Olavi-Jüri Luik, Margus Poola

The pre-contractual obligation of the parties to provide information before concluding the non-life insurance contract

1. Introduction

The European Commission is conducting a project, which aims at harmonising the insurance law of European Union. Based on the above, principles of European insurance contract law (PEICL[1]) will be developed in the framework of the Common Frame of Reference (CFR). Applying PEICL to insurance contracts is one option for the parties to the insurance contract. This option is particularly important in an open market situation, where foreign insurers can offer their services also in other member states. PEICL is expected to intensify the conclusion of cross-border insurance contracts, which results in greater freedom for the provision of services — for a little market like Estonia, the increase in the freedom of provision of services will undoubtedly entail the emergence of some new services and, what is even more important, more intensive competition in the range of offered services (intensive competition usually brings along a fall in prices).

This report explores the differences between Estonian Law of Obligations Act (LOA) and PEICL, concerning the issues of the obligation of the parties to provide pre-contractual information

The obligation of the parties to provide information can be divided into the insurer's obligation to provide information (LOA § 428 vs. PEICL Article 2:201) and the policyholder's obligation to provide information (LOA § 440 vs. PEICL Article 2:101). The insurer's obligation to provide information, i.e. LOA § 428 is based on the Council directive 92/49/EEC[2]. The above also coincides with the respective PEICL regulation.

The Draft Common Frame of Reference (DCFR) does not directly stipulate the obligation of the parties to provide information. Article II-3:301 (2) and (3) provide that a person who has negotiated or broken off negotiations contrary to good faith and fair dealing is liable for the losses caused to the other party. The Estonian Law of Obligations Act provides that in the stage of pre-contractual negotiations, the obligation to provide information is one of the main obligations of the parties and an expression of their good faith. During negotiations the parties must above all provide such information that is not available to the other party, especially when it concerns the fulfilment of contractual obligations, legal qualities of the object of the contract or other important circumstances related to the object of the contract[3].

PEICL provides more detailed pre-contractual principles than DCFR. PEICL Article 2:201 provides that the policyholder shall inform the insurer about all the circumstances of which he/she is or ought to be aware and the circumstances that the insurer has clearly and unambiguously asked him/her to provide. According to the Law of Obligations Act, the pre-

[1] http://restatement.info/cfr/Draft-CFR-Insurance-Contract-17122007-FINAL.pdf
[2] "On the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance" — OJ No L 228, 11.08.1992, pp. 0001–0023
[3] P. Varul et al. Võlaõigusseadus I. Kommenteeritud väljaanne. Tallinn, 2006, p. 60.

contractual negotiations and the obligation of the parties to provide information and to cooperate is mainly a matter of good faith (LOA § 14).

2. The pre-contractual obligation of the policyholder to provide information

The pre-contractual obligation to provide information in the case of non-life insurance contracts can basically be regulated in two ways:
a) the insurer presents the policyholder a questionnaire and the policyholder answers all the required questions;
b) the policyholder must inform the insurer about all the significant circumstances.

The main difference between those two solutions lies in the party who should bear the risk of taking into account all the circumstances that are material when concluding the non-life insurance contract.

In Estonia, upon entering into the contract, the policyholder shall, according to LOA § 440 (1), inform the insurer of all circumstances known to the policyholder which, due to their nature, may influence the insurer's decision to enter into the contract or enter into the contract on agreed terms (material circumstances). At the same time, material circumstances are presumed to be circumstances about which the insurer has directly requested information in a format which can be reproduced in writing.[4]

Several publications have found that the LOA navigates between the two possible regulations: on the one hand, the policyholder is under obligation to inform the insurer on his/her own initiative about all the material circumstances concerning the conclusion of the contract, but on the other hand, he/she must, in any case, provide the insurer with requested information.[5] In Estonian legislation it is presumed that if the insurer has not directly required information about certain circumstances, these circumstances are not considered to be material.[6]

PEICL Article 2:101 (1) provides that when concluding the contract, the policyholder shall inform the insurer of circumstances of which he/she is or ought to be aware, and which are the subjects of clear and precise questions put to him/her by the insurer.[7]

The aim of the PEICL regulation is to grant the insurer the right to require information about risk factors and use this information when deciding upon entering into the contract or rejecting it.[8] The selection of the so-called questioning method provided in Article 2:101 is mainly based on the fact that generally it is more difficult for the policyholders to decide which information is significant when evaluating the insured risk. Imposing the obligation of asking clear and precise questions on the insurer is likely to decrease the possible unnecessary transaction costs and eliminates the potential arguments between the insurer

[4] Law of Obligations Act. 29 September 2001. – RT I 2001, 81, 487; RT I 2010, 7, 30.
[5] J. Lahe. Kindlustusõigus. Tallinn, 2007, p. 50.
[6] Varul, P., et al. Võlaõigusseadus II. Kommenteeritud väljaanne. Tallinn, 2007, p. 475, clause 3.2.
[7] PEICL comments. *Op.cit,* p. 77.
[8] PEICL comments. *Op.cit,* p. 77.

and the policyholder. That is why the current insurance practice recognizes the method of posing questions rather than the so-called self-initiative method that was only recently the common policy in most of European countries.[9]

Another difference in the given regulation between PEICL and LOA is that the Law of Obligations Act only handles the information that the policyholder is aware of, whereas PEICL also handles the information that the policyholder is or ought to be aware of. Nevertheless, the abovementioned difference is marginal, because the Law of Obligations Act only has negative consequences in the case of conscious behaviour (LOA § 441).

2.1 The consequences of the violation of the pre-contractual obligation of the policyholder to provide information

The LOA provides two consequences for giving false information about risk factors:
(i) if the policyholder intentionally fails to provide information, the insurer may withdraw from the contract (LOA § 441 (1)) and
(ii) if the policyholder has failed to provide the information unintentionally, the insurer may demand payment of a reasonably higher insurance premium from the policyholder (LOA § 460).

In case the policyholder has failed to provide information, PEICL Article 2:102 provides the insurer with two options:
(i) to propose reasonable amendment of the contract or
(ii) to terminate the contract.

With regard to the above, PEICL regulations provide the policyholder with the possibility to reject the proposal to amend the contract within one month from the receipt of the notice; in that case the insurer shall be entitled to terminate the contract within one month.

Generally, the PEICL regulations restrict the right of withdrawal only with wrongful violation of the terms. At the same time, PEICL provides the right of withdrawal in the case of no-fault violation, if the insurer is able to verify that it would not have entered into the contract if the insurer would have had the undisclosed information.

Hence, there are two differences between these regulations of the LOA and PEICL. Firstly, unlike PEICL regulations, LOA does not provide the insurer with the opportunity to demand changing the insurance premium (i.e. amendment of the contract) in case of the policyholder's wrongful violation of the obligation to provide information. Secondly, LOA does not provide the right of withdrawal in the case of no-fault violation, if the insurer is able to verify that the contract would not have been entered into if the insurer would have had the undisclosed information.

To the authors' opinion, the inflexible and termination oriented regulation of the LOA is unsubstantiated. The insurer should have the opportunity to decide upon the termination of

[9] PEICL comments. *Op.cit,* p. 78.

the contract or the increase of the insurance premium and the continuation of the contract on case-by-case basis according to the extent to which the policyholder has violated the terms. The exclusion of the claim to change the insurance premium in the case of wrongful violation of the terms leads to the termination of the contract. The authors' believe that the regulation of the law should rather guide the parties to continue the contract on amended terms than to terminate it. PEICL regulation allows it. Due to that, PEICL regulations should be preferred in similar matters, since in the case of violation of pre-contractual obligation to provide information, PEICL regulation conforms to international insurance practice to a larger extent compared to the LOA regulation, and allows the insurers to respond more adequately to risk factors.

The authors would also like to draw attention to another significant difference between PEICL and LOA regulations, which concern the norms that regulate the insurer's right of withdrawal. Namely, the PEICL regulations provide that the termination of the insurance contract takes effect one month after the corresponding notice has been received by the policyholder. This provides the policyholder with the opportunity to use the still valid insurance cover within one month and at the same time look for a new insurer, who would grant equivalent protection.

On the other hand LOA § 442 (1) requires the insurer to withdraw from the contract within a one-month deadline as of the moment when the insurer becomes aware or should have become aware of the violation of the obligation to provide information. However the abovementioned deadline only limits the time the insurer has the right to withdraw from the contract. At the same time it does not eliminate the possibility that the insurer withdraws from the contract within one month and the contract will be terminated at the moment the policyholder has received a corresponding notice of withdrawal or in an unreasonably short period after that. This creates a situation where the policyholder cannot insure his/her risk in a way that ensures continuous insurance cover. LOA § 442 would not be difficult to amend in a way to provide the moment of the termination of the contract, which could be, similarly to PEICL, one month after the corresponding notice has been received by the policyholder.

Another question I would like to address is LOA § 460 (1). If the insurer does not have the right to withdraw from the contract due to the provision of false information, the insurer may demand payment of a reasonably higher insurance premium from the policyholder as of the beginning of the current period of insurance. According to LOA § 453 a period of insurance is the period of time based on which the insurance premiums are calculated. It is presumed that a period of insurance lasts for one year. This means that if the insurer and the policyholder have agreed upon a one-year insurance period, the policyholder pays four periodic insurance premiums and the insurer has a right to increase the premiums retroactively. Let us assume that the violation of the obligation to provide information becomes apparent in the middle of the fourth quarter, after which the insurer has the right to demand the fourth periodic payment and also multiply all the premiums (including the three premiums that have been paid previously) with a certain coefficient.

The authors do not find the retroactive application of higher insurance premiums to be justified, because it imposes an obligation on the policyholder without any consideration in return. Considering the nature of the insurance contract, it is not reasonable to apply higher

premiums in order to "punish" the policyholder for breaching the obligation to provide information. The negative consequences of the violation of the obligation to provide information should only be applied to the following premiums (as of the time when the insurer becomes aware of the violation) and not the premiums that have already been paid. Similarly to PEICL regulations, an insurer in Estonia should have a right to increase only subsequent premiums and with the consent of the policyholder, i.e. if within one month the policyholder notifies the insurer of his/her discontent with higher premiums, the insurer has a right to withdraw from the contract within one month, which results in the termination of the contract within one month as of the time the policyholder receives the corresponding notice from the insurer.

3. The pre-contractual obligation of the insurer to provide information

LOA § 428 (1, 2) provide the information that the policyholder shall disclose to the insurer before entering into an insurance contract.

These provisions are imperative, except in the case of contracts with immediate insurance cover (LOA § 432 (4)). Since this article only handles the matters related to non-life insurance, but LOA § 428 (2) concentrates on life insurance, let us focus on subsection 1 of the following section.
LOA § 428 provides:
(1) An insurer shall ensure that a natural person who wishes to enter into an insurance contract is provided, prior to entering into the contract, with at least the following information:
1) the name and legal form of the insurer;
2) the address of the insurer, and the address of the office through which the contract is entered into if this is not done at the seat of the insurer;
3) standard terms applicable to the insurance contract, including the insurance premium rate and information concerning the provisions of law applicable to the contract;
4) obligations of the insurer if different from those prescribed in the policy conditions and in the insurance premium rate;
5) the period of validity of the insurance contract and conditions for termination thereof;
6) the size of the insurance premiums and the procedure for payment thereof, stating separately the size of the different insurance premiums if the insurance relationship is to comprise several independent insurance contracts;
7) the total amount payable together with the insurance premiums, including additional payments to be made or expenses to be covered by the policyholder and the principles of their formation;
8) the term during which the person wishing to enter into the insurance contract is bound by the application to enter into the contract;
9) the address of the competent insurance supervisory body where the policyholder may lodge a complaint concerning the activities of the insurer.

LOA § 428 regulation is based on the German Insurance Supervision Law § 10a (1) (resp VAG Appendix D Clause 1) and on the Council directive 92/49/EEC. PEICL has the same regulations in Article 2:201. Thus, there are no contradictions between the regulations of the LOA and PEICL.

The only issue here is LOA § 428 (1) Clause 9. Namely, LOA § 428 does not provide the insurer's obligation to clarify the procedures of lodging complaints about the insurance contract to a policyholder, who is a natural person. Instead, the insurer is obliged to inform the policyholder about the address of the competent insurance supervisory body where the policyholder may lodge a complaint concerning the activities of the insurer. The indicated directive does not provide that forwarding the address of the competent insurance supervisory body is sufficient. Council directive 92/49/EEC[10] provides that the procedure of handling complaints concerning contracts and the dispute settlement body should be clarified to the policyholder. The Financial Supervision Authority certainly does not serve as a settlement body for insurance disputes. The indicated directive only considers insurance dispute commissions, the Consumer Protection Board and the court as dispute settlement bodies. The procedure of settling disputes originate is a matter of the regulation of general conditions (how and within which time limits the insurer examines the lodged complaints). Hence, the Estonian law does not correspond to the directive in this matter.

About the authors:

Mag. iur. Olavi-Jüri Luik is Doctoral candidate in the Faculty of Law at the University of Tartu.

Margus Poola works is a Doctoral candidate in the Faculty of Law at the University of Tartu.

2010 Summer

[10] Available in web: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=DD:06:01:31992L0049:ET:PDF