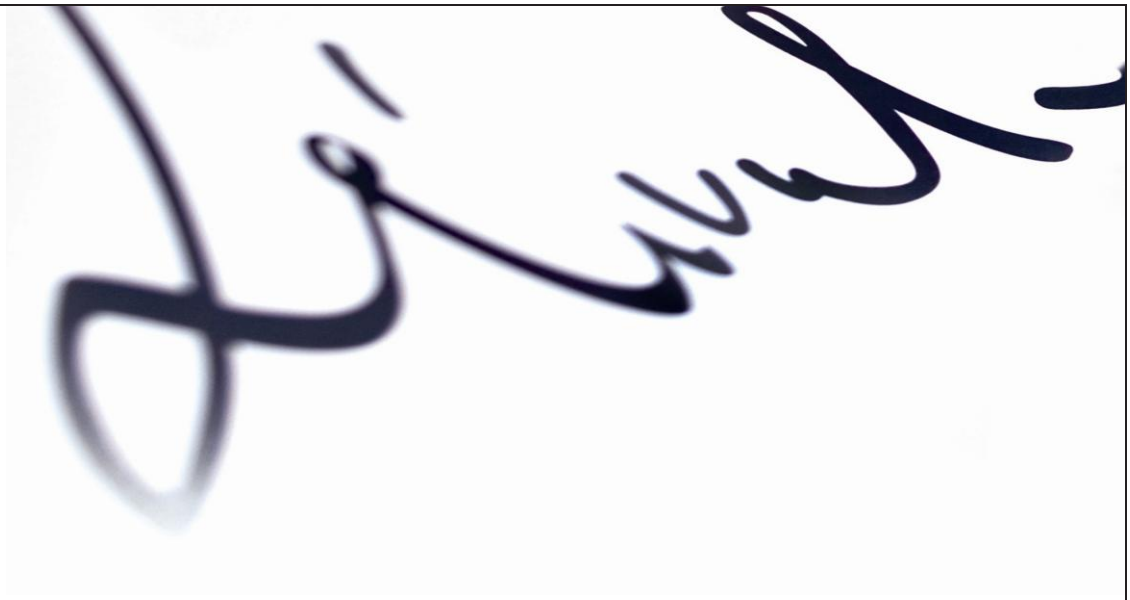


Momentum

Finance and Governance

March 30, 2012

Diligence Duties of Insurers in Credit Protection Insurance

Given the current economic climate, it is increasingly the case that credit institutions grant credit (personal loans, home loans or other types of loans) only when credit insurance is underwritten, in order to ensure that, in the case of the client being temporarily unable to repay a loan due to accident, illness, or involuntary unemployment, the insurer steps in to pay the due installments.

However, these credit protection insurance policies do not only fulfill this economic function, but also have an important role of a social dimension, to the extent that they protect consumers of said insurances in extreme situations and in cases of grave misfortune.

In this vein, the Portuguese Insurance and Pension Funds Supervisory Authority (ISP - Instituto de Seguros de Portugal), in its role as regulatory and supervisory authority of the Portuguese insurance activity, of the contractual conditions and underwriting practices existent

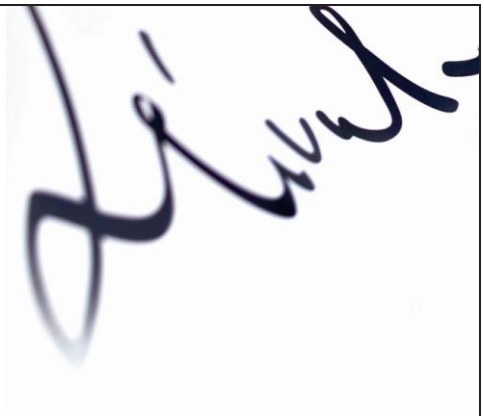
in the market, issued on March 1, 2012, Circular 2/2012, regarding the legal duties of care incumbent on insurers for this type of insurance.

The ISP Circular touches upon four different themes: (i) product design, (ii) pre-contractual information and clarification, (iii) drafting of policies, and (iv) underwriting practices.

The ISP's first preoccupation resolved in the Circular is that right from the product design phase it be rigorously identified what the product's target audience is and what the latter's needs are.

On this point, the ISP specifies that the design of products must ensure that the limitations and scope of coverage, as well as the maximum compensation and the period for which it is paid, the deferred periods or deductibles provided for, do not misalign the coverage from the needs of the target audience.

The aim of the ISP is that the insurance being sold be adequate for the customer interested in it. The emergence of new products, along with their complexity, has led to supervisory bodies reinforcing the need to test how adequate the products on the market are for their target audience. With regards to this issue, it should in fact be noted that the new law on insurance contracts (LCS) introduced in its Article 22 a special duty regarding the clarification of the types of contracts which are more convenient for the aim which is intended with the entering into of the contract, a provision that is not reflected in the closest comparable law. However, it should be stressed that this special duty of clarification is expressly precluded in Paragraph 4 of the same Article whenever the contract includes the intervention of an insurance broker



(role taken on by credit institutions in this type of insurance), which means that the Circular could not result in nor does it attribute to the insurer a duty which in fact it does not have under the law.

The second point the Circular focuses on is the pre-contractual information and clarification duties. First of all, the ISP insists that the core concepts in the delimitation of coverage and exclusions, e.g. those derived from labor law and that delineate the situations of incapacity, should be understood by the average consumer. Secondly, the ISP reminds that a general contractual clause that is not duly communicated or that is communicated with pretermission of the duties of information must be excluded from the contract, regardless of the question on which is the entity burden with the duty of pre-contractual communication (the insurer or the group policyholder) and who didn't carry out said duty (although many other aspects regarding this topic remain yet to be explained, such as the relationship between the regime of general contractual clauses and the onus on the policyholder to invoke the discrepancies between that agreed and the content of the policy in order to prevent the consolidation of the contract).

In terms of the drafting of the policies, the Circular underlines the need to avoid vague or ambiguous wording in the definitions of coverage, in exclusions or clauses limiting coverage.

Moreover, it is stressed that, the unclearness of concepts may lead to the application of the terms of Article 11 of Law-Decree 446/85, of October 25, in its current version, which states that ambiguous clauses

will be interpreted in the way that is most favorable to the adherent (in this case the policyholder).

Still with regards to the drafting of the clauses, the ISP recommends that the coverage of incapacity or of unemployment be defined in positive terms, and it reinforces the need for the terms of adhesion to the insurance contract to be worded in a rigorous and complete manner, thereby preventing any erroneous or ambiguous interpretations of said conditions.

Lastly, with regards to the drafting of the clauses, the ISP alerts to the need for insurers to take extra care in drafting the contractual clauses defining risks, since celebrated insurance contracts could be rendered void due to lack of interest or lack of risk (Article 43, Paragraph 1, LCS).

As far as underwriting goes, it should be noted that insurers have the duty to make sure that the potential policyholder has the conditions that make him/her eligible for taking on the insurance. This analysis should not be done only at the time that insurance is claimed. Referring to the provisions relating to the interest and risk in insurance contracts, the ISP basically refers to the solution of nullity of the contract, which has little added value however for the policyholder, namely for his/her expectation of cover at the time of claiming the insurance, apart from the almost natural consequence of the return of the premium.

In general terms, based on the above, it could be said that the Circular in question does not introduce any innovative aspects to that which already results from the applicable legal regime resulting from the LCS, nor

does it constitute a valuable interpretative aide, since the content of the normative statements in question is not exactly impenetrable.

However, this does not mean that the issues covered by the Circular should be analyzed less rigorously by their target, i.e. essentially, insurers.

On the contrary, if this subject is covered by law, and yet the ISP feels the need to issue the Circular, this is symptomatic of the reservations the ISP has regarding the practices followed by insurers, this being a real exhortation that the latter review their products, contractual clauses, operations and practices, in order to test their alignment with the preoccupations expressed by the Circular, thereby preventing the consequences that may come about as a result of noncompliance, not only in relation clients but also to the supervisory body.

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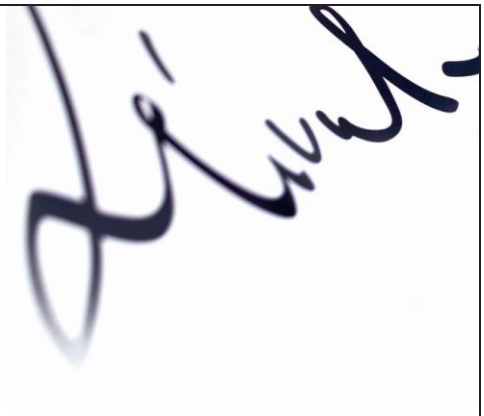

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