jointly appointed by the parties, this value shall not be objected (...) The cost of the expertise shall be borne by the party who requested the agreed value”* (Taking into account that the insurance on agreed value is always the result of mutual consent, the last sentence about cost distribution might be judged to violate the good faith principle);
- *Credit Insurance GC (B.3): “The policyholder shall be entitled to claim losses (...) only if the conditions set forth in the credit limit request approved by the Insurer are met”* (discretionary power granted to the user of the GCC to define the conditions of coverage);

<sup>50</sup> Some of the cases cited by the Directive are irrelevant for insurance (for example the exoneration clauses in case of death or personal injury of the contracting partner- EU Directive List 1(a)).

<sup>51</sup> Principles of European Insurance Contract Law (PEICL) prepared by the Project Group Restatement of European Insurance Contract Law, Chaired by Helmut HEISS and edited by the Drafting Committee BASEDOW/BIRDS/CLARKE/COUSY/HEISS, 2009, p.120-121 (C 14). See also CLARKE, whose work served as a model to the Restatement Group with regards to the examples of unfair clauses (The Law of Insurance Contracts, 19-5A4).

- *Special clause inserted in the TPL insurance contract: “Liability arisen from erection and dismantling of cranes is excluded”* (where the main activity of the policyholder is the erection and dismantling of cranes, this clause would be against the good faith requirement);
- *Special clause inserted in “Machinery Breakdown” insurance “Excavators are covered only when they are not excavating”* (The scope of coverage might be judged to be excessively narrowed);
- *“Proof satisfactory to the insurer”* (discretionary power granted to the user of the GCC to decide whether satisfactory proof is brought);
- *“Non compliance by the Insured with its obligations under the Policy will lead to forfeiture of its rights under the Policy, with the Insured remaining subject to all its obligations under the Policy, particularly for payment of premium (which will become immediately due in full). In the event of forfeiture, the insured must repay to the Insurer any indemnity paid under the Policy within 10 days of the Insurer’s request to do so”* (Vague provision without stating what non-compliance means and without looking for a chain of causality);
- *“Loss resulting directly or indirectly from any of the following occurrences is not covered (...) (ii) the insured provoking the host Government in some manner”* (Vagueness regarding application);
- *“The insurer is the sole party entitled to match any and all premiums or amounts to be paid, with any and all amounts paid within the scope of this policy”* (Discretionary power of the insurer);
- *“All sums due by the insured, including reimbursement of indemnity (...) where it has been established that cover did not apply, will be subject to interest calculated at the applicable legal rate plus the penalty interest rate specified in the special conditions”* (Might be an excessive penalty)

#### **4. GCC Falling Outside the Scope of Judicial Control**

##### **a. In General**

The newly introduced rules in the TCO do not limit judicial control at all. It seems as if the judge could revise every contractual term. However, the aim of judicial review reveals also the limits under Turkish law<sup>52</sup>: the aim is to control GCC terms which unilaterally deviate from the legal rules, which otherwise would have been applicable. That means any clause in GCC, which just reproduces the applicable legal rule, should be immune to judicial control, since there is no ground for control. However there are certain restrictions to this exemption: first of all the rule reproduced in the GCC must be really the one applicable. Choosing another legal rule, which is more favourable to the user of GCC, falls certainly under the scope of control. Secondly, the usage of discretionary powers granted in non-mandatory rules does not fall under

<sup>52</sup> Cf. for German law in detail BILLING, Die Bedeutung von § 307 III 1 BGB im System der AGB-rechtlichen Inhaltskontrolle, München 2006, p. 151 *et seq.*

this exemption. If for example the user exonerates himself for *culpa levis*, or prohibits assignment, or introduces a penalty clause he certainly makes use of the discretion given to him in the law, but this is exactly about control of GCC. As a rule, the user of GCC has to stand in for all types of fault, assignment is free and there is no penalty clause by itself. The user of GCC deviates from the just legal equilibrium.

A second important limit stems from the principles of free market economy: contract stipulations regarding the subject matter of the contract and the price or remuneration are beyond control. As long as competition is secured on the market, prices have to be controlled by the market mechanisms. Whereas the first limit to control is not expressed in any of the Turkish provisions regarding control of GCC, the second limit is at least stated in the 2003 Regulation at Art. 6(2) and should be applicable also for B2B contracts. Below only the second issue will be dealt with in detail given its importance for insurance contracts.

### **b. GCC Determining the Respective Obligations of the Contracting Parties (Core Terms)**

The GCC relating to the respective essential obligations will remain outside the control. This is due to the fact that where free market economy prevails, the determinant factor is the market conditions<sup>53</sup>. Prices are not controlled save in very rare occasions. We do not have any reliable instrument to ascertain the “right price”.

Art. 6(3) of the 2003 Regulation provides that no control shall be made in respect of the equilibrium that should exist between the essential obligations of the contracting parties or between the goods/services and the price agreed in the contract. However control is possible with regards to the contract terms on place or time or manner of performance of the essential obligations stipulated. Similarly, the terms conferring the faculty of altering unilaterally the price, quantity, quality or object of the obligation shall be subject to control. The same is valid also for contract stipulations that may lead at any moment to unforeseen alteration of the price, stipulations on conditions of becoming due and payable of an obligation, terms on payment, the right to make deductions, to change currency<sup>54</sup>. These are not considered to relate to the balance between the essential obligations of the concerned contracting parties.

The distinction between contract provisions determining directly the obligation and those determining indirectly the obligation seems to be an appropriate criterion for the judge to decide which contract terms would be subject to control.<sup>55</sup> Control of the content will be exercised only in respect of provisions having an indirect impact whereas the provisions directly determining the price would remain outside that control and the judge would intervene solely for violation of the “transparency” requirement.

Hence transparency is the only mean to effectively control the contract terms defining

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<sup>53</sup> CALAIS-AULOY/TEMPLE, no. 182.

<sup>54</sup> Cf. the decision of the Turkish Court of Cassation above at fn. 46.

<sup>55</sup> Cf. for German law H. SCHMIDT, in: Beck'scher Online-Kommentar BGB, Bamberger/Roth (eds.), 22nd ed., BeckOK BGB § 307, para 78 *et seq.*

the respective essential obligations. Very often prices are not expressed in a simple way (such as cover = x TL). But there is need to indicate the price clearly and in a comprehensive manner in order to allow the client to make comparisons with similar products. Indication of premium and insurance cover e.g. should be made in a manner to allow the contracting partner (prospective policyholder) to be accurately informed and make comparisons (to decide whether or not to enter into a more advantageous contract)<sup>56</sup>. Hence the control would avoid the hiding into the GCC some elements that would affect the price. It is not aimed at controlling the balance between the respective essential obligations but at making sure that those respective essential obligations are properly conceived by the contracting party. Transparency will then contribute to a better market.

Recital 19 of the Directive (93/13/EEC) on unfair contract terms explicitly emphasizes that assessment of unfair character shall not be made of terms describing the main subject matter of the contract, nor the quality/price ratio of the goods or services supplied. The cited Recital says also that in the field of insurance, contract terms clearly defining or circumscribing the insured risk and the insurer's liability shall not be reviewed (since these restrictions are taken into account in calculating the premium).

In the PEICL, the expression used to define the terms remaining outside the control is different: PEICL 2:304 (3) (b) exempts "the terms that state the essential description of the cover granted and the premium agreed"<sup>57</sup>. Thus only "core terms" are exempted from the fairness test on the ground that the essential elements of the insurance contract (i.e. the scope of cover and the premium paid) should be shaped by market effects and the agreement of the concerned parties. In that regard core terms are terms that define

- the type and subject of insurance
- the insured risk
- the insurer's liability
- the insurance benefit
- the sum insured
- the insured interest (insurable value)

However terms restricting, changing, elaborating or modifying the insurer's obligation to perform are not to be considered as core terms. The discussion in respect of insurance contracts relates especially to whether contract terms related to "exclusions" (of insurance cover) are "core terms" or on the contrary terms that exclude insurer's liability (being subject to control). Given that the cover of each and every insurance contract is not defined by law and the repartition of the rights and obligations most

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<sup>56</sup> MICKLITZ/REICH/ROTT, p.137-138.

<sup>57</sup> PEICL 2:304 (3) is drafted as follows: "(3) This Article applies to terms that restrict or modify cover but it applies neither to (a) the adequacy in value of the cover and the premium, nor to (b) terms that state the essential description of the cover granted or the premium agreed, provided the terms are in plain and intelligible language."

appropriate to the nature of the insurance contract has to be defined for each case by the judge it has to be submitted that it underlies judicial control to define what exactly the core terms of each insurance contract are.<sup>58</sup>

However, the High Court of England ruled on the Jet-ski accident case<sup>59</sup> that “the exclusion of liability in insurance contracts can be seen as specification of the risks covered by the policy”. In the concrete case two jet-ski riders collided at sea and one rider was seriously injured. The insurers refused to pay on the ground that section 9 of the standard terms of insurance provided that “(the insurers) will not pay for compensation or other costs arising from accidents involving the (insured’s) possession of any (...) motorized waterborne craft”.

In contrast the German High Court (Bundesgerichtshof, BGH) decided that a clause in insurance contracts is only a core term if the contractual commitment cannot be determined without this clause, otherwise if it merely modifies the contractual promise and is subject to the fairness test<sup>60</sup>. The decision was rendered in relation to a theft case. Valuables were stolen from a safe cut open. Insurers invoked the exclusion of “deliberate actions of domestic employees or persons living in the home of the policyholder”. The BGH stated that mere descriptions establishing type, scope and quality of the service owed were not subject to the review (these are clauses not affecting the legal provisions which apply to the service) whereas clauses limiting changing, developing the principal service were in contrast subject to control. According to the BGH only the descriptions of service without whose existence an effective contract cannot be concluded are exempt from review. Indeed in the absence of those descriptions, the certainty or determinability of the essential content of the contract would be lacking.

The Turkish Court of Cassation has no special ruling regarding core terms of general or special conditions of insurance. But in other areas it constantly controls rules in GCC concerning fees without even questioning their transparency at all. For example annual fees charged by banks in exchange of the use of credit cards are qualified as unfair just for the sole reason of not being negotiated with the client<sup>61</sup>. In another decision the Court declared a clause invalid (signed by the contracting partner) according to which default interest at the monthly rate of 12 % would be charged, on the basis that it was not proven that the clause in question had been negotiated<sup>62</sup>. The same is true for default interest rates in mobile phone contracts: According to the

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<sup>58</sup> In detail for insurance contracts BILLING, p. 25 *et seq.*; ULMER/BRANDNER/HENSEN, AGB – Recht, 11th ed. 2011, Spez. AGB Werke, Teil 4 (7) Versicherungsbedingungen, para 7.

<sup>59</sup> *Bankers Insurance Company Ltd vs. South and Gardner*, Cases Materials and Text on Consumer Law (General editors: MICKLITZ/STUYCK/TERRY; Coordinating editor: DROSHOUT), 2010, p.296.

<sup>60</sup> BGH 21 April 1993, Cases Materials and Text on Consumer Law (General editors: MICKLITZ/STUYCK/TERRY; Coordinating editor: DROSHOUT), 2010, p.296-297.

<sup>61</sup> For example 13<sup>th</sup> Civil Chamber, decision no. E. 2008/15042 K.2009/5386 of 20.4.2009 ([www.kazanci.com](http://www.kazanci.com)).

<sup>62</sup> 13<sup>th</sup> Civil Chamber, decision no. E. 2007/510 K.2007/1989 of 15.2.2007([www.kazanci.com](http://www.kazanci.com)).

constant ruling<sup>63</sup>, the fairness (or unfair character) of the default interest should be assessed by taking into account the average rates (i.e. rates applied by other mobile phone companies). It is obviously very dangerous that the Highest Court does not seem to have any doubts in regard of price control and does not even bother to give an explanation where exactly it derives from the power to do so.

### **c. Sanction of Being Qualified as Unfair**

According to Art. 6(2) of the Turkish Consumer Code unfair contract terms are not binding for the consumer. Art. 25 Turkish CO does not provide explicitly the sanction that would be applied in case of violation of the good faith principle through GCC. But as a general rule Art. 27 TCO defines that all contractual provisions which are contradicting mandatory rules are invalid. Given that Art. 25 TCO is also a mandatory rule stipulations in GCC against good faith are going to be judged as invalid. The result would be a partial invalidity. In the area of GCC the principle "utile per inutile non vitiatur" (what is not valid would not invalidate what is valid) shall prevail. Therefore the contract shall remain in force without the invalid provision (favor contractus/favor negotii).

Partial invalidity seems to be an established solution: Unfair Contract Terms Directive (93/13/EEC) article 6 (1), BGB § 306 and PEICL (Principles of European Insurance Contract Law) Article 2:304 (2) are in that direction. The provision in the PEICL can be given as a good model:

*"The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term. If not, the unfair term shall be substituted by a term which reasonable parties would have agreed upon had they known the unfairness of the term"*

Turkish CO article 27(2) second sentence stipulates that any party to the contract can prove that his hypothetical will would lead to the invalidity of the entire contract. This seems to be an unhappy solution since it allows the user of the GCC to avail itself of the partial invalidity, which would put his contracting party in a worse position. But it is generally accepted that the party using GCC cannot make use of this right given in Article 27(2).

## **F. CONCLUSION**

With the changes in the Turkish Code of Obligations and Code of Commerce coming into effect in July 2012 the means of controlling general contract conditions in B2B contracts will be introduced into Turkish law. These new rules will have to be applied besides those already existent since 2003 for B2C contracts. These new provisions certainly mean an important improvement in regard of control of GCC but they will also give rise to some questions as regards compatibility. This paper aims at showing a combined way of making use of all these provisions in order to achieve the

<sup>63</sup> Such as in 13<sup>th</sup> Civil Chamber, decision no. E. 2005/11099 K.2005/17357 of 24.11.2005(www.kazanci.com).

maximum level of protection against unfair GCC, without losing sight of the need for balancing both parties' interests.

These provisions open also a new dimension for the control of insurance contract terms. Even though until today the Turkish Court of Cassation did not make much use of the 2003 rules on consumer protection in order to control insurance contracts, it can be expected that this will change in the near future due to the boost of these new provisions. Given that the overall picture of the provisions pretty much reflects the European standard of GCC control the same problems will certainly generate discussion also under Turkish law, especially in regard of the role of the transparency requirement. As the Court of Cassation has never made reference to this rule or applied this principle until today comparative research in this area will help gaining valuable insight on the issue and will give guidance to Turkish Courts.

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# Transparency in Liability Insurance, Particularly in the Claims Settlement

by Robert Koch\*

## I. Introduction

There is no International Law or European Law defining transparency. At the EU-level, Art. 5 of the Council directive 93/13/EEC on unfair terms in consumer contracts does not use the phrase “transparency” but requires that a contractual term, which has not been individually negotiated, is drafted

“in plain, intelligible language.”<sup>1</sup>

Art. 13 para. 1 lit b) Directive 2002/92/EC on insurance mediation requires intermediaries to provide all information

“in a clear and accurate manner, comprehensible to the customer.”<sup>2</sup>

A similar provision can be found in Art. 3 para. 2 of Directive 2002/65/EC concerning the distance marketing of consumer financial services.<sup>3</sup> Art. 1:203 para. 2 of the Principles of European Insurance Contract Law (PEICL), which is modeled on Art. 5 of Directive 93/13/EEC, reads:

“All documents provided by the insurer shall be plain and intelligible and in the language in which the contract is negotiated.”<sup>4</sup>

The Draft Common Frame of Reference (DCFR)<sup>5</sup> provides for a definition of

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<sup>1</sup> Council directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts O.J. L 95 , 21.4.1993, p. 29

<sup>2</sup> Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation requires intermediaries O.J. L 9, 15.1.2003, p. 3.

<sup>3</sup> Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services, O.J. L 271 , 9.10.2002 p. 16.

<sup>4</sup> <http://www.uibk.ac.at/zivilrecht/restatement/sprachfassungen/peicl-en.pdf>.

<sup>5</sup> [http://ec.europa.eu/justice/contract/files/european-private-law\\_en.pdf](http://ec.europa.eu/justice/contract/files/european-private-law_en.pdf).

transparency. Under the heading “Duty of transparency in terms not individually negotiated” Art. II. – 9:402 reads:

“(1) A person who supplies terms which have not been individually negotiated has a duty to ensure that they are drafted and communicated in plain, intelligible language. (2) In a contract between a business and a consumer a term which has been supplied by the business in breach of the duty of transparency imposed by paragraph (1) may on that ground alone be considered unfair.”

The Italian Chapter of AIDA seems to have a somewhat broader understanding of transparency since, for the purpose of the questionnaire for the AIDA World Congress 2014, which is hosted by the Italian Chapter,

“transparency means the clarity, comprehensibility and exhaustiveness of a contractual text.”<sup>6</sup>

The OECD’s Guidelines for Good Practice for Insurance Claim Management (2004) drawn up by the OECD’s Insurance Committee do not define transparency but identifies as good practice

“adequate, fair and transparent claim assessment and processing”<sup>7</sup>

According to the Insurance Core Principles (ICP) published in October 2011 by the International Association of Insurance Supervisors (IAIS) the supervisor should require that insurers

“promote products and services in a manner that is clear, fair and not misleading” (ICP 19.4)

and

“have fair and transparent claims handling” (ICP 19.9.1).<sup>8</sup>

Finally, for Wikipedia

“[t]ransparency, as used in science, engineering, business, the humanities and in a social context more generally, implies openness, communication, and accountability. Transparency is operating in such a way that it is easy for others to see what actions are performed. For example, a cashier making change at a point of sale by segregating a customer’s large bills, counting up from the sale amount, and placing the change on the counter in such a way as to invite the customer to verify the amount of change demonstrates transparency.”<sup>9</sup>

There are many other approaches to define and to describe transparency but for the purpose of this paper it seems sufficient to register that the concept of transparency

<sup>6</sup> <http://www.aida.org.uk/worldcongress10/default.asp>.

<sup>7</sup> For the text see <http://www.oecd.org/dataoecd/43/44/33964905.pdf>, and Annex I of this paper.

<sup>8</sup> For the text see [http://www.iaisweb.org/\\_\\_temp/Insurance\\_Core\\_Principles\\_Standards\\_Guidance\\_and\\_Assessment\\_Methodology\\_\\_October\\_2011.pdf](http://www.iaisweb.org/__temp/Insurance_Core_Principles_Standards_Guidance_and_Assessment_Methodology__October_2011.pdf), and Annex II of this paper.

<sup>9</sup> [http://en.wikipedia.org/wiki/Transparency\\_\(behavior\)](http://en.wikipedia.org/wiki/Transparency_(behavior)).

is somewhat linked to the principle of fairness and/or good faith<sup>10</sup>, and that there is a substantive form of transparency and a procedural one.

The first part of my paper will deal with the concept of substantive transparency that is related to the content of the contract including information e.g. on how to exercise contractual rights. I will give a brief overview of the legal requirements, identify characteristic elements of liability insurance where transparency is of special importance and illustrate a recent decision by the Frankfurt Court of Appeal on the transparency of “cost inclusive” clause in a D&O insurance policy. The second part will be devoted to procedural transparency in liability insurance which is associated with decision making processes and thus relevant for the settlement of liability claims. Of particular interest is the question of whether, and to what extent, the insurer is obligated to inform the insured on the assessment of the claim of the third party, the claim processing and the claim settlement.

## II. Substantive Transparency in Liability Insurance

### 1. Legal Requirements for Substantive Transparency

The terms and conditions of an insurance policy are generally not the result of individual negotiations. They are rather one-sided and therefore subject to the Council directive 93/13/EEC which deals with the substantive form of transparency. Unlike under the Directive, the scope of protected persons under German law is considerably wider in that not only the consumer is protected, but every natural or legal person, against whom standard contract terms are used. By requiring a plain, intelligible language, Art. 5 Council directive 93/13/EEC lays down the prerequisites needed to ensure that an appropriate level of information is provided to the insured so as to put him in the position to evaluate the coverage offered, to assess his rights and obligations and hence to make a well-informed decision.<sup>11</sup>

The policy wording has to be clear, concise and comprehensible. It must not be ambiguous or misleading. The benchmark under German law is the average insured who is reasonably observant and circumspect.<sup>12</sup> The policy moreover must not

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<sup>10</sup> See Art. 1:203 PEICL comment C 2: “That the contents should be expressed fully and clearly is an aspect of the requirement of good faith to enable policyholders to assess their right and obligations”

<sup>11</sup> See ECJ, 10.5.2001, C-144/99 - Commission v Kingdom of the Netherlands [2001] ECR I-03541, para. 17 (stating, that, to implement the principle of transparency in full, “it is essential that the legal position under national law is sufficiently precise and clear that individuals are made fully aware of their rights” and that “even where the settled case-law of a member state interprets the provisions of national law in a manner deemed to satisfy the requirements of a Directive, that cannot achieve the clarity and precision needed to meet the requirement of legal certainty”); for similar statements see ECJ 7.5.2002, C-478/99 - Commission of the European Communities v. Kingdom of Sweden [2002] ECR I-04147, para. 18; ECJ 9.9.2004, C-70/03 -Commission v. Kingdom of Spain [2004] ECR I-0799, para. 15.

<sup>12</sup> See BGH, 23.2.2011, NJW-RR 2011, 1144, 1145: „Abzustellen ist bei der Bewertung der Transparenz einer Vertragsklausel auf die Erwartungen und Erkenntnismöglichkeiten eines durchschnittlichen Vertragspartners des Verwenders im Zeitpunkt des Vertragsschlusses. Dabei sind Allgemeine Geschäftsbedingungen nach ihrem objektiven Inhalt und typischen Sinn einheitlich so auszulegen, wie sie von verständigen und redlichen Vertragspartnern unter Abwägung der Interessen der

include any hidden clause which placement or presentation may make it difficult for the insured to understand circumstances related to the coverage or can contribute to erroneous understanding of circumstances related to the coverage. For example, clauses containing limitations or exclusions from coverage or imposing obligations on the insured must not be placed or presented in a manner which makes it difficult for the insured to get acquainted with them before the conclusion of the contract.<sup>13</sup>

The Council directive 93/13/EEC does not specify (with the exception of the *contra proferentem* rule, see Art. 5 para. 2) the consequences of lack of transparency. Under the German Civil Code (BGB), clauses that lack transparency are null and void (sect. 307 para. 1 BGB). In case they are surprising, they do not become part of the contract (sect. 305c para. 1 BGB). According to a comparative analysis of the University of Bielefeld, the vast majority of EU member states have declined to regulate the consequences for breach of the transparency requirement in individual actions.<sup>14</sup>

## 2. The Need for Transparency in Liability Insurance

Liability insurance protects individuals and businesses against the financial risk of legal liability to third parties for death or injury, loss or damage to property, or “pure economic” loss. The policy must clearly state what type of damage is insured and whether the insurance provides both defense and indemnity coverage, or indemnity only coverage. In Germany, most common are policies which provide defense and indemnity coverage. Here, once a claim against the insured has been filed by a third party the insurer is obligated to defend and/or to indemnify the insured provided that the claim falls within the coverage of the policy. The latter requires that the insured’s liability must arise from activities specified in the policy such as the carrying on of a particular business, the management of companies, the shipment of goods, the manufacture and sale of goods, etc.<sup>15</sup>

Moreover, the period of cover must be specified. Since the conduct of the insured that gives rise to liability often occurs some time before the injured party claims for compensation, the insured event which triggers insurer’s liability must be defined. Where coverage is provided on a “claims made” basis, as, for example, it is generally the case in D&O- insurance cover, the insurer is liable for any claim made against the policyholder during the period of cover. Policies covering liability for personal injury

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normalerweise beteiligten Kreise verstanden werden.“ The Council directive 93/13/EEC does not contain clear guidelines this regard.).

<sup>13</sup> These requirements are in line with the IAIS Insurance Core Principles on insurer conduct of business according to which the insurer “should take reasonable steps to ensure that a customer is given appropriate information about a policy in good time and in a comprehensible form so that the customer can make an informed decision about the arrangements proposed” (ICP 19.5.1) and the information provided should “be easily understandable;... and not hide, diminish or obscure important statements or warnings” (ICP 19.4.3).

<sup>14</sup> See Consumer Law Compendium, 2008, C. Unfair Contract Terms Directive (93/13), at p. 415 et seq., [http://www.eu-consumer-law.org/study2\\_en.pdf#tm00138](http://www.eu-consumer-law.org/study2_en.pdf#tm00138).

<sup>15</sup> For the nature and scope of defense costs clauses see Colinvaux’s Law of Insurance, 9th ed., 2010, 20-047/048.

or damage to property are more commonly written on an “occurrence” or “events” basis. Occurrence policies provide coverage for any injury or damage that takes place during the policy period, regardless of when the claim is reported. Under an events-based policy, the immediate cause of bodily injury or property damage triggers the coverage, neither the act giving rise to the policyholder’s liability nor the claim made by the injured party at a later date; thus, for example, coverage is triggered when a defectively manufactured product leads to an accident causing bodily injury as opposed to the point when the defective product was manufactured or the injured party’s discovery that the product was defective. Where environmental damage is concerned, “the first verifiable discovery” of the personal injury, damage to property, or financial loss triggers the coverage.

Restrictions in coverage follow from the limit of indemnity, i.e. the maximum amount that insurers will pay. Here, the policy must clearly indicate whether the limit operates either on an “each and every” claim basis or on an “aggregate” basis. In the former case, the full limit of indemnity under the policy is available to satisfy each claim which might arise during the period of insurance. In the second alternative, the limit of indemnity applies as a maximum total payment irrespective of the number of claims notified during the period of insurance. The insurer’s liability is further limited by “series clauses.” Such clauses require careful drafting since they work on the basis of two fictions in that two or more claims arising from one specific cause, which is attributable, for instance, to the same event, condition, defect or hazard, or failure to warn, are treated as a single insured event that, depending on the definition of the insured event, is deemed to have happened on the day on which the earliest claim was first made, on the day of the first occurrence, or the first event or the first verifiable first discovery.

### **3. Judgment of the Frankfurt Court of Appeal of 9 June 2011 on “cost inclusive” clause**

There are only few decisions where the courts in Germany found that a clause in a liability insurance contract is intransparent (and therefore void). One of the decisions is of particular interest and deserves special attention because it deals with the transparency of a defense cost clause in a D&O-insurance policy. Defense cost clauses may further limit the amount of the sum insured depending on whether the policy is on a “costs inclusive” or on a “costs in addition” basis. In a “costs inclusive” policy, the defense costs have to be subtracted from the amount insured, while in a “costs in addition” policy defense costs are paid by the insurer in addition to the sum insured.<sup>16</sup>

The Frankfurt Court of Appeal, in its judgment of 9 June 2011, held that a “cost inclusive” clause, according to which costs for lawyers, expert, witnesses and court fees in defending the liability claim are included in the insured sum<sup>17</sup>, is intransparent

<sup>16</sup> Prölss/Martin/Lücke, 28th ed., Vorbemerkung zu den §§ 100–112, Rn. 1; Colinvaux’s Law of Insurance, 9th ed., 2010, 20-027.

<sup>17</sup> OLG Frankfurt/M., 9.6.2011, RuS 2011, 509.

because the definition leaves the insured in a limbo under which conditions such costs incur.<sup>18</sup> The Frankfurt Court of Appeal argued that from the wording of the clause it was not clear for the insured whether the costs to be credited were supposed to be incurred for defending the liability claim or if the clause also applied to costs incurred for investigating whether the insured was entitled to coverage or not, for example, due to an exclusion. Moreover, the Frankfurt Court of Appeal argued that the insured would not know the exact amount left for the settlement of the claim if it came, in the course of the defense proceedings, to a dispute between the insured and the insurer over insurance coverage. In fact, it is not uncommon that liability insurers provide conditional coverage for initial defense costs but later deny full coverage due to an exclusion clause after having had the chance to a full review of the statement of claim and the insured statement of defense and possibly as a result of own investigations. In such a case, the Frankfurt Court of Appeal reasoned that the insured would bear the risk to partially lose a coverage claim against the insurer and consequently not to get reimbursed by the insurer for his legal cost (under the loser pays the winner's legal fees rule). The case is pending before the German Supreme Court (BGH), and a final decision is expected by the end of this year.

I do not find the reasoning of the Frankfurt Court of Appeal with regard to the interpretation of the defense cost clause in question very convincing. It is important to note, however, that whenever the insured's liability and/or the quantum of damage suffered by the injured party are in dispute the insurer *de facto* has discretion either to settle the claim or to defend the claim and to indemnify the insured once the injured party has succeeded in obtaining judgment against him. The insurer's discretion is only limited by his obligation under the German Civil Code (sect. 241 para. 2 BGB) to take account of the rights, legal interests and other interests of the insured. Where the defense costs have to be paid out of the insured sum and total costs and damages (if any) might reach or exceed the policy limits or where the claim already exceeds policy limits, it is safe to say, that the insurer must act reasonably and always keep the insured's interest in mind.<sup>19</sup> This conclusion leads us to the next question as to what transparency standards the insurer owes to the insured in the settlement of claim proceedings.

### III. Transparency in the Claims Settlement

#### 1. Typical Steps of a Claims management process

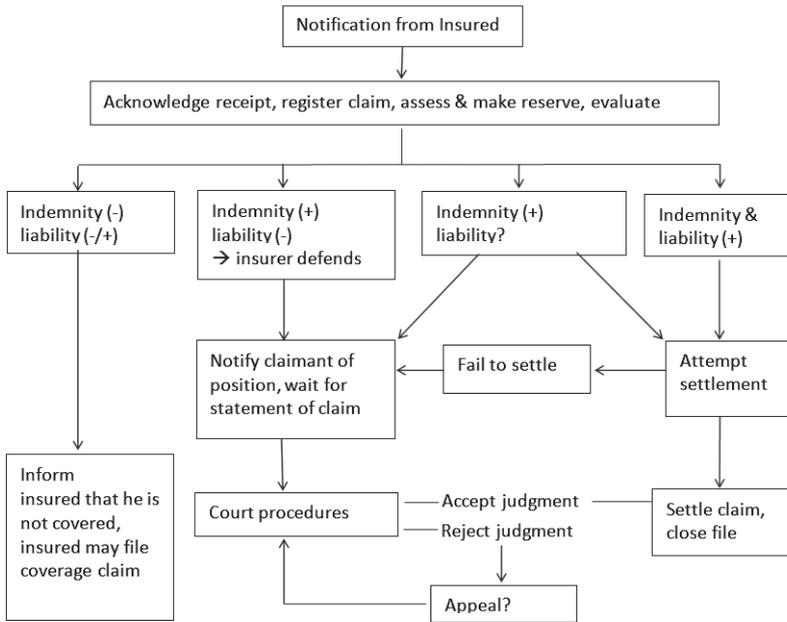
Before I deal with transparency in the claims settlement procedure, I would like to illustrate the general path a claim can take, and the progress of a claim from the allegation of a claim to settlement:

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<sup>18</sup> OLG Frankfurt/M., 9.6.2011, RuS 2011, 509.

<sup>19</sup> Under English law the insurer owes a duty of care to the assured to conduct negotiations with the third party with the interests of the insured in mind. See Colinviaux's Law of Insurance, 9th ed., 2010, 20-045.

**Claims management process**



**2. Legal Requirements for Transparency in the Claims Settlement**

In the EU, there are some rules in the field of compulsory liability insurance establishing standards with regard to the processing of liability claims. Compulsory liability insurance schemes often not only provide the right of a direct claim against the insurer but also provide rules for the settlement of claims to effectively protect the injured party. For example, the Directive 2009/103 on compulsory insurance cover for motor vehicles requires the insurer to make within three months of the date when the injured party presented his claim for compensation a reasoned offer of compensation in cases where liability is not contested and the damages have been quantified, or to provide a reasoned reply to the points made in the claim in cases where liability is denied or has not been clearly determined or the damages have not been fully quantified (see Art. 23 of Directive 2009/103/EC).<sup>20</sup>

In the field of non-compulsory liability insurance, from what little research I have done on the Internet, there were no references to a country’s national laws and regulations on insurance claims management standards. The German Insurance Contract Act

<sup>20</sup> Directive 2009/103/EC of the European Parliament and of the Council of 16 September 2009 relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability, O.J. L263, 7.10.2009, p. 11; for regulations outside the EU see Claims management standards and guidelines issued by the Queensland Workers’ Compensation Regulatory Authority (<http://qcomp.com.au/media/65110/insurer-performance-standards--and--guidelines-effective-july-2009-version-6.pdf>), which are aimed at assisting insurers in meeting their obligations under the Queensland Workers’ Compensation and Rehabilitation Act 2003 (<http://www.legislation.qld.gov.au/legisltn/current/w/workerscompa03.pdf>).

2008 (VVG), for example, does not contain rules, as in the EU Directive 2009/103, that requires the insurer to make an offer of indemnification to the insured (far from the injured party). There are only provisions that impose on the insurer the obligation to release the insured from the third party's claim within two weeks once the insured's liability has been established by final non-appealable judgment, by (the insurer's) acknowledgement or by settlement (sect. 106 VVG). If the insured is liable towards several third parties and their claims are in excess of the sum insured, the insurer furthermore must pay these claims in proportion to their amounts (sect. 109 VVG). There are a few non mandatory rules on defense costs according to which the insurer has to bear all costs incurred at the insurer's instigation (sect. 101 VVG).

Yet, I did find the OECD's guidelines for good practices for insurance claim management of 2004 and the IAIS Insurance Core Principles on insurer conduct of business of 2011, which contain principles on claims handling. Besides, there are awareness programs on claims management issues by insurance businesses. Lloyds, for instance, has published detailed claims management principles und minimum standards.<sup>21</sup> Other insurers, like Allianz Global Corporate Speciality (AGCS)<sup>22</sup>, or ORACLE<sup>23</sup> provide a short overview on how claims are handled. Moreover, there is a research report of the Australian Productivity Commission on "Public Liability Claims Management" that was released in January 2003.<sup>24</sup> The study was part of a package of measures of the Australian government aimed at reducing claims costs and increasing the transparency of insurance industry practices through better data collection. The primary purpose, however, was not to provide guidelines for claims management but to benchmark the Australian Insurers' claims management practices in the public liability class of insurance against world's best practice.<sup>25</sup> In the following, due to the role of the OECD and the IAIS as global standard setters, I will only deal with the OECD's guidelines and the IAIS Insurance Core Principles on claims handling.

### **3. OECD's Guidelines for Good Practices for Insurance Claim Management and the IAIS Insurance Core Principles on Claims Handling**

The OECD's guidelines for good practices for insurance claim management call on insurance companies to handle claims speedily and fairly. Similarly, ICP 19.9 states that the "supervisor requires that insurers have policies and processes in place to handle claims in a timely and fair manner." The OECD's guidelines, however, are neither binding nor exhaustive, but should only serve as a "checklist" to assist insurance companies in handling claims.<sup>26</sup> They do not seek to impose a "one size fits all" claims

<sup>21</sup> <http://www.lloyds.com/~media/Files/The%20Market/Communications/Market%20Bulletins/2011/03/Y4479.pdf>.

<sup>22</sup> <http://www.agcs.allianz.com/services/claims/philosophy-and-processes/>.

<sup>23</sup> <http://www.oracle.com/us/industries/insurance/045594.pdf>.

<sup>24</sup> <http://www.pc.gov.au/projects/study/insurance/docs/finalreport>.

<sup>25</sup> See foreword of the research report, <http://www.pc.gov.au/projects/study/insurance/docs/finalreport>.

<sup>26</sup> <http://www.oecd.org/dataoecd/43/44/33964905.pdf>.

management approach but just serve as a framework that needs to be tailored to the specific circumstances of each case. According to the OECD “they will provide a touchstone for best practice in both OECD countries and others, in an area where till now there was no international guidance.”<sup>27</sup> The OECD urges insurance firms to “inform customers of complaints procedures and address complaints promptly, keeping policyholders informed of what they are doing in response to complaints.”<sup>28</sup> According to the IAIS, the Insurance Core Principles “provide a globally accepted framework for the supervision of the insurance sector” and “can be used to establish or enhance a jurisdiction’s supervisory system.”<sup>29</sup>

Both, the OECD’s guidelines and the IAIS Insurance Core Principles do not specifically address a certain type of insurance. As it can be seen in the following, they do not give full account of the essential characteristics of liability insurance i.e. that the injured party is not a party to the insurance contract, that the insurer does not owe payment before the insurer has had the opportunity for a full review of the merits of the claim or the insured’s liability has been established by a judgment or arbitration award. It seems as if the drafter of the guidelines were focused on first party coverage claims made by the insured. I have extracted some of the recommendations on providing information to insureds about the assessment and the processing of claims which do fit liability insurance.

### **a) Decision on the Insurance Claim for Coverage**

Once the insured has notified the insurer of the claim the latter must decide whether or not the claim falls within the scope of cover and communicate to the insured its decision as soon as possible. In case the insurer does not want to provide coverage the OECD guidelines and the IAIS Insurance Core Principles contain the following recommendations:

#### **OECD Good practice 6: Claim processing**

Cases of no/partial payment claims:

- If the claim is denied, the insurance company states explicitly to the policyholder/claimant/beneficiary the policy provision, conditions or exclusion on which the denial is based.
- If the amount offered is different from the amount claimed, the insurance company explains the reason for this to the policyholder/claimant/beneficiary.
- When the insurance company is not responsible (by virtue of policy clauses) for meeting all or any part of the claim, it notifies the policyholder/claimant/beneficiary of this fact and explains why.

<sup>27</sup> See [http://www.oecd.org/document/42/0,2340,en\\_2649\\_201185\\_33963626\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/42/0,2340,en_2649_201185_33963626_1_1_1_1,00.html).

<sup>28</sup> See [http://www.oecd.org/document/42/0,2340,en\\_2649\\_201185\\_33963626\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/42/0,2340,en_2649_201185_33963626_1_1_1_1,00.html).

<sup>29</sup> See Insurance Core Principles, Standards, Guidance and Assessment Methodology, [http://www.iaisweb.org/\\_\\_temp/Insurance\\_Core\\_Principles\\_Standards\\_Guidance\\_and\\_Assessment\\_Methodology\\_\\_October\\_2011.pdf](http://www.iaisweb.org/__temp/Insurance_Core_Principles_Standards_Guidance_and_Assessment_Methodology__October_2011.pdf), Introduction para. 6 and para. 16.

## ICP 19.9

### Claims Handling

- 19.9.5 Claim-determinative factors such as depreciations, discounting or negligence should be illustrated and explained in comprehensive language. The same applies where claims are denied in whole or in part.

With regard to liability insurance, procedural transparency requires that the insurer not only informs the insured about the (partial) denial of coverage but also explains the reasons for it by making reference to the conditions in the policy that are not met, for example, if the claim is for pure economic loss when the policy only provides coverage for bodily injury or damage to property. The same is true if an exclusion from coverage e. g. for claims relating to damages due to asbestos applies. When, based on the facts alleged by the third party, the conditions for coverage are not met the insurer must give the insured the opportunity to comment on the allegations. The same applies to allegations of the third party, which, if true, would lead to the application of an exclusion from coverage. If the insurer wants to reserve its right to reclaim e.g. the defense costs in case the allegations of the third party turns out to be right in the course of the proceedings, procedural transparency requires an express reservation.

### **b) Assessment of the Third Party Claim**

In case the insurer decides to provide coverage the following recommendations by the OECD guidelines and the IAIS Insurance Core Principals apply:

#### **Good practice 5: Claims assessment**

- Information to policyholders:
  - When the damage is assessed through a written estimate made on behalf of the insurer, the insurer sends the policyholder/claimant/beneficiary a copy of the document used to set the amount of compensation.

## ICP 19.9

- 19.9.9 ... Adjusters should be able to make recommendations, independent of the insurers' instructions, on the settlement of individual claims.
- 19.9.10 ... Decisions should include the reasoning in clear language relating closely to the specific disputable issues

Adjusting liability insurance claims is particularly difficult for the insurer because the third party is under no contractual obligation to cooperate with the insurer. An assessment through a written estimate by a loss adjuster, therefore, may be difficult. For that reason, the General Conditions of Insurance for Liability Insurance (AHB), which form in Germany the basis of all liability insurance types not covering pure economic losses, provide that the insured must submit comprehensive damage reports to the insurer, inform the insurer of all circumstances relating to the claim and forward all documents which in the view of the insurer are of relevance to assess the claim.

### **c) (Timely) Processing of the Third Party Claim**

The OECD guidelines and the IAIS Insurance Core Principals contain the following recommendations with regard to the processing the third party claim:

#### **Good practice 6: Claim processing**

- Provision of information to policyholders:
  - The company keeps policyholders/claimants/beneficiaries informed of the progress during the claims process. The company provides information on when payments, repairs or replacements are expected to be made, and, if necessary, explains why additional time is required.
  - When the company decides to call on outside parties (i.e. loss adjusters, solicitors, surveyors, etc.), it informs policyholders/claimants/beneficiaries of this fact, gives the reasons for this decision and explains the role that these outside parties will play in processing the claim.
  - When a final payment or offer of settlement is made, the company explains to policyholders/claimants/beneficiaries what the payment or settlement is for and the basis used for the payment/settlement.
  - The insurance company documents their claim files in order to be able to address questions that may arise concerning the handling and payment of the claim.

#### **Good practice 7: Timely claim processing**

- In accordance with applicable insurance law, companies may specify in the contract the most likely period of time for responding to correspondence from policyholders/claimants/beneficiaries.
- The insurance company endeavours to settle the claim as soon as possible and advises in writing the policyholder/claimant/beneficiary on the reasons for any delay.
- After an agreement has been reached between the company and the policyholder/claimant/beneficiary on the amount of compensation, the payment is effected within a reasonable amount of time.

#### **ICP 19.9**

- 19.9.3 Claimants should be informed about procedures, formalities and common timeframes for claims settlement.
- 19.9.4 Claimants should be given information about the status of their claim in a timely and fair manner.

The recommendations exemplify that procedural transparency requires information and explanation about the decision making process in claims management by the insurer. Since the concept of transparency is somewhat linked to the principle of fairness and/or good faith, it seems reasonable to obligate the insurer to inform the insured in good time prior to any decision which may have a negative impact on the coverage of the liability claim. This is not the case where the insured is liable and the

damages claimed do not exceed the sum insured. In this scenario the insured has no real interest in the outcome. The situation may be different when the insured is not liable, or his liability cannot be assessed by the insurer, or the damages claimed exceed the sum insured. Depending on whether or not the defense costs are included in the sum insured and suit is brought in a jurisdiction that follows the “English rule,” whereby the loser pays the winner’s legal fees, or the “American rule,” which requires each side to pay its own legal fees, the decision of the insurer to defend the claim might be to the detriment of the insured. In any event, where the damage claim exceeds the sum insured the insurer is not entitled to make use of its right to settle the full claim with the third party on the insured’s behalf.<sup>30</sup>

#### **IV. Conclusion**

The concept of transparency in liability insurance contracts has a substantive and a procedural side. Substantive transparency pertains to the content of the liability insurance contract and requires, first, a policy wording that is intelligible to the average insured, and second, an appropriate level of information on insurance coverage to put the insured in the position to assess his rights and obligations. Procedural transparency relates to the management of the third party claim and requires the insurer to provide to the insured information and explanation on the progress of a claim from notification to settlement. In this regard, the OECD Guidelines for Good Practice for Insurance Claim Management of 2004 as well as the ICP 19.9 of IAIS Insurance Core Principles of 2011 generally provide appropriate guidance on how to achieve procedural transparency in liability insurance.

#### **ANNEX of the OECD Guidelines for Good Practice for Insurance Claim Management (2004)<sup>31</sup>**

##### **Good practice 1: Claims reporting**

The insurance company writes insurance policies in easily understandable language. Policies spell out what is covered and what is not covered. If necessary, plain language explanations could be an addendum to the legal language.

The insurance company draws the attention of the policyholder/claimant/beneficiary both when he/she signs a policy (for policyholders only) and when he/she reports a loss on his/her duties related to claim reporting which include:

- To try to minimise losses;
- To report claims in a timely fashion;
- To co-operate in the investigation by providing the company with all relevant

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<sup>30</sup> Under AHB the liability insurers generally reserve their right to conduct all negotiations with third party claimants against the insured, to defend any proceedings which may be brought, and to settle the claim with the third party on the insured’s behalf. If the liability claim results in a lawsuit the insured must furthermore leave the handling of the claim to the insurer, grant power of attorney to the lawyer appointed or designated by the insurer.

<sup>31</sup> <http://www.oecd.org/dataoecd/43/44/33964905.pdf>.

information and, in particular, copies of official documents regarding the damage (accident, loss, etc.);

- To authorise the company to handle necessary inspections and assess the extent of the damage prior to any repairs or replacement;

To ensure that the claims reporting phase proceeds as smoothly as possible, the insurance company sends to the policyholder/claimant/beneficiary within a reasonable period of time (beginning from when the loss is reported):

- An appropriate claim form (when the loss reporting is made in writing) for the type of policy - prepared either by an individual insurance company or at the national level by companies or the supervisory authorities together with instructions and useful information on how to comply with the terms of the policy and the legitimate requirements of the company;
- The information necessary to help them to report the claim.

### **Good practice 2: Receipt of claims by the company**

- The company claim department and/or the intermediary (if applicable) are as accessible as possible for the claimant. If an intermediary is an initial contact for claimants, claims should be sent to the company claim department within an appropriate time period.
- The insurance company contacts the policyholder/claimant/beneficiary or sends an acknowledgement of receipt as soon as the claim is received.
- Subsequently, if it appears that the claim cannot be settled rapidly, the company notifies the policyholder/claimant/beneficiary and indicates that he/she will be recontacted within reasonable time limit.
- When it is necessary for the policyholder/claimant/beneficiary to provide specific documents when filing a claim, the company sends him/her the list of these documents as soon as possible. In addition, a specific notification listing the elements to be provided when another insurance company is involved is sent to the policyholder/claimant/beneficiary.
- If it appears that the claim is not covered by the insurance policy, the company sends a notification as soon as possible to the policyholder/claimant/beneficiary, explaining why it is not covered.
- When the claimant is not the policyholder, the company sends him/her information on his/her rights and duties when relevant.
- When appropriate, the insurance company notifies the policyholder of his/her right of subrogation and informs him/her of the main principles governing the subrogation procedure.

### **Good practice 3: Claims files and procedures**

Once a claim has been filed and, when applicable, after any additional documents that are required to process the claim have been received, the file established by a company contains the following documents:

- Claim filing number;
- Policy number;
- Name of the policyholder/claimant/beneficiary;
- Summary sheet showing development / review of the claim;
- Type of insurance concerned;
- Opening date of the file;
- Date of loss;
- Reporting date;
- Description of the claim;
- Information on claimants;
- Assessment date;
- Electronic and/or paper copy of the adjusters' and investigators' reports where applicable;
- Identity of the adjuster;
- Estimated cost of damage;
- Dates and amounts of payments;
- Date of denial, if applicable;
- Name of intermediary, if applicable;
- Date of file closure;
- Documents recording contacts with the policyholder/claimant/beneficiary.

#### **Good practice 4: Fraud detection and prevention**

In order to curb the growth of fraudulent claims and the rise in premium costs that results from them, companies take the following steps:

- They establish compliance programs for combating fraud and money laundering appropriate to their exposure and vulnerabilities.
- In the claim filing phase, they discourage fraudulent practices by making the policyholder/claimant/beneficiary aware of the consequences of submitting a false statement (which in particular could be liable to prosecution) and/or an incomplete statement. To this end, insurance companies place a notification on their claims forms referring to the appropriate law, statute or insurance regulation that addresses the filing of fraudulent or incomplete claims.
- Where legally possible, companies participate in relevant databases where claims susceptible to be fraudulent would be reported. Moreover, public authorities may encourage or take steps to initiate the creation of a public or private bureau of insurance fraud.
- Besides, companies provide their claims department staff with adequate training on fraud indicators.

**Good practice 5: Claims assessment**

General issues:

- Any method of taking into account specific factors such as depreciation, discounting or negligence on the part of the victim is clearly outlined in the claim file.
- Any loss evaluation methods used by the company are reasonable and coherent.
- The insurance company uses internal methods for assessing claim values based on the applicable law of the jurisdiction.

The role of claims adjusters:

- Companies that use claims adjusters or intermediaries will need to ascertain their competence qualifications. Moreover, if these claims adjusters/intermediaries were to commit any errors or misappropriation of funds affecting their policyholders, claimants or beneficiaries within the framework of the contract with the insurance company, the latter would be held responsible. Consequently, companies may decide to limit the scope of action of claims adjusters and intermediaries (for example, by setting ceilings on the number of claims they can handle).
- Companies notify policyholders/claimants/beneficiaries whenever they use independent claims adjusters or intermediaries.

Information to policyholders:

- When the damage is assessed through a written estimate made on behalf of the insurer, the insurer sends the policyholder/claimant/beneficiary a copy of the document used to set the amount of compensation.

**Good practice 6: Claim processing**

General issues:

- A company's claim procedures are gathered together in a manual for internal use. At least, one staff member should be responsible for ensuring that the manual is kept up to date and additions/amendments are made when necessary.
- Companies' claims department staff possesses proper qualifications. To this end, companies encourage ongoing internal or external training of their claim staff.
- Regular internal audits are carried out for all claims not settled in their entirety. Internal audits apply to all stages of the claims management process. Peer reviews (where the claims department staff review each others' files) could also be carried out.
- In case of claim settlement procedures involving several insurance companies, policyholder indemnification is a priority: the claim should be compensated in an appropriate time period while potential disputes between

insurers are resolved at a later stage. For the most common insurance claims (related to motor insurance, for instance), specific agreements are concluded between insurers to accelerate and simplify claims settlement procedures involving several insured parties.

- Insurance companies do not:
  - Conceal policy coverage provisions of any insurance policy when they are pertinent to a claim.
  - Dissuade policyholders/claimants/beneficiaries from obtaining the services of an attorney or adjustor.
  - Attempt to settle claims for less than the amount to which the claimant would be entitled to receive according to any written or printed advertising material accompanying the application forms. However, insurers may take legal action against any intermediary that has made irresponsible promises.
  - Deny a claim without reasonable investigation.
  - Transfer responsibility for the claim to others, except as may be expressly provided for by policy conditions.

Provision of information to policyholders:

- The company keeps policyholders/claimants/beneficiaries informed of the progress during the claims process. The company provides information on when payments, repairs or replacements are expected to be made, and, if necessary, explains why additional time is required.
- When the company decides to call on outside parties (i.e. loss adjusters, solicitors, surveyors, etc.), it informs policyholders/claimants/beneficiaries of this fact, gives the reasons for this decision and explains the role that these outside parties will play in processing the claim.
- When a final payment or offer of settlement is made, the company explains to policyholders/claimants/beneficiaries what the payment or settlement is for and the basis used for the payment/settlement.
- The insurance company documents their claim files in order to be able to address questions that may arise concerning the handling and payment of the claim.

Cases of no/partial payment claims:

- If the claim is denied, the insurance company states explicitly to the policyholder/claimant/beneficiary the policy provision, conditions or exclusion on which the denial is based.
- If the amount offered is different from the amount claimed, the insurance company explains the reason for this to the policyholder/claimant/beneficiary.
- When the insurance company is not responsible (by virtue of policy clauses) for meeting all or any part of the claim, it notifies the policyholder/claimant/beneficiary of this fact and explains why.

**Good practice 7: Timely claim processing**

- In accordance with applicable insurance law, companies may specify in the contract the most likely period of time for responding to correspondence from policyholders/claimants/beneficiaries.
- Once policyholders/claimants/beneficiaries have filed a claim
  - They are informed of the acceptance or denial of the claim within a reasonable amount of time after the receipt of the notification.
  - The insurance company contacts any other company that is involved in the claim within a reasonable amount of time, and resolves inter-company claim disputes as quickly as possible.
- The insurance company endeavours to settle the claim as soon as possible and advises in writing the policyholder/claimant/beneficiary on the reasons for any delay.
- Quick claims settlement as well as high-quality and punctual information provided to the policyholder/claimant/beneficiary are key competition features for insurance companies.
- After an agreement has been reached between the company and the policyholder/claimant/beneficiary on the amount of compensation, the payment is effected within a reasonable amount of time.
- Insurance companies implement and update their own statistical database tracing their performance in the timely settlement of claims as well as in trends in settlements and expenses. A proper procedure for the coding and statistical processing of losses is developed for this purpose.

**Good practice 8: Complaints and dispute settlement**

## Complaints/Disputes:

- When the policyholder/claimant/beneficiary files a complaint, the company:
  - Acknowledges receipt of the complaint within a reasonable period of time;
  - Provides policyholders/claimants/beneficiaries with explanations on how their complaints will be handled and on the procedures to be followed;
  - Provides information to policyholders/claimants/beneficiaries on internal and external dispute settlement procedures;
  - Processes complaints promptly and fairly;
  - Keeps policyholders/claimants/beneficiaries regularly informed of how their complaints are progressing;
  - Provides a final response in writing within a reasonable period of time.
- If the policyholder/claimant/beneficiary is dissatisfied with the final response that he/she has been sent by the company, he/she can activate

an internal appeals process. He/she can also appeal to the dispute settlement procedures available outside the company (for example, the handling of complaints by the supervisory authorities). In case of a dispute, the insured/claimant/beneficiary should be informed by the company of the existence of these appeal procedures.

### **Good practice 9: Supervision of claims-related services**

The insurance supervisory authorities may conduct examinations on claims management services especially where problems are suspected.

In these cases, the following elements are taken into account:

- Possible access to non-confidential claims data for all open and closed files within a specified time frame (e.g. for the current year and the two preceding years);
- Maintenance of sufficient and appropriate information on claims files;
- Use of the appropriate type of claim form for the type of insurance;
- Proper qualification of the claims department's employees based inter alia on the applicable insurance code;
- Valuation of claims payments according to company procedures;
- Appropriate tracking of the nature and number of complaints related to claim management process;
- Monitoring of the proportion of claims that result in litigation;
- Compliance with procedures for combating fraud and money laundering;
- Regular internal audit practices on claims files;
- Appropriate internal claims procedure manuals;
- Proper procedure for coding and statistical reporting of losses;
- Performance in terms of the speed of claim settlements (as assessed according to the statistical database implemented by virtue of item 7).

### **Good practice 10: Market practices**

The public authorities promote the implementation of a benchmark exercise regarding the claims process or a specific part of this process (i.e. handling of complaints).

The terms of remuneration of insurance company employees or other services in charge of claim management do not give incentives to disadvantageous treatment of policyholders/claimants/beneficiaries, as regards the handling or the outcome of claims.

## **Annex II**

**Excerpt of ICP 19 of the Insurance Core Principles Standards, Guidance and Assessment Methodology (ICP) published in October 2011 by the International Association of Insurance Supervisors**

## ICP 19 Conduct of Business

**The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.**

### *Pre-sale Process*

#### **19.4 The supervisor requires insurers and intermediaries to promote products and services in a manner that is clear, fair and not misleading.**

19.4.1 Before an insurer or intermediary promotes an insurance product, it should take reasonable steps to ensure that the information provided is accurate, clear and not misleading. Ideally, procedures should provide for an independent review of advertising materials and other communications intended for Customers other than by the person or organisation that prepared or designed them.

19.4.2 If, subsequently, an insurer or intermediary becomes aware that the information provided is not accurate and clear or is misleading, it should withdraw the information and notify any person that it knows to be relying on the information as soon as reasonably practicable.

19.4.3 The information provided should:

- be easily understandable;
- be consistent with the result reasonably expected to be achieved by the majority of Customers of that product;
- state prominently the basis for any claimed benefits and any significant limitations; and
- not hide, diminish or obscure important statements or warnings.

19.4.4 The insurer should be responsible for providing information that is accurate, clear and not misleading not only to Customers but also to intermediaries who may rely on this information in providing advice to Customers.

#### **19.5 The supervisor sets requirements for insurers and intermediaries with regard to the timing, delivery, and content of information provided to Customers at point of sale.**

19.5.1 The insurer or intermediary, as relevant, should take reasonable steps to ensure that a Customer is given appropriate information about a policy in good time and in a comprehensible form so that the Customer can make an informed decision about the arrangements proposed.

### *Timing of the Provision of Information to Customers*

19.5.2 Customers should be appropriately informed before and at the point of sale. Information should enable an informed decision to be made before entering into a contract.

19.5.3 In determining what is “in good time,” an insurer or intermediary should consider the importance of the information to the Customer’s decision-making process and the point at which the information may be most useful.

*Delivery of Information to Customers*

- 19.5.4 Information should be provided in a way that is clear, fair and not misleading. Wherever possible, attempts should be made to use “plain language” that can easily be understood by the Customer.
- 19.5.5 Product information should be provided in writing or another durable medium.
- 19.5.6 It is advisable to focus on the quality of product disclosure rather than the quantity of disclosure, as there is a risk that if the disclosure becomes too voluminous then the Customer may be less likely to read the information. The quality of disclosure may also be improved by the introduction of a standardised format for disclosure (such as a product information sheet), which will aid comparability across competing products and allow for a more informed choice.
- 19.5.7 There is likely to be an enhanced need for clear and simple disclosure for more complex or “bundled” products, which are difficult for Customers to understand, such as packaged retail investment products (PRIPs), particularly regarding the costs and risks involved.
- 19.5.8 Supervisors should encourage insurers and intermediaries to obtain acknowledgements from Customers that they have received and understood the information provided.

*Content of the Provision of Information to Customers*

- 19.5.9 The information provided should enable Customers to understand the characteristics of the product they are buying and help them understand whether and why it meets their requirements.
- 19.5.10 The level of information required will tend to vary according to matters such as:
- the knowledge and experience of a typical Customer for the policy in question
  - the policy terms and conditions, including its main benefits, exclusions, limitations, conditions and its duration
  - the policy’s overall complexity
  - whether the policy is bought in connection with other goods and services
  - whether the same information has been provided to the Customers previously and, if so, when.

*Disclosure of Product Features*

19.5.11 While the level of product information required may vary, it should include information on key features, such as:

- the name of the insurer, its legal form and, where relevant, the group to which it belongs
- the type of insurance contract on offer, including the policy benefits
- the level of the premium, the due-date and the period for which the premium is payable, as well as the consequences of late or non-payment. Where a policy is bought in connection with other goods or services (a bundled product) good practice would be to disclose premiums for each benefit (both main benefits and supplementary benefits) separately from any other prices and whether buying the policy is compulsory
- the type and level of charges to be deducted from or added to the quoted premium, and any charges to be paid directly by the Customer
- when the insurance cover begins and ends
- a description of the risk insured by the contract and of the excluded risks
- prominent and clear information on significant or unusual exclusions or limitations. A significant exclusion or limitation is one that would tend to affect the decision of Customers generally to buy. An unusual exclusion or limitation is one that is not normally found in comparable contracts. In determining what exclusions or limitations are significant, an insurer or intermediary should, in particular, consider the exclusions or limitations that relate to the significant features and benefits of a policy and factors which may have an adverse effect on the benefit payable under it. Examples of significant or unusual exclusions or limitations may include:
  - deferred payment periods
  - exclusion of certain conditions, diseases or pre-existing medical conditions
  - moratorium periods
  - limits on the amounts of cover
  - limits on the period for which benefits will be paid
  - restrictions on eligibility to claim such as age, residence or employment
  - excesses.

19.5.12 Where information provided about an Investment policy includes an indication of past, simulated or future performance, the information should include any limits on upside or downside potential and a prominent warning that past performance is not a reliable indicator of future performance.

19.5.13 A helpful means to ensure that accurate and comprehensible information is provided to the Customers is a product information sheet containing information on key product features that are of particular significance to the conclusion or performance of the insurance contract. The product information sheet should be clearly identified as such and it should be pointed out to the Customer that the information is not exhaustive. Insofar as the information concerns the content of the contract, reference should be made as appropriate to the relevant provisions of the contract or to the general policy conditions underlying the contract. Insurers should consider the use of evaluation by third parties, such as Customer testing, in developing product information sheets in order to ensure their understandability.

#### *Disclosure of Rights and Obligations*

19.5.14 Retail Customers in particular often have only limited knowledge about the legal rights and obligations arising from an insurance contract. Before an insurance contract is concluded, the insurer or intermediary, as relevant, should therefore inform a retail Customer on matters such as:

- General provisions – including the law applicable to the contract
- Obligation to disclose material facts – including prominent and clear information on the obligation on the Customer to truthfully disclose material facts. Ways of ensuring a Customer knows what he or she must disclose include explaining the duty to disclose all circumstances material to a policy and what needs to be disclosed, and explaining the consequences of any failure to make such a disclosure. Alternatively, rather than an obligation of disclosure, the Customer may be asked clear questions about any matter material to the insurer
- Obligations to be complied with when a contract is concluded and during its lifetime, as well as the legal consequences of non-compliance
- Obligation to monitor cover – including a statement, where relevant, that the Customer may need to review and update the cover periodically to ensure it remains adequate
- Right to cancel – including the existence, duration and conditions relating to the right to cancel. If there are any charges related to the early cancellation or switching of a policy, this should be prominently disclosed
- Right to claim benefits – including conditions under which the policyholder can claim and the contact details to notify a claim
- Right to complain – including the arrangements for handling policyholders' complaints, which might include an insurer's internal claims dispute mechanism or the existence of an independent dispute Reinsurer mechanism.

- 19.5.15 Where applicable, the **Customer** may also be provided with information on any policyholder protection scheme or compensation scheme in the case of an insurer not being able to meet its liabilities and any limitations on such a scheme.
- 19.5.16 If the insurance undertaking is a foreign insurer, the insurer or intermediary should be required to inform the **Customer**, before any commitment is entered into, of details of the home authority responsible for the supervision of the insurer, and of the jurisdiction in which the head office or, where appropriate, the branch with which the contract is to be concluded is situated.

### ***Policy Servicing***

- 19.8 **The supervisor requires insurers to:**
- **service policies appropriately through to the point at which all obligations under the policy have been satisfied;**
  - **disclose to the policyholder<sup>[2]</sup> information on any contractual changes during the life of the contract; and**
  - **disclose to the policyholder further relevant information depending on the type of insurance product.**

*[2] For the purposes of Standard 19.8 and corresponding guidance, “policyholder” refers to the party to whom a contract of insurance is issued by an insurer.*

- 19.8.1 Ongoing supervision of insurers should include the monitoring of insurers’ conduct of business with regard to policy servicing, in particular:
- the provision of ongoing information to policyholders;
  - the handling of policyholders’ claims; and
  - the handling of policyholders’ complaints.
- 19.8.2 Appropriate policy servicing also includes fair treatment in the case of switching between products or early cancellation of a policy, which goes beyond information disclosure.
- 19.8.3 Supervisors should require insurers to have sufficient safeguards in place to ensure that obligations under a policy are satisfied in an appropriate manner. The same should apply to intermediaries where they participate in policy servicing tasks.

### ***Information on the Insurer***

- 19.8.4 Information to be disclosed about the insurer includes:
- any change in the name of the insurer, its legal form or the address of its head office and any other offices as appropriate
  - any acquisition by another undertaking resulting in organisational changes as far as the policyholder is concerned
  - where applicable, information on a portfolio transfer (including policyholders’ rights in this regard).

*Information on Terms and Conditions*

- 19.8.5 Insurers should provide evidence of cover (including policy inclusions and exclusions) promptly after inception of a policy.
- 19.8.6 Information needs of policyholders differ depending on the type of insurance product. Whilst such information is generally provided on a regular basis, in some jurisdictions it is practice for policyholders to receive this information only on request.
- 19.8.7 Information to be provided on an ongoing basis, including changes in policy terms and conditions or amendments to the law(s) applicable to the policy, will vary by type of policy and may cover for example:
- main features of the insurance benefits, in particular details on the nature, scope and due-dates of benefits payable by the insurer
  - the total cost of the policy, expressed appropriately for the type of policy, including all taxes and other cost components; premiums should be stated individually if the insurance relationship comprises several independent insurance contracts or, if the exact cost cannot be provided, information provided on its basis of calculation to enable the policyholder to verify the cost
  - any changes to the cost structure, if applicable, stating the total amount payable and any possible additional taxes, fees and costs not levied via or charged by the insurer, as well as any costs incurred by the policyholder for the use of communication methods if such additional costs are chargeable
  - Duration of the contract, terms and conditions for (early) termination of the contract and contractual consequences
  - means of payment of premiums and Duration of payments
  - premiums for each benefit, both main benefits and supplementary benefits
  - information to the policyholder about the need to report depreciation/ appreciation
  - information to the policyholder about other unique circumstances related to the contract
  - information on the impact of a switch Option of an insurance contract
  - information on a renewal of the contract.
- 19.8.8 Additional information regarding life insurance and annuities (products with an investment element) should at a minimum include:
- participation rights in surplus funds
  - the basis of calculation and state of bonuses
  - the current cash surrender value
  - premiums paid to date
  - for unit-linked life insurance, a report from the investment firm (including performance of underlying funds, changes of investments, Investment strategy, number and value of the units and movements during the past year, administration fees, taxes, charges and current status of the account of the contract).

19.8.9 Where there are changes in terms and conditions, the insurer should notify the policyholder of their rights and obligations regarding such changes and obtain the policyholder's consent as appropriate.

**19.9 The supervisor requires that insurers have policies and processes in place to handle claims in a timely and fair manner.**

19.9.1 Supervisors should require that insurers have fair and transparent claims handling and claims dispute Reinsurer procedures in place.

*Claims Handling*

19.9.2 Insurers should maintain written documentation on their claims handling procedures, which include all steps from the claim being raised to its settlement. Such documentation may include expected timeframes for these steps which might be extended in exceptional cases.

19.9.3 Claimants should be informed about procedures, formalities and common timeframes for claims settlement.

19.9.4 Claimants should be given information about the status of their claim in a timely and fair manner.

19.9.5 Claim-determinative factors such as depreciations, discounting or negligence should be illustrated and explained in comprehensive language. The same applies where claims are denied in whole or in part.

19.9.6 Sometimes intermediaries serve as an initial contact for claimants, which may be in the common interest of the policyholder, intermediary and insurer; however, this does not diminish the insurer's responsibilities.

19.9.7 A fair claims assessment requires appropriate competence of insurers' and – where applicable – intermediaries' staff who are involved in claims settlement procedures, as well as ongoing training.

19.9.8 Competence requirements for claims assessment differ depending on the type of insurance policy and generally include technical and legal expertise.

*Claims Disputes*

19.9.9 Staff handling claims disputes should be experienced in claims handling and be appropriately qualified. Adjusters should be able to make recommendations, independent of the insurers' instructions, on the settlement of individual claims.

19.9.10 Dispute Reinsurer procedures should follow a balanced approach, bearing in mind the legitimate interests of all parties involved. Procedures should avoid being overly complicated, such as having burdensome paperwork requirements. Decisions should include the reasoning in clear language relating closely to the specific disputable issues.

19.9.11 Supervisors may encourage insurers to ensure that relevant policies are in place by establishing a Claims Redress Committee acting as an appellate body within the insurer to promote fair play and objectivity in the decisions.

# Transparency in Life Insurance & Private Pension

Ayşegül Oktay\*

## 1. INTRODUCTION

Each year the global economy adds an estimated 150 million new customer of financial services. Protecting the interest of consumer has become an important component of sound and competitive financial markets. Even in well-developed markets, weak consumer protection and a lack of financial literacy can render households vulnerable to unfair and abusive practices by financial institutions as well as financial frauds and scams operated by intermediaries. At its heart, the need for consumer's protection arises from an imbalance of power, information and resources between consumers and financial service providers, most often placing a consumer at a disadvantage. Consumer protection aims to address this market failure.<sup>1</sup>

That is why Lord Sassoone has made the following statement under section 19(1)(a) of the United Kingdom Human Rights Act 1998.

"In my view the provisions of the Consumer Insurance (Disclosure and Representations) are compatible with the convention rights."<sup>2</sup>

A well-designed consumer protection framework can help the imbalances of power and information between consumers and financial institution.

### What Do We Mean by Transparency?

A financial sector should provide consumers with:

- Transparency by providing full, plain, adequate and comparable information about the prices, terms and conditions (and interest risks) of financial products and services,
- Choice by ensuring fair, non-coercive and reasonable practices in the selling of financial products and services and collection of payments;

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\* Head of Legal / Allianz Turkey

<sup>1</sup> Rodney Lester, "Consumer Protection Insurance," The World Bank, 7 August

<sup>2</sup> Lord Sassoone, "Consumer Insurance (Disclosure and Representation) Bill, Parliamentary Copyright House of Lords, London, 2011, p.55/1

- Redress by providing inexpensive and speedy mechanism to address complaints and resolve disputes (...)³ Those three key criteria which are inevitable in all financial products are enriched by portability, adequacy, flexibility, simplicity, security, cost saving and transparency for pension and life contracts, where a long tail contractual relation exists.

But in today's context the word "transparency" cannot be limited within the borders of a well-designed and consumer protecting terms and conditions of a contract, although this study's first aim is to focus on "disclosure and presentation" in life insurance and pension contracts due to the fact that a financial institution which have not a sound financial structure may not be eligible enough to protect insured's rights even if those rights are very well defined.

Therefore, when we talk about transparency we mean both;

- The financial transparency of the institutional body.
- And, contractual transparency of its financial products.

In this study, insured or policyholder means the individual who enters into an insurance contract wholly or mainly for purposes unrelated to the trade, business or profession.

## 2. FINANCIAL TRANSPARENCY

Overall desired outcome is an insurance industry that is adequately capitalized, soundly managed and that treats its customer fairly.<sup>4</sup>

In its April 2008 report, the Joint Forum of the Basel Committee on Banking Supervision, the International Organization of Securities Commission and the International Association of Insurance Supervisors identified three key risks related to possible "miss-selling" of financial products to retail customers.<sup>5</sup>

They are: (1) legal risk, if successful lawsuits from collective action by customers or enforcement actions by supervisory agencies result in obligations to pay financial compensation or fines; (2) short-term liquidity risk and long term solvency risk, if retail customer are treated unfairly and thus shun the financial institution and withdraw their business; and (3) contagion risk, if the problems of one financial institution (or type of financial product) spread across the financial sector.

The insurers are not susceptible as banks to a loss of confidence. Of course if policyholders lose confidence in the market, the future for insurance companies will be grim; however, this will not bring about the collapse of the system in the short term. Unlike banks, their customers are not automatically creditors. A policyholder only

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<sup>3</sup> Rodney Lester, p.2

<sup>4</sup> Sarch Wilson, FSA, "The future of Life Insurance: Great Transparency and fairness" <http://www.fsa.gov.uk/library/communication/speectos/2006>

<sup>5</sup> Rodney Lester, p.2

becomes a creditor on the occurrence of a loss, causing event covered by the policy. In the majority of policies this event will not occur during the period covered. There cannot be a “run” on a general insurer.<sup>6</sup>

But on the other hand, insurance companies have a great importance on individuals by alleviating the financial hardship if a covered risk takes place, and on an economy by giving a considerable amount of saving, providing financial security to household and enterprises and financing the development.

This is even more important in a long term life insurance & pension contract promising a financial stability to individuals.

That is why the supervisory authorities impose rules to facilitate customer’s periodic control on their on-going contracts as to their returns on investment and the conformity with their expectations.

For this reason;

- The customer should receive periodic statements of the value of their policy in the case of savings and investment contracts. For traditional savings contracts this should be at least yearly, however more frequent statements should be produced for investment linked contracts.
- Customers should have a means to dispute the accuracy of the transactions recorded in the statement within a stipulated period.
- Insurers should be required to disclose the cash value of a traditional savings or investment contract upon demand and within a reasonable time. In addition a table showing projected cash values should be provided at the time of delivery of the initial contract and at a time of any subsequent adjustments.

Apart from the conformity of an insurance policy with consumer’s expectations, an insurance contract benefits can be obtainable only if an insurance company is financially sound.

This fact obliges to launch financial criteria showing the soundness of insurance companies. As a general rule;

- Every insurance undertaking is required to establish an available solvency margin in respect of its entire business.
- The solvency margin shall correspond to the assets of the undertaking free of any foreseeable liabilities less any intangible item.
- Detailed rules of assets that can be included in the available solvency margin.<sup>7</sup>

The problem with this solvency requirement for several insurers (now known as Solvency I) is that it is rather crude “one size fits all” sets of rules. Therefore the standard is the same irrespective of the business activities of an insurer.

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<sup>6</sup> *ibid*, p.124

<sup>7</sup> [http://europa.eu.int/comm/internal\\_market/insurance](http://europa.eu.int/comm/internal_market/insurance) (michaela surchardova) p.13

Another criticism of the Solvency I approach is that it only considers underwriting risk. The rules are not designed to take into account credit, market or liquidity risk.

Initially the EU announced back in 2001 that they would be moving towards implementation of solvency II in 2004. This was rapidly put back as the complexity of the programme was realised. In July 2007, the European Commission announced that they were going to “take a global lead in insurance regulation” .... by 2013. So for it appears that this remains the deadline.

The Solvency II exercise envisages a principals-based system, similar to the Basel II approach. Under the new system, the insurers themselves would need to assess their capital needs, which would reflect business activities, degree of volatility, availability of reinsurance and other risk-relevant factors such as credit, market and liquidity risks. This would be termed the own risk and solvency assessment. The role of the regulator would no longer be concentrated on the monitoring of rule compliance, but would become one of evaluation of insurers’ risk profile, solvency assessment, risk management and governance systems via the Supervisory Review Process.

Finally, the system will be underpinned by transparency, discipline and disclosure. This requires full disclosure to the regulator together with the regulator adapting an inquisitorial stance where appropriate.<sup>8</sup>

The transparency will be consistent by means of the public supervision authority which has to publish annual public reports related to the strength and soundness of insurance sector and insurers are required to provide their financial information to enable the general public to form an opinion as to the financial situation of the company.

### 3. CONTRACTUAL TRANSPARENCY

Financial transparency is a very useful and almost sufficient tool to protect consumers of financial product from serious uncertainties. It is obvious that the transparency of an insurance product as to its terms and conditions is very important from the points of view of consumer-policy holder protection.

This arises from the opaque if not, ambiguous or uncertain perception of insurance products by the consumer.<sup>9</sup>

Consumer products can be broken into three categories: **search goods** (can be assessed in advance of purchase-e.g. a piece of art), **experience goods** (can be assessed relatively quickly with use- e.g. soap powder), **credence good** (attributes only discovered after a long delay or upon occurrence of contingent event or never-e.g. a mutual fund). Insurance clearly fits into the credence good category and the sector thus relies heavily on the public’s trust that it will deliver what it promises.<sup>10</sup>

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<sup>8</sup> Rodney Lester, p.125

<sup>9</sup> Standard&Poor’s, “Disclosure&Transparency in Insurance: A rating Agency Perspective” David Anthony, AFIRC Conference, 17-18th October, 2011, Lebanon, p.3

<sup>10</sup> Rodney Lester, p.125

Therefore contractual transparency is a duty of insurer towards consumer before the inception of an insurance contract.

Because the aim of policy holder protection should surely be to:

- a) Protect policyholders against losses arising from fraud (...) of insurer or intermediaries.
- b) Ensure that policyholders are not misled as to the nature or suitability of the policy due to the insurers'/ intermediaries' greater expertise.
- c) Prevent insurers from unfairly avoiding claims.
- d) Provide compensation for policyholders who suffer loss due to negligent advice or performance.<sup>11</sup>

The insurance contract is no exception to the general rule requiring offer, acceptance, agreement, consideration and intention to create legal relations in or to find a binding legal contract.<sup>12</sup> An offer to enter into an insurance contract may be made by a prospective insured or by an insurer. Regardless to which party is the proposer, an insurance contract -likewise other legal contract- is supposed to be concluded with good faith.

Good faith "bona fide" may require varying conduct in response to different stages of a contract's life. During the negotiations leading to a contract, good faith might require the parties to;

- a) keep every promise which is made,
- b) negotiate in such a way as to avoid taking advantage of another or the counterpart suffering prejudice,
- c) do one's best to complete the negotiations,
- d) act fairly and honestly,
- e) co-operate,
- f) inform the other party of all the needs to know,
- g) avoid lies and misleading conduct,
- h) abstain from fraud<sup>13</sup>

Additionally, in British Law "whereas under general law of contract there is no positive duty of disclosure, contracts of insurance are species of contracts *uberrimae fidei* (of utmost good faith)": Consequently, both parties, i.e. the insured and the insurer are bound to disclose every material fact affecting the risk to the other before the contract is concluded."<sup>14</sup>

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<sup>11</sup> Rob Thoys, **Insurance Theory and Practice**, Routledge, London and New York, 2010, p.241

<sup>12</sup> John Lowry, Philip Rawlings and Robert Merkin, **Insurance Law, Doctrines and Principles**, Third Edition, Oxford and Portland, Oregon, 2011, p.84

<sup>13</sup> Peter Macdonald Eggers, Simon Picken, Patrick Foss, **Good Faith and Insurance Contracts**, Third Edition, Lloyd's List, London, 2010, p.6

<sup>14</sup> John Lowry, p.84

### **a. Historical Background of the Disclosure Obligation**

In practice, non-disclosure was considered as a duty of the insured and was often used as a defence mechanism of insurer against payment of claims.

Also much of the jurisprudence developed by the courts over the years which have marked the development of the duty has been concerned principally with the position of the assured in bearing the full weight of the obligation to observe good faith in his dealing with the insurer, chiefly because the assured knows much more about the insured risk than the insurer.<sup>15</sup>

On the other hand, there had been some examples as to the duty of utmost good faith to be obeyed by insurers as well. The fact that “the duty of good faith is mutual” was first recognized by Lord Mansfield in *Carter V Boehm* in 1766. In that case, the Lord Chief Justice preferred an example of an underwriter accepting the insurance of a vessel for a voyage, which the underwriter, but not the assured, knew to have arrived.

The first law regulating the mutual obligation of utmost good faith was Marine Act 1906.

According to section 17 “Disclosure and Representations,” a contract of marine insurance is a contract based upon the utmost good faith, and if the utmost good faith be not observed by either party, the contract may be avoided by the other party.

Section 19 of the Marine Insurance Act 1906 goes on to lay down a separate duty of disclosure by intermediaries (agents or brokers) who are responsible for placing the cover on behalf of the insured. Their duty has two limbs. First, section (a) provides that agents must disclose every material circumstance actually known to them or which in the ordinary course of business ought to be known by, or to have been communicated to them. Secondly, section 19 (b) provides that they must disclose every material circumstance which the insured is bound to disclose (unless it comes to the knowledge of the insured too late.)<sup>16</sup>

The logic defined under those two sections was first recognized for a life insurance contract by the courts in 1909. It was *Refugee Assurance Company Limited V Kettlewell* case, where the insurer’s agent represented to the assured that if she paid four more years’ premium (and so renewed the life policy), she would be entitled to a free policy without the need of paying any further premium. The Court of Appeal, whose judgment was approved by the House of Lords, held the assured to be entitled to recover the premium as money had and received, alternatively damages, on the ground of fraudulent misrepresentation.<sup>17</sup> But the court did not address the misrepresentation as offending any notion of good faith peculiar to insurance contract.

Indeed the subject had not been discussed under the aegis of good faith until *Banque*

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<sup>15</sup> Peter Macdonald Eggers, Simon Picken, Patrick Foss, p.301

<sup>16</sup> *ibid*, p.110

<sup>17</sup> *ibid*, p.302

Financière de la Cité V Westgate Insurance Co Ltd (sub nom Banque Keyser Ullman SA V Skandia UK Insurance Co Ltd-1990). In this case, Banque Financiere agreed to make some very substantial loans on condition that, *inter alia*, binding contract of credit insurance had been issued before the money would be advanced. A fraudulent broker issued cover notes to the banks despite there was a shortfall in the cover. This misrepresentation of the broker was discovered by a senior underwriter but this was not told to the Bank. Then a fraudster borrower didn't refund the money back to the bank and bank made a claim against the broker and claimed on the insurance contract as well. Their claim was rejected by the insurer arguing that the contract contained a clause against fraud attempted by any person. Then, the Bank sued the insurer for damages for the latter's failure to disclose to them the broker's fraud. In this piece of litigation, it was explicitly declared that the requirement of utmost good faith applies to both parties to the insurance contract and there was a bold attempt by the judge having applied such a duty on an insurer. The court of Appeal and House of Lords accepted that there was a duty, however they held that the only remedy for breach was the traditional one of avoidance of the contract.

But in other cases the Court of Appeals rejected such kind of claims due to the reason that insurance law did not refer to damages being available for a breach of the requirement of utmost good faith.

### **b. Today's Practice of Disclosure Obligation**

However recent development in consumer rights and protection obliges insurers to bear their responsibility arising out of the duty of "disclosure" as a matter of good faith.

To protect the consumers right in insurance, many attempts have been made worldwide. By means of those attempts, disclosure requirements from insurers have been set by some rules, starting from advertisement and marketing to the inception of the policy.

As to our main subject of the study, those issues have greater importance due to the reason that, "the modern forms of life policies are numerous, ranging from the traditional whole life policy which simply pays an agreed sum of money on the date of the life insured, and the term policy which pays on death within a stated time, through endowment policies, often linked to mortgages effected for house purchase, to annuities and policies linked to investment in securities or property."<sup>18</sup>

In the context of a pure life policy, arguments of this kind are rare, but they are very common in relation to investment policies, where investors allege that statements as to likely investment return, or guarantees against loss or likely surrender values have been made and have been incorporated into the contract.<sup>19</sup>

In addition to that, pension scheme members would be provided with full and regular information about their schemes in precisely the same way that shareholders receive information about their companies. The information would cover:

<sup>18</sup> John Birds, **Bird's Modern Insurance Law**, Eight Edition, Sweet&Maxwell, London, 2010, p.363

<sup>19</sup> Andrew McGee, **Life Assurance Contracts**, Routledge, Caverdish, Oxon, 2006, p.33

- the status of employee and employer contributions into the scheme;
- the value and type of assets in the pension fund;
- the rates of return generated on the assets;
- the fees or commissions charged by the scheme administrator and pension fund manager
- an estimate of the weekly pension that the current value of the assets can be expected to buy at normal retirement age.

Summary information on scheme structure and performance would be made publicly available.<sup>20</sup>

Thus, in many countries legislators introduced some rules into the market defining insurer's duty to inform consumers. In principal, all texts stresses on the duty of the insurer that must provide consumer-policyholder with all relevant information concerning the insurance contract under negotiations.

The form of this information must be in writing, and the aim is to protect consumer from non-disclosure of insurer and protect insurer from complaints of consumer that some issues were not disclosed and also prevent the consumer from withdrawal for this reason.<sup>21</sup>

The same tendency has been seen in all countries under observation in this study, for instance, under code of Federal Regulations in USA, any depository institution or any person selling, soliciting, advertising or offering insurance product or annuities to a consumer at an office of the institution or on behalf of the institution must disclose the following:

- 1) The insurance product or annuity is not a deposit or other obligation of, or guaranteed by, the depository institution or its affiliate;
- 2) The insurance product or annuity is not insured by the Federal Deposit Insurance Corporation or any other agency of the United States, the depository institution or its affiliate.
- 3) In the case of an insurance product or annuity that involves an investment risk, there is investment risk associated with the product, including the possible loss of value.

These disclosures must be made orally and in writing before completion of the sale of an insurance product or annuity (...) <sup>22</sup> (published 4 December 2000) (effective from 1 April 2001).

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<sup>20</sup> David Blake, **Pension Schemes and Pension Funds in the United Kingdom**, Oxford University Press, 2nd Edition, forthcoming

<sup>21</sup> Ana Kegljevic, "Precontractual information duties in Insurance contract law. European Regulation, Comparison of Laws and challenges for Croatia"

<sup>22</sup> Board of Governors of the Federal Reserve System, Federal Report Insurance Corp., [www.federalreserve.gov/bacarddocs/press](http://www.federalreserve.gov/bacarddocs/press)

Another discussion in USA, standardization of policy wording which is actually quite old issue which was first started in the early twentieth century, when numerous insurance companies failed after a massive earthquake. Of course, there are various justifications and explanations for policy standardization other than facilitating, allow consumers to more easily comparison shop on the price and service. Improved comparison shopping through standardization not only presents a race to the bottom but also arguably limits competition among insurer on the basis of misleading comparisons, fringe coverage and other non-price considerations.

The European Council issued directive on Unfair Terms in Consumer Contracts in 1993 (93/13/EEC). This directive provides that a contractual term which is not “individually negotiated” will be unfair where it causes contrary to “the requirement of good faith”, “a significant imbalance in the parties”, contractual right and obligations to the detriment of the consumer.

Where the terms of a contract are offered to a consumer, the terms must be in “plain intelligible language” and where there is a doubt about the meaning of the term, the “interpretation favourable to the consumer shall prevail.”<sup>23</sup>

Also several directives in Europe hold financial institutions responsible for the content of their public announcement. These are the Directive on the Distance Marketing of Financial Services, 2002/65/EC and the Directive on Comparative Advertising, 1997/55/EEC.

As to the transparency in life assurance, according to the Art.36 and annex 111 of Directive 2002/83/EC, a written information to policyholders must be submitted relating to the definition of benefits, term of the contract, means of payment of premiums, surrender value and paid-up value (if any) and a cancellation period. Art 35 states that the policyholder has to have the opportunity to cancel the contract within a period of between 14 and 30 days from the time the policy holder was informed that the contract was incepted (cooling of period). Since the life insurance contract is a long-term contract, individual may be persuaded by high pressure salesmanship to enter into contracts which may not be entirely appropriate for them.

When we examine the impact of those directives and market dynamics, almost the same requirements for disclosure are codified in member countries under consideration e.g. in Great Britain [Consumer Insurance (Disclosure and Representation) Act 2011]; Germany (new VVG 2008 and VVG-Info V), Italy (ISVAP Regulation No:35 26 May 2010).

As a summary, all those countries introduced for the purpose of consolidating the duties of transparency and disclosure for insurance undertakings and the obligation to deliver to the policyholder a written information containing all general and special terms and conditions applicable to the insurance contract.

Nevertheless the insurance contract rules are not harmonized in life assurance and pension.

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<sup>23</sup> Peter Macdonald Eggers, Simon Picken, Patrick Foss, p.301

But Life-Insurance may require systematic notification of technical bases used for calculating scales of premiums and technical provisions despite this cannot be required as a prior condition for carrying a business (Directive 2002/83/EC art 6).

Also there is not a prior approval or systematic notification by supervisory authorities in both Home and in Host State, But a posterior and non-systematic control is being done.

#### 4. TRANSPARENCY REQUIREMENTS

As a conduct of business, mainly the following information must be disclosed to consumers:

- 1) The name and the main business of the firm, the geographical address.
- 2) Where the firm has a representative established in the Consumer's state of residence, the name of that representative and geographical address.
- 3) The name and address of the insurance intermediary (if any)
- 4) Standardization to some external or at least a type of control on policy wording may be useful.
- 5) Insurers should ensure their advertising and sales materials and procedures do not mislead customers. Regulatory limits should be placed on investment returns used in life insurance value projections.<sup>24</sup>
- 6) Insurers should be legally responsible for all statements made in marketing and sales materials they produce related to their products.<sup>25</sup>
- 7) All marketing and sales materials should be easily readable and understandable by the general public.<sup>26</sup>
- 8) A key facts document should be attached to all sales and contractual documents, disclosing the key factor of the insurance product or services in large print.<sup>27</sup>
- 9) The consumer should have the right to require disclosure of commission paid to an intermediary for long term savings contracts.
- 10) There must be a reasonable cooling off period for long term life saving contract,
- 11) A definition of each benefit and option.<sup>28</sup>

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<sup>24</sup> Rodney Lester, p.11

<sup>25</sup> *ibid*, p.11

<sup>26</sup> *ibid*, p.11

<sup>27</sup> *ibid*, p.11

<sup>28</sup> John Birds, p.364

- 12) The term of the contract and the means by which it may be terminated.<sup>29</sup>
- 13) The method of calculating bonuses and the distribution of bonuses.<sup>30</sup>
- 14) An indication of surrender and paid-up values and the extent to which these values are guaranteed.<sup>31</sup>
- 15) An indication of the premiums for each benefit.<sup>32</sup>
- 16) In respect of unit linked policies, a definition of the units and an indication of the nature of the underlying assets<sup>33</sup> for a unit linked policy, charges and expiries are all explicit charges and expenses the customer may bear.<sup>34</sup>
- 17) The period within which the policyholder may cancel the contract.<sup>35</sup>
- 18) The tax arrangements applicable to the policy.<sup>36</sup>
- 19) The arrangements for hedging complaints.<sup>37</sup>
- 20) The law applicable to the contract.<sup>38</sup>
- 21) Any document containing a projection must contain an example, tables, deductions summary, commission and remuneration and a statement telling that these figures are only examples and not guaranteed.

#### 4.1. Results of non-disclosure or misrepresentation of the insurer and its agent

What remedies are available to the victim of bad faith?

- Avoidance (rescission): Avoidance of a contract refers to the remedy which allows the settings aside of a contract which has been agreed and otherwise would be enforceable, as if the contract had never been agreed. It involves the extinction of the contract *ab initio*. This must be a breach of the duty of good faith in the agreement of an insurance contract because of the misrepresentation or non-disclosure of a material fact.
- Termination of the insurance contract: Such an option may be preferable if, for example, the innocent party wishes to retain the benefits transferred to him already under the contract (for example, the premium which has been made).

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<sup>29</sup> *ibid*, p.364

<sup>30</sup> *ibid*, p.364

<sup>31</sup> *ibid*, p.364

<sup>32</sup> *ibid*, p.364

<sup>33</sup> *ibid*, p.364

<sup>34</sup> Andrew McGee, p.109

<sup>35</sup> John Birds, p.364

<sup>36</sup> *ibid*, p.364

<sup>37</sup> *ibid*, p.364

<sup>38</sup> *ibid*, p.364

- Compensation: If the innocent party was included to enter into the contract by reason of the misrepresentation, the fact is material that its tendency was to induce the represented to contract; an innocent party may be compensated. The plaintiff's right to claim damages for the tort of deceit is treated as a cumulative, not an alternative, right to claim avoidance or rescission of the contract which was born of the fraudulent misrepresentation. Damages will be available in the established categories of deceit, negligent misrepresentation and breach of the contract by the insurer.<sup>39</sup>

What will happen if non-disclosure and misrepresentation was done by an agent?

It is often critical to determine whether the agent's principal is the insured or the insurer. For example, where a material fact is disclosed by the insured to the agent, the insurer will not be able to avoid the policy for non-disclosure if it is found to be the agent's principal and the court imputes the agent's knowledge of the material fact to it. Identifying the agent's duties is owed.

As far as it is possible to formulate a general rule, it can be said that agents and brokers are presumed to be the agents of the insured, while company representatives (agents and employees), are deemed to be agents of the insurer.<sup>40</sup>

If a written answer in the proposal form failed to disclose a material fact made known to the agent at the time of its completion because the agent innocently, negligently or fraudulently transcribed an incorrect answer, the issue that arose was whether the agent's actual knowledge could be imputed to the insurer.<sup>41</sup>

That's very important information because as a principal, an agent is imputed to his principal so that the latter is deemed to know what the agent knows. Therefore, when an intermediary does something as an appointed representative of the insurer, and/or when he collects information from the consumer having been explicitly authorized to do so by the insurer and when he enter into the contract as the insurer's agent, any failure of disclosure makes responsible his principal, that is to say the insurer. If the agent is the representative of the insured (broker) any failure to ask the insured about facts that the broker knows material, makes him liable in damages to the insured if the insurer doesn't accept liability. If a broker is liable in damage to the insured, the remedy will usually be the same as the indemnity that insured would recover from the insurer.

All insurance intermediaries should be licensed and proof of license should be readily available to the general public, and their sales personal must have educational background and sufficient qualifications especially for intermediaries selling long term saving and investment insurance products.

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<sup>39</sup> Peter Macdonald Eggers, Simon Picken, Patrick Foss, p.508

<sup>40</sup> John Lory, Philip Rawlings and Robert Merkin, p.9

<sup>41</sup> *ibid*, p.64

## 5. TRANSPARENCY IN TURKEY

### 5.1. Financial Transparency

Insurance and Reinsurance companies must keep their financial statements according to the unique format defined by the Undersecretariat of Treasury (“Treasury”) and publish them at the end of each accounting period. Statements must be announced to the public with an independent auditor’s opinion (Insurance Law, No.5684, 14.06.2007 Art. 18).

According to the regulation about Financial Reporting of Insurance, Reinsurance and Private Pensions Companies (Official Gazette no:26582, 14.07.2007), financial statements consist of the balance sheet, income statement (P/L), cash flow and the statement of changes in equity and dividend pay-out tables (Art.5). Companies must publish their annual reports after the yearly shareholders’ assembly of the company through two daily newspapers as per the Treasury definition of newspaper which takes circulation rate into consideration, and submit them both to the Treasury and Association of Turkish Insurance and Reinsurance Companies.

Insurance Law empowered Treasury to regulate the solvency criteria of insurance and reinsurance companies and other insurance entities. The Treasury used this power by the regulation on Solvency of Insurance, Reinsurance and Pension Companies published on January 19, 2008 (Official Gazette No.26761).

In this Regulation, it is stated that the minimum equity of the company shall be the highest of the results calculated according to the article 7 defining solvency margin in conformity with EU and the article 8 defining risk based capital. And one third of the equity requirement is the minimum amount of guarantee fund. (Art.6)

Solvency Margin Calculation Method: This method is being used especially in EU. The solvency margin is the amount of the regulatory capital which an insurance undertaking is obliged to hold against unforeseen events.

Risk Based Capital Method: It has been mainly used in the US and partially in Japan and also in UK since 1980’s and 1990’s. There are six items to be calculated in this method.

- a) Asset Risk  
Each of asset items of the balance sheet is multiplied by a risk coefficient.
- b) Reinsurance Risk:  
Premiums ceded to Reinsurer multiplied by coefficients defined by the Treasury
- c) Excessive Premium Increase Risk  
Excessive increase is multiplied by 0.2, if increase is 10% above industrial average in obligatory insurance and 50% in other lines
- d) Outstanding Claims Provision Risk  
Net outstanding claims of a branch x coefficient of this branch
- e) Underwriting Risk  
Gross Written Premium x coefficient of insurance branch

f) Currency Risk

Currencies booked in asset and liabilities of the balance sheet converted to TL, then  $(\text{Currency in asset} - \text{currency in liability}) \times 0,075$

On the other hand, in the Private Pension Law, a Pension Monitoring Centre was established to;

- a) Form an infrastructure which facilitates the auditing of pension companies to protect rights of the contributors,
- b) Keep contributors and public authorities informed,
- c) Keep data about contributors, accounts, pension schemes and consolidation of transactions,

Similarly, under the management of the Insurance Data Centre, a unit called “Life Insurance Data Centre” was established and it has a very similar function (Regulation 09.08.2008).

Additionally, all insurance companies must be subject to an external audit according to the regulation published in Official Gazette No: 26934 (July 12, 2008)

An atypical precaution in Turkish Insurance Law, the Companies have to lodge a deposit in favour of the Treasury to protect the insured’s receivables from the companies in case of liquidation, bankruptcy etc. According to the Law 5684, Insurance Companies operating in the life branch must deposit an amount which is equal to their mathematical reserves of the collected premiums, plus outstanding loss. This deposit can be solely used for insured’s claims and cannot be pledged, attached or sequestered by any other party even in case of a bankruptcy.

Finally, under the new Turkish Commercial Law all capital stock companies are obliged to create a Web site; if the company already has a Web site, it must allocate part for “information society” services. The New Law defines “information society” as a society with access to information. The content uploaded according to the article 1524 on the Web site is kept there for at least six months from the upload date, or it is deemed not to have been uploaded. For financial statements, this period is five years.

## 5.2. Contractual Transparency in Turkey

As it was explained in chapter five of this study, the contractual transparency brings responsibilities on to insurance companies and agents. In this chapter we will see how this issue has been regulated in the Turkish Market.

In private law, it is always considered that both parties participating into a contract have equal powers. This consideration doesn’t reflect the reality in insurance contracts where there is an imbalance of power between parties.

The United Nations defined the rights of the consumer in 1985 and the first law passed through the Turkish Parliament in 1995 (Customer Protection Law). In the third article of this law, a customer is defined as a real or legal person who purchases any kind of goods or services without any commercial or professional purpose.

### 5.2.1. Historical Background

In current Turkish Commercial Law which will be applicable until July 2012, articles relating to insurance contracts are codified in the fifth book however there is not any article concerning consumer insurance (Law No.6762, 09.07.1956).<sup>42</sup>

Disclosure Obligation of the insured was considered as a part of “*bona fide*” defined in Turkish Civil Code Act.2 about honesty. As a member of the continental European Law family, Turkish practices were satisfied with this definition and didn't define “*uberrimae fides*” separately.

Although the old Insurance Supervision Act (Law No.7397, 21.12.1959) brought regulations which dealt with the control and audit of insurance companies, it included some articles relating to life insurance contracts explicitly, and with an article added with law No.3379 to the said law, insurance and reinsurance companies and their intermediaries and loss adjusters were obliged to act according to the rules of “*bona fide*”.

The first attempt as to the disclosure obligation of the insurer came into force with Private Pension Law (Law No.4632, 7.4.2001) and new rules launched for misrepresentation and advertisement.

In 2006 the Treasury made other attempt and issued a regulation dated November 28, 2006, referring to the Law 7397 (Art: Add2), but this regulation didn't actually come into force until a new law on Insurance was accepted by the Parliament on June 3, 2007.

Since 2007, the following rules have come into force:

28.10.2007		Regulation on Disclosure in Insurance Contract
27.08.2007	Circular 2007/9	“Circular on Covers in Insurance Contracts”
06.11.2007	Circular 2007/18	“Circular on Pre-contractual Disclosure Obligation”
19.02.2008	Circular 2008/7	“Circular on application of the Regulation related to the disclosure in insurance contracts”
01.05.2008	Circular 2008/12	“Circular on application of the Regulation related to the disclosure in insurance contracts”
19.09.2008	Circular 2008/28	“Circular on Reports to be prepared within the scope of 12 <sup>th</sup> Article of the Disclosure Regulation”
07.03.2008	Announcement	“Announcement on Circular 2008/7”

### 5.3. Parties Responsible For Disclosure

#### 5.3.1. Insurance and Pension Companies

According to Turkish Regulations, Pension Companies can be established as corporate companies and insurance companies can be established either as corporate or mutual companies.

<sup>42</sup> Zihni Metezade, Nurettin T.Güleli, **Türk Ticaret Kanunu Altıncı Kitap, Sigorta Hukuk Açıklamalı ve İçtihatli**, Güner Yayınları, İstanbul, 2011, p.52

Registered capital of the pension company must be at least 20,000,000 Turkish lira and paid-up capital must be 10,000,000 Turkish lira of which the outstanding amount will be committed to be paid in 3 years (Law No.4632, Art.8).

For insurance and reinsurance companies, the Treasury is entitled to determine that the minimum paid-up capital must not be less than five million Turkish lira, by taking into consideration the branch licenses demanded by the company and insurance cover provided for the insured's. The Treasury is allowed to increase the minimum capital requirement according to the inflation ratio declared by Turkish Statistic Institution (Regulation 14.06.2007, *Official Gazette* No.26552).

As a result of this power given by the law, the Treasury asks investors to lodge a cash amount of 11 million Turkish lira into the bank account and demands a financial power of five times of the minimum capital requirement from the investors.

**Licenses** given to the companies for branches **must be published in the Trade Registry Gazette and announced publicly in two daily newspapers** ranked amongst the top 10 in circulation.

### 5.3.2. Intermediaries

There are three types of intermediaries operations in the Turkish Insurance and Pension Market: Agencies, Brokers and Pension Intermediaries.

Agencies can be established as real or legal entities and must be registered with the Turkish Union of Chambers and Commodity Exchanges of Turkey (TOBB). This registration requires prior approval of the Treasury and then must be **published on the TOBB website** . Minimum requirement of capital is 25,000 Turkish lira and 4 percent of the total annual written premiums must be added to its equity. **Limits of the authorization** given to agencies by insurance companies must be registered and **published in the Trade Registry Gazette** and sent to TOBB within 15 days. **Agencies signs** must show clearly the name of the insurance company which the agencies works for as an intermediary, a statement declaring that the agency is an intermediary only and they must not display any fraudulent or false information to the public.

Agencies must possess a professional liability cover of 10,000 Turkish lira per event and 100,000 Turkish lira as aggregate.

Technical staff of the agencies must obtain a professional ID card given by TOBB. **One who does not possess and/or submit an ID Card cannot act as an intermediary** in insurance contracts (Regulation 14.4.2008, *Official Gazette* 26847).

Brokers are licensed by the Undersecretariat of Treasury (Law No.5684). Those licenses are given depending on the branches that the broker will operate at and they are separately issued as life, non-life and reinsurance licenses. **Licensed Brokers are announced through the Trade Registry Gazette and through two of 10** daily newspapers ranked in respect of their circulation. The limits of their professional liability cover are 250,000 Turkish lira per event and 1,000,000 Turkish lira per annum. Minimum capital is 100,000 Turkish lira and additional 25,000 Turkish lira is required for each branch. **On their sign, the term “Broker” must be included** (Regulation 21.6.2008).

In the regulations for Pension Intermediaries dated August 29, 2009, it is stated that; Intermediaries must take an exam organized by the Pension Monitoring Center. Intermediaries must possess a university diploma of four years or a diploma of two years on insurance, banking, and stock exchange.

They must obtain **a license and a professional ID to act as an intermediary** and they must participate in complementary training courses annually after the first two years.

#### **5.4. Main Regulations as to the Transparency in Life Insurance**

According to the new Turkish Commercial Law to be in force as of July 1, disclosure obligation of the insurer is defined in Art.1423.

“The insurer and its agency must disclose in writing to the contractor all information related to the insurance contract to be concluded, i.e. rights of the insured and insured’s obligation of disclosure with respect to the material facts before the inception of the contract. Additionally, the insurer and its agency must declare to the insured in written form the events and developments to be considered ‘material’ during the progress of legal relation arising out of the contract.”

Also, in Insurance Law (No.5684) almost the same definition was done and it is stated that disclosure obligation of the insurer will be regulated by the Undersecretariat of Treasury (Art.11).

Those obligations are very similar to the obligation brought by Private Pension Law (No.4632) in 2001 where it is clearly stated that Pension Companies and intermediaries are prohibited to make any faulty, fraudulent or wrong statement to contributors, third parties and corporate bodies.

In the regulation on disclosure in insurance contracts, the minimum content of the disclosure was defined by the Treasury:

- a) The name of the company and agency
- b) Information in general relating to the contracts
- c) Risks covered
- d) Exclusions that may be covered under the policy with special conditions, and information about clauses
- e) Information about the claims procedure
- f) Complaints management and arbitration

With circular No.2009/3 relating to Life Insurance, two more items were added to the above list:

- a) Deductions from the premium (administrative and acquisition costs)
- b) Taxation

In the new form for life insurance which has been applicable since January 3, 2009, there are various types of benefits/cover given to the insured (Circular 2009/3) such as,

term insurance, whole life policies, policies with profit, endowment policies, marriage-birth policies and unit link policies.

General Information to be given to the insured is as follows:

- Insured benefit amount can be freely defined by parties.
- Insured has always right to make policies with other insurers.
- The coverage can be increased with both parties' consent during the contract term.
- It is forbidden to make a contract upon the death of an infant, incompetent and immature person.
- Conditions regarding the repurchase, loan and lapse of the policy.

### 5.5. Complementary Rules for transparency

- In both Insurance Law and new Commerce Law it is stated that **“the proposal relating to a life insurance will be deemed to be in force if it was not rejected by the insurer within 30 days.”**
- In both life insurance and pension contracts, **administrative costs** and acquisition costs **must be declared** to the contractor.
- **The insurer** is kept **obliged to deliver the insurance policy** to the insured in the case that the insurance contract is issued by themselves or through their agencies within 24 hours. The insurer is responsible for any loss arising from the late delivery of the policy.
- For a **minimum standardization of the policy**, the main policy wording (general conditions) is subject to the approval of the Treasury.
- In case of non-delivery of the policy, the proof of it is subject to the general terms and conditions.
- As an atypical rule, in insurance contracts, **the excluded risks must be explicitly defined**. Those risks which are not excluded explicitly will be deemed to be covered by the contract.
- **The insured may void the contract** within fifteen days from the insurer's notification of his rights of avoidance. The availability of the notification shall be proved by the insurer. In case a notification has not been done, the right of avoidance shall be terminated within one month of payment of the first premium.
- **Claims** shall become due after the delivery of all relevant data to the insurer and after termination of the insurer's investigation but in any case not later than 15 days after the notification of claim.
- **Complaints and information** service will be managed by the company itself by a unit consisting of two people as a minimum and reports on the complaints must be submitted to the Treasury.
- Within the Turkish Insurance and Reinsurance Companies Association, a

**commission of arbitration** is established to solve conflicts between insurance contractors and beneficiaries and risk undertaking entities. Insurance bodies that would like to participate in arbitration system must apply to the commission in writing. The decision of the commission is definitive for cases up to 40,000 Turkish liras. Upon exceeding this amount, the parties may apply to the Court of Appeal. The decision of the Arbitration Committee will be announced online.

- Both insurance and pension companies are prohibited to make false, fraudulent announcements and misrepresentations or engage in unfair competition. Any kind of explanatory booklet, declaration, announcement or advertisement must conform to the rules set by the committee of Advertisement.

### 5.6. Result of Non-disclosure

In the new Turkish Commercial Law, it is stated that “in case of failure in delivering disclosure declaration to the insured, if the contractor doesn’t reject the contract within 14 days, then the contract is deemed to be concluded depending on the terms and conditions stated on the policy. The insurer is responsible for proving the delivery of the disclosure declaration to the insured.”

In the regulation related to the Disclosure in Insurance Contracts, it is stressed that during the negotiations, conclusion and proceeding of the insurance contract, in case,

- a) the disclosure procedure has not been fulfilled properly,
- b) of the availability of any misrepresentation relating to insurer,
- c) of a non-delivery of the disclosure form;
- d) Information on the form does not reflect reality and if any one condition has misled the insured to a faulty decision he is entitled both to cancel the contract and to claim for damages.

*Culpa in contrahendo* means delinquency/defect within the negotiation of the contract.<sup>43</sup> If any loss arises as a result, the offending party must compensate all losses. This principal sets a rule for the negotiation period (pre-contractual period).

As a result, the disclosure responsibility that was not accomplished properly by the insurer or any misrepresentation about the insurer, or non-delivery of the disclosure form, gives the insured the right of avoidance or cancellation of the policy.

If the insured is misinformed by the insurer or agent during the negotiation and if a loss occurs, the insured will be entitled to demand indemnity.

<sup>43</sup> Evrim Akgün, “Sigorta Sözleşmelerinde Bilgilendirme Yükümlülüğü” Yüksek Lisans Tezi, Bahçeşehir Üniversitesi, İstanbul 2010, p.80

## **6. CONCLUSION**

As explained in this study, the need for consumer protection arises from an imbalance of power and resources between the seller and buyer. This imbalance of power inherently places the consumer at a disadvantage. In the past, disclosure obligation was considered mainly as a responsibility of the insured and non-disclosure and misrepresentation of the insurer or its agent was tried to be solved according to the general principals of contract law.

Since private law presumes that both parties have equal power, the consumer, or the insured, was in a more fragile position. For this reason many international and domestic attempts were made to fortify the consumer's position. United Nations defined consumer rights in 1985 and many countries passed Consumer Protection Laws through their legislative systems.

The complexity of insurance contracts caused misunderstandings amongst ordinary consumers which obliged legislators and public authorities to launch new regulations to provide better information for the consumer. In parallel with these developments in consumer rights, Turkey has adopted new regulations to protect policyholder's rights, mostly conforming to the European Union Law. These rules and regulations meet the transparency requirements outlined in this report.





