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TRANSPARENCY, TRUST AND SECURITY: AN EVALUATION OF THE INSURER'S PRECONTRACTUAL DUTIES

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1 Introduction

Historically, the nature and extent of the pre-contractual duty of disclosure by the prospective policyholder has been a pre-occupation in insurance law. The current age of consumerism has, however, seen a paradigm shift to the flipside of the coin: the transparency duties of the insurer towards the consumer. In an increasingly rules-driven environment, values such as transparency, equality and fairness are becoming more obscured because of complicated and extremely detailed legislation. In a frantic attempt to "tick all the boxes", financial services providers face the real danger of losing sight of the values that should inform their conduct. The purpose of this contribution is to establish to what extent South African contract law and insurance legislation partner to strengthen transparency in pre-contractual negotiations for insurance. The current interest in transparency is fuelled by legislation such as the *Promotion of Access to Information Act*,¹ which enhances and builds upon the constitutionally entrenched right of access to information included in section 32 of the *Constitution*.²

Transparency has many faces. It has been described as an omnipresent term, and is usually understood to promote the rule of law, economic efficiency, anti-corruption initiatives, democratic participation and human rights.³ Transparency and accountability are mutually reinforcing principles as the one informs the other. Even before the term "transparency" became popular, transparent conduct has always

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¹ *Promotion of Access to Information Act 2 of 2000*.

² *Constitution of the Republic of South Africa, 1996*.

³ Ala'i and Vaughn *International Handbook on Transparency 2*.

been accepted as an underlying principle of contract law,⁴ and a lack of transparency resulted in consequences for the relationship between the parties involved and consequences focussing on claims for compensation.⁵

Transparency entails removing the barriers to and facilitating free and easy access to laws, rules, processes and information.⁶ It embraces a lack of hidden agendas and conditions, accompanied by the publication of all of the information required to enable collaboration, cooperation and decision making. True transparency in the commercial sense requires a minimum degree of disclosure in terms of which agreements, dealings, practices, and transactions are open to all for verification.⁷ In the context of insurance, transparency in a narrow sense means that precontractual information must be provided in a clear, comprehensible and unambiguous manner. Transparency is essential for a free and open exchange through which all of the parties can effectively assess their rights and duties in a way that is fair and clear. This is especially the case when insurance cover is procured, as it will influence the policyholder's purchase decision. Cost transparency pertaining to the limits of the cover offered and the premiums to be paid in life insurance, for example, is of the utmost importance.

This turns the debate to consumer issues. According to the Financial Services Board:

The asymmetry of information between retail financial services consumers and financial institutions means that financial services consumers are particularly vulnerable to unfair treatment. Typically, financial institutions have far more expertise and resources available to them in designing, distributing and servicing financial products than consumers have available to them in making decisions about financial transactions. The nature of financial products and services is such that, in many instances, the consequences of unfair treatment or poor decisions are only felt some time – in some cases many years – after transacting. Significant hardship

⁴ See for example the discussion on misrepresentation and the duty of disclosure in South African contract law in para 2.1 below; also the Report by the Project Group Restatement of European Insurance Contract Law *Principles of European Insurance Contract Law* (hereafter "PEICL") 48, 58 on a detailed discussion of the European perspective.

⁵ Some of which are examined below.

⁶ Stoop and Chürr 2013 *PER/PELJ* 517, 519-520.

⁷ See for example the description of the transparency duties of the insurer in sched 2 s 24 of the *Australian Competition and Consumer Act* 2010; Business Dictionary date unknown <http://www.businessdictionary.com/definition/transparency>.

can result. In South Africa, these challenges are exacerbated by low levels of both basic and financial literacy, increasing the risk of consumer exploitation.⁸

Insurance contracts are consumer agreements *par excellence*.⁹ Although transparency issues such as non-disclosure and misrepresentation are prevalent throughout the life cycle of insurance contracts, this contribution focuses only on the pre-contractual duties of insurers, intermediaries and advisors towards prospective policyholders.

It is accepted that a "product life cycle" refers to a number of distinct stages in the life span of a financial product.¹⁰ These stages are the product and service design, promotion and marketing, advice, point of sale, information after point of sale, and the handling of complaints and claims.¹¹ Only those rules pertaining to precontractual dealings and, more specifically, promotion and marketing and the conduct of intermediaries before the conclusion of the contract will be investigated. Transparency after the "point of sale" is a subject for another discussion.

The insurer's precontractual duty of disclosure is a primary consumer protection mechanism.¹² In most countries the rules pertaining to precontractual negotiations and the advertising of insurance products are regulated by statute.¹³ In South Africa, the regulations are contained primarily in the *Financial Advisory and Intermediary Services Act* (hereafter the "*FAIS Act*").¹⁴ However, as this statute does not replace

⁸ FSB 2011 <https://www.fsb.co.za/feedback/Documents/Treating%20Customers%20Fairly%20-%20The%20Roadmap%202011.pdf> (hereafter "TCF") 6.

⁹ See, however, the recent exclusion of insurance products and services from the scope of the *Consumer Protection Act* 68 of 2008, as discussed in para 2.2 below.

¹⁰ TCF 8.

¹¹ TCF 8.

¹² Internationally consumer rights include the right to the disclosure of information and the right to fair and responsible marketing to encourage responsible and informed consumer choices and behaviour. See in general s 3(1)(e) of the *Consumer Protection Act* 68 of 2008; s 3(e)(ii) of the *National Credit Act* 34 of 2005 for national recognition of this basic consumer right.

¹³ See for example the third generation European Union Directives on insurance: European Union Directive 92/94/EEZ (Third Non-life Insurance Directive) and European Union Directive 92/96/EEZ (Third Life Insurance Directive) that apply to all EU Member States. An interesting distinction made in the EU is that so-called "large risks" and reinsurance fall beyond the scope of the statutory precontractual information duty. Large risks are described in PEICL 1:103(2)(a), (b) and (c). Such a distinction is foreign to our law. Information duties, whether pre-contractual or during the existence of the contract, apply to most policies. Differentiation applies to the content of disclosures, depending on the type of cover and the nature of the risks insured.

¹⁴ 37 of 2002, specifically s 16(2)(a) and (c).

the common law *in toto*,¹⁵ common law aspects as well as additional provisions contained in the *Long-term Insurance Act* (hereafter "LTIA")¹⁶ and the *Short-term Insurance Act* (hereafter "STIA")¹⁷ will also be deliberated.

2 Promotion and marketing of insurance products and luring potential customers

2.1 General

Whether a particular statement constitutes an advertisement, merely amounts to "puffing" or is in fact an offer that upon acceptance creates consensus and a binding contract will depend on the facts and circumstances of each case.

The duty to inform a contracting party about the information relevant to the prospective contract, and to warn him or her about prejudicial aspects is recognised by the general principles of contract law such as the right to fair dealing and the prevention of improper conduct when concluding a contract. A failure to do so would amount to the so-called *culpa in contrahendo*.¹⁸ As no exclusive *lex specialis* is created by insurance legislation, the common law pertaining to misrepresentations is not limited in its application, but its scope is rather more clearly defined by the statutory intervention as discussed below.

A simple *commendatio non obligat* is a mere general commendation that does not amount to misrepresentation, provided that it "does not condescend to particulars".¹⁹ Although difficult to define, it has been held by our courts that once it is an exaggeration "intermingled with facts and punctuated by details",²⁰ it is seen as a precontractual misrepresentation by a representor, who then suffers its normal

¹⁵ Hattingh and Millard *FAIS Act Explained* 83.

¹⁶ 52 of 1998.

¹⁷ 53 of 1998

¹⁸ This is a term that is specifically used in international literature such as PEICL s II 96. See in general s 2, 3 and 6 of the *General Code of Conduct for Authorised Financial Services Providers and Representatives* (hereafter the "GCC") issued in terms of s 15 of the *FAIS Act* by Financial Services Board Notice 80 of 2003 in GG 25299 of 8 August 2003 in this regard.

¹⁹ *Small v Smith* 1954 3 SA 434 (SWA) 436. Also see in general Christie and Bradfield *Christie's Law of Contract* 284; Hutchison and Pretorius *Law of Contract* 119.

²⁰ *Milne v Harrilal* 1961 1 SA 799 (N) 807. Also see *Geldenhuys and Neethling v Beuthin* 1918 AD 426.

consequences. This entails the innocent party's right to claim rescission of the contract and *restitutio in integrum*, and a potential delictual claim for damages.

Misrepresentations are not always contained in express statements, but can be made by either commissions or omissions.²¹ In insurance the problem is often caused by what the insurer chooses not to disclose, rather than what he does. An *ex lege* duty to speak does not apply in all circumstances. Such a duty will, however, be recognised where there is:

an involuntary reliance of the one party on the frank disclosure of certain facts necessarily lying within the exclusive knowledge of the other such that, in fair dealing, the former's right to have such information communicated to him would be mutually recognised by honest men in the circumstances.²²

This will clearly be the case in insurance matters, as the prospective policyholder cannot usually ascertain or identify omitted information merely by conducting his own due diligence examination.²³ Due to his position as the weaker party at the bargaining table, he is subjected to an involuntary reliance on information provided to him by the more informed insurer. An *ex lege* duty to speak by parties in insurance contracts was recognised in *Iscor Pension Fund v Marine and Trade Insurance Co Ltd*²⁴ as follows:

In some contracts parties are required to place their cards on the table to a greater extent than in others, but the determination of the extent of the disclosure does not depend on the label we choose to stick on a contract. The principles applicable to contracts of insurance do not differ in essence from those applicable to other kinds of contracts, but where one party has means of knowledge not accessible to the other party, and where from the nature of the contract the latter (as in the case of insurance) binds himself on the basis that all material facts have been communicated to him, the non-disclosure of such a fact is fatal.²⁵

²¹ An *omissio per commissionem*. See *Qilingele v SA Mutual Life Assurance Society* 1993 1 SA 69 (A); *Clifford v Commercial Union Insurance Co of SA Ltd* 1998 4 SA 150 (SCA) 156. In insurance, the distinction between a positive misrepresentation and a "negative non-disclosure" is not always clear. See Reinecke, Van Niekerk and Nienaber *South African Insurance Law* 151.

²² In the words of Millner 1957 *SALJ* 189. Also see *ABSA Bank Ltd v Fouche* 2003 1 SA 176 (SCA) for a recent decision on the general duty to disclose information.

²³ See in this regard *McCann v Goodall Group Operations (Pty) Ltd* 1995 2 SA 718 (C) 723 where the courts highlighted that no duty to speak can exist where a party can ascertain information by common observation or ordinary diligence.

²⁴ *Iscor Pension Fund v Marine and Trade Insurance Co Ltd* 1961 1 SA 178 (T).

²⁵ *Iscor Pension Fund v Marine and Trade Insurance Co Ltd* 1961 1 SA 178 (T) 185.

This was subsequently confirmed by the appeal court in *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality*.²⁶

There are several general requirements in common law for an actionable misrepresentation, whether by *commissionem* or by *omissionem*, for all contracts including insurance contracts. These include the making of a false or misleading statement by the insurer or someone for whose acts he is responsible such as his agents and appointed brokers if the representation is material. The interpretation of what will be seen as material and what is seen as merely trivial is not always clear. Materiality appears to depend on a two-pronged test, namely whether the representation was made with the intention to induce the other party to contract, and then whether a reasonable person would have been so induced.²⁷ It is submitted that this must go to the root of the matter as interpreted from the viewpoint of the "reasonable policyholder".²⁸ Furthermore, the statement should induce the prospective policyholder into concluding the insurance contract, yet does not have to be the decisive or dominant cause.²⁹ Finally, the insurer must have had the intention to induce, not necessarily the intention to mislead or defraud.³⁰ This is usually the case as advertisements are drafted with exactly this goal in mind, and not necessarily with ill intent.

The presence of fault is thus not a requirement for the innocent party to rescind from the agreement,³¹ yet a subsequent claim for damages will depend on whether the representation was made fraudulently or negligently.³² The policyholder may rescind

²⁶ *Mutual & Federal Insurance Co v Oudtshoorn Municipality* 1985 1 SA 419 (A) 433.

²⁷ See also *Mutual & Federal Insurance Co v Oudtshoorn Municipality* 1985 1 SA 419 (A) 433. The facts and the circumstances of each case will determine whether facts were material or not, rather than the nature of the contract or the type of transaction.

²⁸ This appears to be the international standard in most other countries in Europe. It is known in Germany, for example, as the "Durchschnittsversicherungsnehmer" or average applicant for insurance cover. *Deutsches BGHZ* 4.4 2001, 112, 115.

²⁹ Whether it in fact caused the inducement is a subjective question in our law, irrespective of whether a reasonable person would have been so induced or not. See *Schultz v Meyerson* 1933 WLD 199.

³⁰ *Novick v Comair Holdings Ltd* 1979 2 SA 116 (W).

³¹ As confirmed in the recent decision in *Brink v Humphries & Jewell (Pty) Ltd* 2005 2 SA 419 (SCA) 421.

³² In the case of a delictual claim for damages, the normal requirements will apply, of which fault is one. See *Bayer South Africa (Pty) Ltd v Frost* 1991 4 SA 559 (A).

from the contract either entirely or partially,³³ provided that the misrepresentation was material and made with the intention to induce, yet he may claim delictual damages only where fault is present.³⁴

It can be argued that false or misleading advertising is equally bad, regardless of whether it pertains to shoes, coffee beans or insurance. However, that ignores the fact that insurance products are credence goods, while shoes and coffee beans are not.³⁵ *Credence* goods and services are those goods of which the quality can be established only at some cost after sale. The value of these goods is typically spread over, or emerges only after a considerable period of time has lapsed. The purchaser who wishes to reverse a transaction for credence goods usually incurs a considerable loss due to benefits foregone, the failure to select an alternative product, or actual costs and expenses incurred. It is simple enough to establish whether shoes or beans are fit for use but whether an insurance product is suitable to a particular consumer is not so evident. Therefore it can be said that it is even more important when advertising insurance to provide the correct information and not to mislead the public. To be transparent in this context means to refrain from luring unsuspecting and uninformed members of the public into transactions under false pretences or by abusing one's superior position, and to ensure that those who do react to advertisements do not do so because of one's deceitfulness. This is discussed in more detail below.

³³ Where the contract is in fact divisible.

³⁴ This is possible where the misrepresentation is intentional or even where it was negligent. See *Bayer South Africa (Pty) Ltd v Frost* 1991 4 SA 559 (A).

³⁵ FSB 2010 <http://www.insurancegateway.co.za/download/1427> (hereafter "TCF Discussion paper"). The FSB explains: "In the case of *search* goods, quality and price can be ascertained at low cost prior to purchase or where a credible warranty is attached. Selection of a shirt, for example, typically involves an evaluation of the fit, style and price prior to purchase. By contrast, *experience*-goods are those whose quality can be ascertained at low cost through use, though not prior to purchase. So for example, evaluation of a vacuum cleaner is typically made after purchase. Moreover, a faulty vacuum cleaner can be returned and a replacement obtained at relatively low cost to the consumer. While the element of uncertainty at the point of purchase is clearly higher than in the case of search goods, the degree of uncertainty is bounded. Many services tend to fall into the experience category, as it is only after the laundry has been done, or the haircut performed, that the consumer may evaluate the quality."

2.2 *General consumer protection legislation*

Some consider that the identification of transparency as a core value of the worldwide drive for maximum consumer protection is derived from the universal right of access to information.³⁶ Although insurance products and services have at last been excluded from the application of the general *South African Consumer Protection Act* (hereafter "CPA"),³⁷ insurance legislation as a special type of insurance consumer law is aimed primarily at protecting the policyholder or insured.

The introduction of the CPA in 2011 initially created difficulties for the insurance industry. The definition of "service" excluded advice provided in terms of the *FAIS Act*, the LTIA and the STIA.³⁸ Services rendered in terms of the *FAIS Act* were definitely excluded from the CPA. However, the exclusion of services rendered pertaining to insurance as meant by the LTIA and the STIA was subject to an exclusion contained in schedule 2, section 10 of the CPA, which stipulated that the insurance industry had a period of 18 months from the commencement of the CPA to align all consumer protection measures with those of the CPA.³⁹ The period of grace lapsed without an effective alignment with the consumer protection measures and criteria found in the CPA in insurance legislation.

On 28 February 2014, however, the *Financial Services Laws General Amendment Act*⁴⁰ came into operation. Section 66, that replaces section 28 of the *Financial Services Board Act*,⁴¹ confirms that the CPA does not apply to:

- (i) any function, act, transaction, goods or services that is or are subject to Financial Services Board legislation; or subject to (ii) the board or a registrar referred to in Financial Services Board Legislation.⁴²

When it comes to the advertising and marketing of insurance products it is submitted that these matters now resort under the ambit of precontractual

³⁶ See s 32 of the *Constitution*.

³⁷ *Consumer Protection Act* 68 of 2008 (hereafter the "CPA").

³⁸ Section 1(c)(i) of the CPA.

³⁹ Millard *Modern Insurance Law* 6.

⁴⁰ *Financial Services Laws General Amendment Act* 45 of 2013, as promulgated in GN 584 in GG 37351 of 18 February 2014.

⁴¹ *Financial Services Board Act* 97 of 1990.

⁴² Section 66(2) of the *Financial Services Laws General Amendment Act* 45 of 2013.

negotiations and will therefore fall squarely within the realm of the industry-specific *FAIS Act*. One should also bear in mind that the LTIA and the STIA also contain consumer protection measures in more product-specific rules, as discussed below. Transparency issues not expressly regulated by these statutes will still be governed by substantive common law provisions, as discussed under paragraph 2.1 above.

2.3 Special transparency duties to be observed in advertising insurance products

2.3.1 FAIS Act

Advertisements for insurance products should not be misleading.⁴³ In this regard, insurers are not in a different position from any other provider who offers products or services. Generally speaking, advertising in South Africa is largely self-regulated.⁴⁴ The Advertising Standards Authority as the regulator operates by bringing together the three parts of the industry, namely the advertisers who pay for the advertising, the advertising agencies responsible for its form and content, and the media which carry it, which together co-operate to set the standards for advertising. More importantly, though, Part X of the GCC in terms of the *FAIS Act* provides strict rules for advertising. According to section 1(1) of the GCC, "advertisement" means:

[A]ny written, printed, electronic or oral communication (including a communication by means of a public radio service), which is directed to the general public, or any section thereof, or to any client on request, by any such person, which is intended merely to call attention to the marketing or promotion of financial services offered by such person, and which does not purport to provide detailed information regarding any such financial services; and 'advertising' or 'advertises' has a corresponding meaning.

In addition, section 14 of the GCC states that an advertisement by a provider must not contain any statement, promise or forecast which is fraudulent, untrue or misleading.⁴⁵ Where an advertisement contains performance data (including awards and rankings), it must also include references to the source and date of the data.⁴⁶

⁴³ Section 16(1)(c) of the *FAIS Act*.

⁴⁴ Advertising Standards Authority of South Africa (hereafter "ASA") *Advertising Code of Practice* <http://www.asasa.org.za/codes/advertising-code-of-practice>.

⁴⁵ Section 14(1)(a) of the *FAIS Act*.

⁴⁶ Section 14(1)(b)(i) of the *FAIS Act*.

Where an advertisement contains illustrations, forecasts or hypothetical data, these must be supported by clearly stated basic assumptions coupled with a "reasonable prospect of being met under current circumstances".⁴⁷ The insurer must also emphasise that these illustrations and forecasts are not guaranteed.⁴⁸ Where returns or benefits are dependant on the performance of underlying assets or other variable market factors such as investments, the advertisement must state that this is the case.⁴⁹ To complicate matters, advertisements with forecasts must also prominently display a warning statement about the risks involved in buying or selling a financial product⁵⁰ and contain an additional warning that past performances are not necessarily indicative of future performances.⁵¹ If the investment value of a financial product mentioned in the advertisement is not guaranteed, the advertisement must contain a warning that no guarantees are provided.⁵²

Advertisements by telephone are also regulated. Although the GCC does not make this distinction, it is submitted that there is a primary distinction between advertisements to existing clients and advertisements to members of the public who are not customers. The latter is a form of "cold calling" and is illegal in terms of the *Protection of Personal Information Act*.⁵³ The former presupposes that the existing client consented to receiving advertisements by phone, and where an insurer then advertises a financial service by telephone, such an insurer must keep an electronic, voice-logged record of all communications.⁵⁴ Where the advertisement did not lead to the rendering of a financial service, the insurer needs to keep the record for 45 days only.⁵⁵ However, if the promotion does result in the rendering of a financial

⁴⁷ Section 14(1)(b)(ii)(aa) of the *FAIS Act*.

⁴⁸ Section 14(1)(b)(ii)(bb) of the *FAIS Act*.

⁴⁹ Section 14(1)(b)(ii)(cc) of the *FAIS Act*.

⁵⁰ Section 14(1)(b)(iii) of the *FAIS Act*.

⁵¹ Section 14(1)(b)(iv) of the *FAIS Act*.

⁵² Section 14(1)(c) of the *FAIS Act*.

⁵³ Sections 5(f), 11(3)(b), 69 of the *Protection of Personal Information Act* 4 of 2013. Also see *Registrar of Financial Services Providers v Catsicadellis and Botha (now Greyvenstein)* (Enforcement Committee) unreported case number 6 of 6 November 2012.

⁵⁴ Section 14(2)(a) of the *FAIS Act*.

⁵⁵ Section 14(2)(a) of the *FAIS Act*.

service, the insurer is obliged to provide full details to the client in writing and within 30 days as per sections 4(1)(a) and 4(1)(c) and 5(a) and (c) of the GCC.⁵⁶

The purpose of these regulations is to ensure that a client who is approached with advertising material and who is in all likelihood preoccupied or not in a position to record all the information presented to him is not prejudiced. This would especially be the case where advertising by phone is instrumental in the conclusion of an insurance contract.

Furthermore, although the relevant regulations are all aimed at transparency, crafty telemarketers are still at an advantage when they deal with clients in this fashion, as they work in high pressure environments and are motivated by set targets for sales. Their own personal objectives may very well lead them to market even more aggressively.⁵⁷ Members of the public should be educated regarding their rights, and telemarketers should be forced to follow up their telephonic advertisements in writing, by mail or email at the request of the person thus targeted.

2.3.2 Role of insurance intermediaries

The activities of insurance intermediaries have always previously been subject to common law (Roman-Dutch law), which was the most important source of the rules pertaining to insurance intermediaries.⁵⁸ In terms of common law, the relationship between insurers, their representatives or employees, brokers and clients is often a matter of agency.⁵⁹ This can entail the agent (the broker, representative or employee of the insurer) performing a juristic act on behalf of another (the principal).⁶⁰ The agent can execute this mandate of the client,⁶¹ represent the client in entering into a legal relationship,⁶² and negotiate between different principals.⁶³

⁵⁶ Section 14(2)(c) of the *FAIS Act*.

⁵⁷ *Registrar of Financial Services Providers v Catscadellis and Botha (now Greyvenstein)* (Enforcement Committee) unreported case number 6 of 6 November 2012.

⁵⁸ Cohen 1997 *SA Merc LJ* 9, 30.

⁵⁹ Hattingh and Millard *FAIS Act Explained* 74; Reinecke *et al General Principles of Insurance Law* 337; Havenga *Law of Insurance Intermediaries* 1.

⁶⁰ Reinecke *et al General Principles of Insurance Law* 337; Havenga *Law of Insurance Intermediaries* 2; Nienaber and Reinecke *Life Insurance* 201.

⁶¹ Reinecke *et al General Principles of Insurance Law* 337, Havenga *Law of Insurance Intermediaries* 2; Nienaber and Reinecke *Life Insurance* 201.

⁶² Nienaber and Reinecke *Life Insurance* 201-202.

However, when the agent is in fact a mandatory, he can complete an application form on the instructions and on behalf of a client,⁶⁴ collect and receive information for an insurer on a prospective insured,⁶⁵ or provide information.⁶⁶ It is also his or her duty to act with care and skill,⁶⁷ to act with good faith⁶⁸ and to account for his actions.⁶⁹

The *FAIS Act* regulates the activities of insurance intermediaries, and has not changed the nature of the relationship between intermediaries and clients. Rather, the Act has introduced minimum standards according to which intermediary services should be rendered. This is because of the complexities associated with financial products and an asymmetry of information.⁷⁰

The Act applies to all types of financial products, including insurance, and section 1(6) provides that the *FAIS Act* must be construed as being *in addition to* any other law not inconsistent with its provisions, and not as replacing any such law. The law of agency and mandate therefore applies, and the *FAIS Act* refines those general principles for the insurance industry. Insurance products are included in the definition of a "financial product".⁷¹ Although the Act does not contain a definition of

⁶³ Nienaber and Reinecke *Life Insurance* 202.

⁶⁴ Nienaber and Reinecke *Life Insurance* 201.

⁶⁵ Nienaber and Reinecke *Life Insurance* 201.

⁶⁶ Nienaber and Reinecke *Life Insurance* 201.

⁶⁷ Havenga *Law of Insurance Intermediaries* 4; Hattingh and Millard *FAIS Act Explained* 75.

⁶⁸ Havenga *Law of Insurance Intermediaries* 4; Hattingh and Millard *FAIS Act Explained* 75. In general, also see Zimmermann "Good Faith and Equity" 217 *et seq.*

⁶⁹ Havenga *Law of Insurance Intermediaries* 4; Hattingh and Millard *FAIS Act Explained* 75. In general, also see Zimmermann "Good Faith and Equity" 217 *et seq.*

⁷⁰ Moolman *et al Financial Advisory and Intermediary Services Guide* 5.

⁷¹ "Financial product" means, "subject to subsec (2)- (a) securities and instruments, including shares in a company other than a 'shareblock company' as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980); debentures and securitised debt; any money-market instrument; any warrant, certificate, and other instrument acknowledging, conferring or creating rights to subscribe to, acquire, dispose of, or convert securities and instruments referred to in subparagraphs (i), (ii) and (iii); any 'securities' as defined in sec 1 of the Securities Services Act, 2002; a participatory interest in one or more collective investment schemes; a long-term or a short-term insurance contract or policy, referred to in the Long-term Insurance Act, 1998 (Act No. 52 of 1998), and the Short-term Insurance Act, 1998 (Act No. 53 of 1998) respectively; a benefit provided by- (i) a pension fund organisation as defined in sec 1(1) of the Pension Funds Act, 1956 (Act No. 24 of 1956), to the members of the organisation by virtue of membership; or (ii) a friendly society referred to in the Friendly Societies Act, 1956 (Act No. 25 of 1956), to the members of the society by virtue of membership; a foreign currency denominated investment instrument, including a foreign currency deposit; a deposit as defined in sec 1(1) of the Banks Act, 1990 (Act No. 91 of 1990); a health service benefit provided by a medical scheme as

"intermediary", "intermediary service" denotes any act other than the furnishing of advice that is performed by a person for or on behalf of a client or product supplier that results in the client entering into or offering to enter into any transaction in respect of a financial product with a product supplier.⁷² Even if the client may enter into any such transaction in future, it means that an intermediary service had been rendered.⁷³ The Act distinguishes intermediary services from "advice", making it clear that "advice" is any recommendation, guidance or proposal of a financial nature furnished by any means or medium, to any client or group of clients.⁷⁴ The advice must pertain to the purchase of any financial product or the investment in any financial product⁷⁵ and includes any recommendation, guidance or proposal of a financial nature:

... on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product.⁷⁶

The emphasis in the Act is therefore on intermediary services and advice. One must recognise that intermediary services and advice are often provided by insurance intermediaries as a single comprehensive service. The distinction in the Act seems to say that it is irrelevant whether an intermediary furnished advice together with assistance to enter into a contract of insurance or whether the intermediary only furnished advice or only assisted a client to enter into a contract. The *FAIS Act* applies in both instances and the insurance intermediary should have complied with all the provisions of the Act.

defined in sec 1(1) of the Medical Schemes Act, 1998 (Act No. 13 1 of 1998); any other product similar in nature to any financial product referred to in paragraphs (a) to (g), inclusive declared by the registrar after consultation with the Advisory Committee, by notice in the *Gazette* to be a financial product for the purposes of this Act; any combined product containing one or more of the financial products referred to in paragraphs (a) to (i) inclusive; any financial product issued by any foreign product supplier and marketed in the Republic and which in nature and character is essentially similar or corresponding to a financial product referred to in paragraphs (a) to (i), inclusive".

⁷² Section 1 (1)(a) of the *FAIS Act*; Hattingh and Millard *FAIS Act Explained* ch 2, 5 *et seq.*

⁷³ Section 1 (1)(a) of the *FAIS Act*.

⁷⁴ Section 1(1)(a) of the *FAIS Act*, *sv* "advice".

⁷⁵ Section 1(1)(a) & (b) of the *FAIS Act*.

⁷⁶ Section 1(i)(c) of the *FAIS Act*.

In addition to the definitions of "intermediary services" and "advice" in paragraph 1(b) above, the Act also introduces a representative as:

... any person who renders a financial service to a client for or on behalf of a financial services provider, in terms of conditions of employment or any other mandatory agreement ...⁷⁷

An employee is anyone who stands in a formal contract of employment with a financial services provider, renders his services under the authority of the service provider and earns a salary and will include an employee who renders services via a call centre.⁷⁸ A mandatory on the other hand serves as a representative under the supervision of a provider but will typically have his own offices with his own staff.⁷⁹ The *FAIS Act* allows for these mandatories to carry on business as sole proprietors or in any other available business form.⁸⁰ In short, it is impossible to sell insurance and not comply with the *FAIS Act*.⁸¹

2.3.3 LTIA and STIA

As indicated in paragraph 2.3.1 above, all advertising of insurance products is subject to the provisions of section 14 of the GCC.

As far as the Policyholder Protection Rules (PPR) (Long-term Insurance) are concerned, Part III Rule 4.1 contains the basic rules of conduct for direct marketing. These prescribe a general standard of conduct to render services honestly, fairly and with due skill, care and diligence. A direct marketer must also act honourably, professionally and with due regard to the convenience of the policyholder.

⁷⁷ Section 1(1) of the *FAIS Act*, *sv* "representative".

⁷⁸ Section 1(1) of the *FAIS Act*, *sv* "representative". On the contract of employment in general, see Van Jaarsveld "Labour Law" 499-533; Van Niekerk *Law@work* 61 *et seq*.

⁷⁹ Van Zyl *Financial Advisory and Intermediary Services Manual* 1-49.

⁸⁰ Van Zyl *Financial Advisory and Intermediary Services Manual* 1-49. On forms of business enterprise in general, see Benade *et al Entrepreneurial Law* 4. The *FAIS Act* is not prescriptive about the form of business enterprise chosen by a service provider. See in general Van Zyl *Financial Advisory and Intermediary Services Manual* 1-42.

⁸¹ Intermediaries need to comply with the *FAIS Act* and specifically with the duties set out in the GCC as discussed in 2(a)(i) above. It is sometimes confusing as policies differ and each product demands different disclosures depending on the complexity and nature of the product. The only differentiation between different kinds of intermediaries pertains to the qualifications they must have, the level 2 examinations applicable to them, and the requirements pertaining to their continuous professional development (Moolman *et al Financial Advisory and Intermediary Services Guide* 42-44).

Rule 4.1(c) specifically prescribes the content of representations made to the policyholder. Rule 4.3 contains an extensive list of particulars that must be disclosed to the policyholder. Rule 4.1(d) requires a direct marketer to disclose any conflict of interest, and Rule 4.1(e) requires the marketer to render services in accordance with the contractual relationships and reasonable requests or instructions of the policyholder. These must be executed as soon as reasonably possible and with due regard to the reasonable interests of the policyholder, which must be accorded appropriate priority over any interests of the direct marketer. These provisions are the same as the corresponding prescriptions and provisions of the FAIS Act. The PPR (Short-term Insurance) contains a similar provision.

3 The role of *bona fides* in pre-contractual negotiations

3.1 Good faith under general contract law

All contracts in our law are in principle *bonae fidei*.⁸² Where contracts are concluded between parties who are not on an equal footing, the universal role of good faith in common law is limited in that it merely underlies the duty imposed on the parties to act in good faith towards one another during the negotiations preceding their eventual agreement (by not making any misrepresentations by commission or omission), yet not upon the actual conclusion of their agreement.⁸³ For the purposes of this contribution on the insurer's duty of transparency, Lubbe's concise view that the principle of good faith is "uncertain in content" can be supported. But, apart from requiring honesty in commercial dealings, he argues that "[i]t at least connotes that a party should show a minimum respect for the interests that the other party seeks to advance by means of the contract".⁸⁴ Good faith is therefore not a validity requirement, or an essential or distinguishing feature of an insurance contract. As confirmed by the Supreme Court of Appeal in *Brisley v Drotzky*.⁸⁵

⁸² *Mutual & Federal Insurance Co v Oudsthoorn Municipality* 1985 1 SA 419 (A) 433.

⁸³ It was already recognised in Roman law in *D 16 3 31* that "[t]he good faith requirement calls for level dealing of the highest degree".

⁸⁴ Lubbe 1990 *Stell LR* 25.

⁸⁵ *Brisley v Drotzky* 2002 4 SA 1 (SCA) 15.

[G]ood faith may be regarded as an ethical value or controlling principle based on community standards of decency and fairness that underlies and informs the substantive law of contract, and not a 'free-floating' requirement for the conclusion of a valid contract or a basis for avoiding contractual liability.⁸⁶

The Supreme Court of Appeal in a recent judgment in the case of *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd*⁸⁷ held that there is no binding duty to enter into *bona fide* negotiations with the purposes or expectation of the conclusion of a contract. In this case the parties agreed that they would negotiate in good faith to amend or renew their existing contractual obligation.⁸⁸ *In casu* the appellant averred that the defendant did not enter into negotiations at all, breaching the agreement and its duty to negotiate in good faith. The court did not address the general duty of good faith, but rather the fact that our common law has to be developed and interpreted according to constitutional values and norms. It held that it was necessary to consider whether to develop the common law in accordance with the *Constitution* and whether the detailed provisions of the clause carry the necessary implication that the renewal was not to be regarded as null and void in every respect.⁸⁹

The proposition that a common law contract principle that provides meaningful parameters to render an agreement to negotiate in good faith enforceable is decidedly more consistent with section 39(2) than a regime that does not. A common-law principle that renders an obligation to negotiate in good faith enforceable cannot be said to be inconsistent with the sanctity of contract and the

⁸⁶ *Brisley v Drotzky* 2002 4 SA 1 (SCA) para 22.

⁸⁷ *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (SCA).

⁸⁸ The lease was for five years from 1 April 2004 to 31 March 2009. Clause 3 provided: "Provided that the Lessee has faithfully and timeously fulfilled and performed all its obligations under and in terms of this Lease, the Lessee shall have the right to renew same for a further period of four years and eleven months commencing on 1st April 2009, such renewal to be upon the same terms and conditions as in this Lease contained save that there shall be no further right of renewal, and save that the rentals for the renewal period shall be agreed upon between the Lessor and the Lessee at the time. The said right of renewal is subject to the Lessee giving written notice to the Lessor of its intention so to renew, which notice shall reach the Lessor not less than six (6) calendar months prior to the date of termination of this Lease. In the event of no such notice being received by the Lessor, or in the event of notice being duly received but the Parties failing to reach agreement in regard to the rentals for the renewal period at least three (3) calendar months prior to the date of termination of this Lease, then in either event this right of renewal shall be null and void."

⁸⁹ *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (SCA) paras 18, 36.

important moral denominator of good faith. Indeed, the enforceability of a principle of this kind accords with and is an important component of the process of the development of a new constitutional contractual order. There is no doubt that a requirement that allows a party to a contract to ignore the detailed provisions of a contract as though they had never been written is less consistent with these contractual precepts: precepts that are in harmony with the spirit, purport and objects of the *Constitution*.⁹⁰

Contracting parties certainly need to relate to each other in good faith. Where there is a contractual obligation to negotiate, it would be hardly imaginable that our constitutional values would not require that the negotiation must be done reasonably, with a view to reaching an agreement and in good faith.⁹¹ This position was due to other complications in the case itself not finally confirmed as a general rule of law that would necessarily apply to all contracts. The path has, however, been paved by this judgment to introduce such a duty on the basis of constitutional values where relevant.

Although specific statutory provisions have been enacted to regulate disclosures in insurance contracts, the insurance legislation examined in this contribution is not all-encompassing, necessitating the application of these general legal principles where statutory regulation is found to be lacking.⁹²

3.2 Precontractual information and bona fide negotiations in terms of insurance statutes

3.2.1 FAIS Act

Where common-law rules pertaining to precontractual negotiations are often more general,⁹³ statutory rules pertaining to financial products are not only very detailed but also designed to force insurance companies to be transparent. Section 3 of the GCC in terms of the FAIS Act places specific duties on services providers when

⁹⁰ *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (SCA) para 36.

⁹¹ *Everfresh Market Virginia (Pty) Ltd v Shoprite Checkers (Pty) Ltd* 2012 1 SA 256 (SCA) para 73.

⁹² See also PEICL a 2:301 c12 n1, 105.

⁹³ Reinecke *et al General Principles of Insurance Law* 179, 376

rendering financial services and this applies to all insurance contracts. It states that when rendering these services (which would include the rendering of advice or intermediary services pertaining to a long-term insurance product) the provider must ensure that the representations made and information provided to a client by the provider must adhere to a number of requirements.⁹⁴

The information and representations must be factually correct⁹⁵ and provided in plain language.⁹⁶ It must also avoid uncertainty or confusion and must not be misleading.⁹⁷ This reflects the general scope of transparency in that the information disclosed must be clear, understandable or intelligible, and unambiguous. Furthermore, it must be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client,⁹⁸ and it must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction.⁹⁹ Representations and information may, subject to the provisions of this Code, be provided orally and, at the client's request, confirmed in writing within a reasonable time after such a request.¹⁰⁰ Where information and representations are provided in writing or by means of standard forms or format, it must be in a clear and readable print size, spacing and format.¹⁰¹

Because the *FAIS Act* deals with financial products, the GCC further stipulates that information and representations regarding all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein and payable to the product supplier or the provider must be reflected in specific monetary terms.¹⁰² This stipulation further enhances transparency. Furthermore, where any

⁹⁴ See *JJ Grove v National Insurance Co-ordinators CC* unreported case number FOC 4564/06-07/GP (3) of 2 November 2012.

⁹⁵ Section 3(1)(a)(i) of the *FAIS Act*.

⁹⁶ Section 3(1)(a)(ii) of the *FAIS Act*.

⁹⁷ Section 3(1)(a)(ii) of the *FAIS Act*.

⁹⁸ Section 3(1)(a)(iii) of the *FAIS Act*.

⁹⁹ Section 3(1)(a)(iv) of the *FAIS Act*.

¹⁰⁰ Section 3(1)(a)(v) of the *FAIS Act*.

¹⁰¹ Section 3(1)(a)(vi) of the *FAIS Act*.

¹⁰² Section 3(1)(a)(vii) of the *FAIS Act*.

such amount, sum, value, charge, fee, remuneration or monetary obligation is not reasonably predeterminable, its basis of calculation must be adequately described.¹⁰³

Simply reading off the list makes one feel exhausted, and hence the question: Could the Regulator not simply have stipulated that intermediaries and advisors should at all times be transparent in their dealings with prospective insureds? In this vein one can understand the question raised internationally of whether a *sui generis* insurance law principle of a general duty of transparency has in fact developed over time.¹⁰⁴ A perusal of Ombud determinations in South Africa, however, tends to refute this claim.

One example of where the Regulator opted for detailed rules as opposed to more general ones is the GCC's stipulations on conflict of interests. A recent example of a conflict of interest is *Registrar of Financial Services Providers v Fusion Properties 268 CC t/a Broker's Choice*, which was heard by the Enforcement Committee.¹⁰⁵ The respondent *in casu* was Fusion Properties 268 CC t/a Broker's Choice, a close corporation and authorised financial services provider. The respondent was represented by Mr Botha, the sole member and key individual of the respondent. On 24 August 2011 some fourteen clients of the respondent replaced their short-term policies on the respondent's advice. The replacement policies were administered by Counterpoint Trading 328 CC t/a Policy Provider, the latter also being an authorised financial services provider. The practice of moving clients' policies is not suspect in itself. In fact, if a broker realises that his clients are not receiving value for their money or that a particular insurer is factually insolvent, it is expected of that broker to advise his clients accordingly and make suggestions regarding alternative insurance.

¹⁰³ Amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned need not be duplicated or repeated to the same client unless material or significant changes affecting that client occur, or the relevant financial service renders it necessary, in which case a disclosure of the changes to the client must be made without delay.

¹⁰⁴ A possibility also considered by the authors. Although this contribution does not also include a comparative study, this universal question has for example been critically discussed at the *Transparency in Insurance Law Joint Seminar* held on 4 May 2012 by the German and Turkish Chapters of AIDA (Istanbul); and is also considered in PEICL 94 to 96.

¹⁰⁵ *Registrar of Financial Services Providers v Fusion Properties 268 CC t/a Broker's Choice* (Enforcement Committee) unreported case number 22 of 10 July 2012.

There were however two issues with this particular move. The first *transgression* pertained to the respondent's failure to disclose to the clients the actual and potential financial implications, costs and consequences of the replacement policy and is not relevant to the present discussion. The second issue pertained to the respondent's failure to disclose to its clients that Mr Botha was the key individual of Counterpoint Trading 328 CC t/a Policy Provider and that he had an ownership interest as well as a financial interest in the replacement policies. The parties agreed that the respondent's failure to disclose these key facts regarding the replacement policies constituted a contravention of sections 8(1)(d)(i) and 8(1)(d)(ii) of the GCC.

Board Notice 58 of 10 April 2010 (which had already been introduced before the *Fusion Properties case*) introduced a statutory definition for conflict of interest as opposed to a common law definition and, in addition, terms such as "financial interest", "ownership interest", "immaterial financial interest" and "third party" were clearly defined.¹⁰⁶ Cases such as *Fusion Properties* illustrate that common-law definitions are not always sufficient and that more detailed rules are needed in order to enhance transparency.¹⁰⁷

The GCC now stipulates that the provider must disclose to the client the existence of any personal interest in the relevant service, or of any circumstance which gives rise to an actual or potential conflict of interest in relation to such a service, and take all reasonable steps to ensure the fair treatment of the client.¹⁰⁸ Non-cash incentives offered and/or other indirect considerations payable by another provider, a product supplier or any other person to the provider could be viewed as a potential conflict of interest.¹⁰⁹ Furthermore, the service must be rendered in accordance with the

¹⁰⁶ Moolman *et al Financial Advisory and Intermediary Services Guide* 168.

¹⁰⁷ "Conflict of interest" is defined in the GCC, as are terms such as "financial interest", "ownership interest", "immaterial financial interest" and "third party". Accordingly, "conflict of interest" denotes: "*any situation* in which a provider or a representative has an actual or potential interest that may, in rendering a financial service to a client, -(a) *influence* the *objective performance* of his, her or its obligations to that client, or (b) *prevent* a provider or representative from rendering an *unbiased and fair* financial service to that client, or from acting in the interests of that client, including, but not limited to- (i) a *financial* interest; (ii) an *ownership* interest; and (iii) *any relationship* with a *third party*". Own emphasis.

¹⁰⁸ Section 1(1) of the GCC, *sv* "Conflict of Interest". Also see s 3(f) of the GCC.

¹⁰⁹ *Registrar of Financial Services Providers v Fusion Properties 268 CC t/a Broker's Choice* (Enforcement Committee) unreported case number 22 of 10 July 2012.

contractual relationship and reasonable requests or instructions of the client, which must be executed as soon as reasonably possible and with due regard to the interests of the client. These must be accorded appropriate priority over any interests of the provider.¹¹⁰

Also, the transactions of a client must be accurately accounted for and the provider involved must not deal in any financial product for his own benefit, account or interest where the dealing is based upon advanced knowledge of pending transactions for or with clients. This also applies to any non-public information the disclosure of which would be expected to affect the prices of such a product.¹¹¹

In addition to all the above-mentioned precontractual obligations, the GCC further stipulates that a provider must disclose to a client information on the relevant product suppliers, providers and most importantly, information about the financial service.¹¹² In the case of life insurance, a reasonable and appropriate general explanation of the nature and material terms of the contract must be provided. The intermediary must, for example, explain to a client whether a contract constitutes whole-life insurance or endowment insurance.¹¹³ Transparency is further enhanced by placing an obligation on the intermediary to make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision, and also to disclose material contractual information. For instance, if a life policy excludes claims where the life insured died as a result of suicide, this fact should be disclosed.

For life insurance it is also obligatory to provide full and appropriate information of the name, class or type of policy, the nature and extent of the benefits to be provided, and the manner in which the benefits will be paid. Information on the

¹¹⁰ Section 3(d) of the GCC.

¹¹¹ Section 3(e) of the GCC.

¹¹² Section 7 of the GCC.

¹¹³ According to Nienaber and Reinecke *Life Insurance* 74-75, whole life insurance is a basic life insurance policy. Against a premium, the policy guarantees to pay the sum insured. Endowment insurance is different because such a policy has a term and a maturity date. The policyholder or beneficiary receives a benefit either whether he dies before the maturity date or whether he is alive on the maturity date.

nature and extent of the client's monetary obligations, which in the case of long-term insurance is the payment of the premium, must also be disclosed in full.¹¹⁴

In explaining the client's monetary obligations, an intermediary must also explain how payment should be made and how often,¹¹⁵ and very importantly, what the consequences will be in the case of non-payment. An aspect which is important for long-term insurance policies is any anticipated or contractual escalations, increases or additions to the product, such as premium increases due to inflation. Furthermore, a client must be informed of the nature, extent and frequency of any incentive, remuneration, consideration, commission, fee or brokerages (any "valuable consideration"),¹¹⁶ which will or may become payable to the provider, by any product supplier or any person other than the client, or for which the provider may become eligible. Payments made must be as a result of the rendering of the financial service, as well as the identity of the product supplier or other person providing or offering the valuable consideration.¹¹⁷

As far as the proposed contract between the parties is concerned, the intermediary has an obligation to disclose to the client concise details of any special terms or conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided and any guaranteed minimum benefits or other guarantees. Further disclosures must be made regarding the extent to which the product is readily realisable or to which the funds concerned are accessible.¹¹⁸ The GCC also provides for disclosures regarding material tax considerations, whether cooling-off rights are offered and, if so, the procedures for the exercise of such rights. It is important to disclose any material investment or other risks associated with the product and, where provision is made

¹¹⁴ Section 7 of the GCC.

¹¹⁵ Section 7 of the GCC.

¹¹⁶ Meaning any value changing hands, not to be confused with the English doctrine of valuable consideration in the context as a requirement for the valid conclusion of a contract, which does not apply in our law.

¹¹⁷ Provided that where the maximum amount or rate of such a valuable consideration is prescribed by any law, the provider may (subject to s 3(1)(a)(vii)) elect to disclose either the actual amount applicable or such a prescribed maximum amount or rate.

¹¹⁸ In addition, there should be disclosures regarding any restrictions on or penalties for early termination of the contract or withdrawal from the product, or other effects, if any, of such a termination or withdrawal (s 7(1)(c)(ix) of the GCC).

for an increase of premiums, the amount of the increased premium for the first five years and thereafter on a five year basis but not exceeding twenty years.¹¹⁹

An intermediary must fully inform a client in regard to the completion or submission of any transaction requirement – such as an application form – that all material facts must be accurately and properly disclosed, and that the accuracy and completeness of all answers, statements or other information provided by or on behalf of the client are the client's own responsibility.¹²⁰ Where the provider completes or submits any transaction requirement on behalf of the client, the client should be satisfied as to the accuracy and completeness of the details.¹²¹ Furthermore, a client should be informed of the possible consequences of the misrepresentation or non-disclosure of a material fact or the inclusion of incorrect information.¹²² It is also imperative to inform a client that he has the right to be supplied with a copy or written or printed record of any transaction requirement within a reasonable time, should he request this.¹²³ No provider may in the course of the rendering of a financial service request any client to sign any written or printed form or document unless all details required to be inserted thereon by the client or on behalf of the client have already been inserted. Having a client sign only a blank application form clearly goes against the notion of transparency. It can once more be emphasised that these rules apply to all types of insurance contracts.

3.2.2 LTIA and STIA

Although PPRs seemingly have bearing upon existing contracts and should not form part of the discussion on precontractual negotiations, the conduct of intermediaries is often the direct cause of the inclusion of a clause in a contract that is unfair to the client and ultimately results in some direct or indirect advantage to the intermediary and/or the insurer. There is probably an overlap between some of the GCC's stipulations and the PPRs on precontractual negotiations. Although this may lead to

¹¹⁹ Section 7 of the GCC.

¹²⁰ Section 7 of the GCC.

¹²¹ Section 7 of the GCC.

¹²² Section 7 of the GCC.

¹²³ Section 7 of the GCC. In keeping with the consumer maxim *verba volant, scripta manent*, which roughly translates as "spoken words fly away, yet written words remain".

problems of interpretation and is less than ideal, it actually has the effect of enhancing consumers' rights.

For long-term insurance, it deserves mentioning that Part IX Rule 19.1 of the PPR voids any waiver or conduct to induce a waiver of any right or benefit conferred upon a policyholder. In addition, Part IX Rule 20 provides for the payment of penalties where an insurer contravenes or fails to comply with any of the PPRs, with the result that insurers who are in breach of this rule face penalties regardless of whether such waiver actually had detrimental consequences or not.

In a similar way, Part VI Rule 8 of the PPRs in terms of the STIA voids any waiver or conduct to induce a waiver of any right or benefit conferred upon the policyholder by these Rules. Transparency requirements are further enhanced by Rule 4.2(c), which requires disclosure records and documentation to be kept for at least five years after the termination of the relevant policy. Rule 5 provides details of the provisions that will be void upon inclusion in the contract, and Rule 6 prescribes the format of the policy document.¹²⁴ Finally, Rule 9 provides for the payment of penalties where an insurer contravenes or fails to comply with any of the PPR.

4 Consequences, sanctions and penalties for failure to comply with transparency, good faith and fairness duties

4.1 General

In the light of the above, it is necessary to consider the consequences of infringing the common law and statutory duties pertaining to precontractual information obligations. Because various consequences attach to infringements, it is best to categorise infringements in accordance with these consequences. For the purposes

¹²⁴ This rule deals with issuing the policy document and not with the conclusion of the insurance contract. It may be issued only if the provisions are recorded, as regards layout, letter types and spacing, in an easily readable manner and if the wording of every provision of the policy has a reasonably precise, ascertainable meaning. In addition, the insurer must, within a reasonable period, inform a policyholder in writing of the details of any available internal complaint resolution system and procedures, as well as full particulars relating to the Short-term Insurance Ombudsman. Rule 7.5 specifically requires an insurer to ensure that a policy contains a provision for a period of grace for the payment of premiums of not less than 15 days after the relevant due date for payment, provided that if it is a monthly policy, such a provision must apply with effect from the second month of the currency of the policy.

of this discussion a distinction is made between consequences that affect the obligations between the parties and can roughly be categorised as contractual matters, and consequences that invoke penalties and other enforcement actions.

4.2 Consequences that affect the obligations between the parties and dispute resolution by the FAIS Ombud

4.2.1 Under general common law

Failure to comply with this common law duty leads to a misrepresentation, which renders the contract not *ipso facto* void, but merely voidable at the election of the prejudiced party.¹²⁵ The insurance proposer has a right to avoid liability on the contract just as the insurer has the right to do so where a proposer misrepresents a material fact. Should the contract be voided at the election of the innocent party, an *ex lege* duty to give restitution exists.¹²⁶ Where the contract is divisible, it may be partially voided and the non-offending portion of the contract maintained.

Where the misrepresentation causes a *iustus error* in the mind of the prospective policyholder, the aggrieved party can in the alternative rely on the total absence of consensus. A contract will be deemed to be void *ab initio* only where the error is both material and reasonable. The court pointed out in *Brink v Humphries & Jewell (Pty) Ltd*¹²⁷ that "[w]here the misrepresentation results in a fundamental mistake, the 'contract' is void *ab initio*".¹²⁸ In this scenario there is no *ex lege* duty to give restitution and claim the return of performances already delivered. An error will be deemed to be reasonable when it is caused by the other party's misrepresentation. It should be noted that errors in motive are not seen as material or relevant, and the prospective policyholder cannot rely on a mistake of this nature.

Yet where an insurer fails to disclose material and relevant information pertaining to the insurance product, which creates an error in motive that induces the prospective

¹²⁵ *Allen v Sixteen Stirling Investments (Pty) Ltd* 1974 4 SA 164 (D) 169; *Feinstein v Nigli* 1981 2 SA 684 (A) 700.

¹²⁶ *Extel Industrial(Pty) Ltd v Crown Mills (Pty) Ltd* 1999 2 SA 719 (A); 733 on the possibility of a claim for damages.

¹²⁷ *Brink v Humphries & Jewell (Pty) Ltd* 2005 2 SA 419 (SCA).

¹²⁸ *Brink v Humphries & Jewell (Pty) Ltd* 2005 2 SA 419 (SCA) 421.

policyholder to conclude the insurance contract, that qualifies as an actionable misrepresentation. Provisions that are agreed to yet not transparent due to errors or misrepresentations can in this manner be held to be non-binding.¹²⁹ Where the policyholder would choose to maintain the policy yet insists that an ambiguous or unclear provision be interpreted to his benefit, the *contra preferentem*-rule would offer some relief.

4.2.2 Under statutory law

A transgression of section 14 of the GCC falls within the FSB's Enforcement Committee's jurisdiction.¹³⁰ Furthermore, a client who had acts to his own detriment because of advertising that was misleading and fell short of the minimum standards as set out by section 14 of the GCC has recourse against the advertiser. This means that the matter may be referred to the FAIS Ombud or to a court.

Where an intermediary, representative or employee of an insurance company breaches any of his duties to a client, the client (the policyholder) has a right to take recourse in accordance with the provisions of the *FAIS Act*. It depends on the facts in each case whether the intermediary will be liable or whether liability attaches to the intermediary and the insurer.¹³¹ For instance, where the intermediary or advisor was in fact an employee or a representative of the insurer in terms of an employment or other contract, the insurer is liable as well, because the employee or representatives rendered services under the insurer's supervision.¹³²

A complainant can complain to the FAIS Ombud. A complaint can be about a contravention of the *FAIS Act* or a failure to comply with a provision of the Act which has led to the complainant's suffering financial prejudice or damage or, where he

¹²⁹ It is usually the case in consumer contracts where clauses must be fair to the consumer, that a non-transparent provision is held to be unfair and therefore non-binding.

¹³⁰ Also see para 4.4 below.

¹³¹ See Moolman *et al Financial Advisory and Intermediary Services Guide* 61, 73-79. The insurer will be a defendant in such an action where the insurer was the employer of the advisor or intermediary in accordance with the principles of vicarious liability. On vicarious liability, see Neethling and Potgieter *Law of Delict* 372.

¹³² See *Judith Augusta Theophiel Eduard Campioni-De Vleesshauwer v Suzette Brickhill and Mathys Johannes Marais t/a Protea Makelaars* unreported case number FAIS 04437/11-12/LP 3 of 21 January 2014.

has not already suffered financial prejudice or damage, is likely to do so in future.¹³³ For the purposes of a case before the Ombud, it is not necessary to prove that there has already been a loss, but even a future loss can found a case. However, if a policyholder wants to approach a court, it is necessary to prove that a contravention of the *FAIS Act* has already caused financial prejudice. Another cause of complaint to the Ombud is the wilful or negligent rendering of a financial service to the complainant, which has caused prejudice or damage to the complainant or which will cause prejudice or damage in future. Again, in order to found a civil action, the wilful or negligent rendering of a financial service does provide a disgruntled policyholder an action in a civil court, but the Ombud can also hear cases where a complainant is expected to suffer prospective damage. Finally, the Ombud can hear cases where the complainant has been treated unfairly.¹³⁴

There are great similarities between the powers of a civil court and that of the office of the Ombud. For instance, a determination by the Ombud has the same effect as a court order. However the monetary jurisdictional limit on Ombud cases is R800 000.¹³⁵

Because the *FAIS Act* must be construed as being *in addition to* any other law not inconsistent with its provisions, the Ombud should also consider common-law aspects pertaining to contract, such as the validity of contracts or individual provisions in contracts, as set out above.¹³⁶

In the light of the above, the question is really whether and under which circumstances infringement will affect a contract or individual contractual provisions to such an extent that the particular contract or individual provisions will be invalid. As already stated, this will be determined on a case-by-case basis in the first instance according to the relevant statutory criteria and, where necessary, in conjunction with and as informed by the provisions of substantive common law.

¹³³ Section 1(1)(a) of the *FAIS Act*, *sv* "complaint". "Financial prejudice" or "damage" all have very specific meanings in law. See para 4.3 below for a discussion on this matter.

¹³⁴ Reinecke *et al General Principles of Insurance Law* 354.

¹³⁵ See the discussion of such a monetary claim in para 4.3.

¹³⁶ Section 1(6) of the *FAIS Act*.

4.3 Payment of damages or other compensation

Where an infringement of the rules pertaining to *bona fide* negotiations has not resulted in an invalid contract or invalid contractual provisions but it has caused the policyholder harm, one may ask whether and under which circumstances infringement may result in damages or other compensation being awarded to the insured or a party such as a beneficiary.

Where the misrepresentation is intentional or negligent, the presence of fault enables the prospective policyholder to claim delictual damages, provided the other requirements for a delictual damages claim are also met.¹³⁷ Acknowledging a contractual damages claim for a precontractual misrepresentation will not be possible, as it would elevate the duty of representation to a contractual provision.¹³⁸ The courts furthermore have an inherent jurisdiction to award a damages claim based on a failure to adhere to statutory administrative procedures and in extreme cases even constitutional damages where an infringement of a constitutional right (in this case the right of access to information) causes compensable damages.¹³⁹

For insurance claims, the FAIS Ombud has extensive discretionary powers to award an amount as fair compensation for any "financial prejudice" or "damage" suffered.¹⁴⁰ As stated above, this is limited to a maximum amount of R800 000.¹⁴¹ The Ombud may also prescribe interest at a rate within his discretion, as discussed above. It is submitted that such a claim for damages in terms of the *FAIS Act* by far outweighs the onerous process of claiming damages in a court of law. This appears to be the most suitable remedy for the disgruntled policyholder where the insurer's conduct lacks transparency.

¹³⁷ Conduct (either a commission or an omission of an *ex lege* duty to disclose); wrongfulness; fault; causation (both physical and legal) and loss or damages.

¹³⁸ As pointed out by the court in *Trotman v Edwick* 1951 1 SA 443 (A) 449.

¹³⁹ This will clearly depend on whether or not such an award is seen as "appropriate relief" in accordance with s 38 of the *Constitution*, which poses its own unique challenges which include approaching the court at great expense. In this regard also see *Fose v Minister of Safety and Security* 1997 3 SA 786 (CC).

¹⁴⁰ Section 20 of the *FAIS Act*.

¹⁴¹ In this regard see Moolman *et al Financial Advisory and Intermediary Services Guide* 233.

The complainant, applicant or plaintiff bears the general burden of proof. It must be proven on a balance of probabilities that damage or loss was suffered and a reasonable estimate provided to the Ombud or court of law or other determination tribunal or body. An award will be in the discretion of the Ombud or the presiding officer.

4.4 Consequences that invoke statutory enforcement action

4.4.1 Enforcement Committee actions in terms of the FAIS Act

The FSB acts against insurance intermediaries via the Enforcement Committee. The Enforcement Committee is an administrative body which adjudicates all alleged contraventions of legislation administered by the FSB.¹⁴² The Committee may impose unlimited penalties, compensation orders and cost orders. Such orders are enforceable as if they were judgments of the High Court of South Africa.¹⁴³ The Enforcement Committee may rule against a contravention of *any* legislation administered by the FSB and in the context of insurance this means a contravention of the LTIA Act, the STIA and the *FAIS Act*, although the bulk of rules fall within the ambit of the *FAIS Act*. The ruling is made against the perpetrator and the facts of the matter will determine whether only the intermediary or the intermediary and the insurer will be liable to pay the penalty.

In addition to the payment of penalties, the FSB may pursue a variety of other enforcement actions.¹⁴⁴ Section 14(a) provides for the debarment of persons who no longer meet the personal characteristics or qualities of honesty and integrity or where such a person contravenes *any* provisions of the *FAIS Act*. For instance, if a broker is found guilty of fraud in a criminal court he no longer meets the Fit and Proper Requirements.¹⁴⁵

¹⁴² This Committee functions in accordance with s 10 of the *Financial Services Board Act* 97 of 1990.

¹⁴³ FSB 2015 <https://www.fsb.co.za/enforcementCommittee/Pages/enforcementActions.aspx>.

¹⁴⁴ Hatting and Millard *FAIS Act Explained* 181-198.

¹⁴⁵ Moolman *et al Financial Advisory and Intermediary Services Guide* 28-31.

The Registrar is entitled to suspend or withdraw any licence of FSP.¹⁴⁶ This will also be a remedy where any FSP no longer meets the financial and procedural requirements for it to operate as an FSP.¹⁴⁷ The *FAIS Act* also provides for voluntary sequestration, winding-up and closure of an FSP, which provides indirect protection to clients and prospective policyholders.¹⁴⁸ The removal of directors facilitates the enforcement of the *FAIS Act*.¹⁴⁹

Appeals regarding any administrative action taken by the Registrar may be made to the FSB Appeal Board.¹⁵⁰ The High Court has inherent jurisdiction to review any administrative action, including action taken by the Registrar.

4.4.2 Actions in terms of the LTIA and STIA

The LTIA provides for the registration of long-term insurers, for the control of certain activities of long-term insurers and intermediaries, and for matters connected therewith. As the Act is of a regulatory nature, it prescribes rules for the registration of insurers, business and administrative practices and policies of insurers and intermediaries, financial arrangements, judicial management and the final winding-up of insurers. The Act also creates punishable offences and prescribes penalties for non-compliance. It does not contain specific rules on transparency issues. The STIA provides for the registration of short-term insurers; the control of certain activities of short-term insurers and intermediaries; and for matters connected therewith such as short-term insurance business, which include business and administrative practices and policies, financial arrangements, judicial management and the winding-up of insurers, prescribes specific fee structures and allows for an order to pay penalties for non-compliance. Therefore, unless an insurer is prohibited from carrying on business or is debarred or placed in liquidation or under sequestration, there is nothing that prevents such an insurer or his representatives from entering into contracts.

¹⁴⁶ Section 9 of the *FAIS Act*.

¹⁴⁷ Section 8 of the *FAIS Act*. Also see Hatting and Millard *FAIS Act Explained* 181 for a general discussion on suspensions and the withdrawals of licences.

¹⁴⁸ Section 38 of the *FAIS Act*.

¹⁴⁹ Section 8(1) of the *FAIS Act*.

¹⁵⁰ Section 26 of the *FAIS Act*. Also see Hatting and Millard *FAIS Act Explained* 195 for a discussion on the appeals procedure.

Although these consequences can be seen either as the carrot or the stick, they do not enable the policyholders any right of financial redress due to the resulting lack of transparency. Courts have an inherent jurisdiction to adjudicate and determine issues of a failure to comply with the LTIA and the STIA, as set out above, yet the statutes do not allow the courts to award any financial compensation to policyholders who suffer losses due to the insurer's failure to comply with its duties in terms of the acts.¹⁵¹

5 Conclusion

It remains an international question whether a *sui generis* insurance law principle of a general duty of transparency has in fact developed over time. It is ubiquitous as it features throughout the insurance sector and the product life cycle – in the precontracting process as discussed in this contribution, the rights and duties of the contracting parties (which include product and cost transparency), dispute resolution and insurance supervisory law.¹⁵²

Transparency as a value is firmly embedded not only in common-law rules pertaining to precontractual negotiations that have bearing on insurance contracts, but also in the detailed rules that govern the behaviour of insurers, intermediaries and advisors. This is a matter that most modern-day insurance lawyers struggle with, as common law and statutory principles cannot be disengaged into two autonomous sets of rules. In a nutshell, irrespective of the source of the rules, transparency is brought about when all of the relevant information is completely, clearly and with certainty disclosed in an intelligible manner. Not only does this promote trust in our financial services industry but it also promotes a feeling of security for consumers.

The drive to professionalise the financial services industry and to develop the skills and knowledge of those who sell insurance products not only saw the promulgation of the *FAIS Act* but also amendments to the PPRs. The message is clear: the insurance industry cannot afford to do business in a way that is not consumer-

¹⁵¹ The same applies where there is a contravention of the *Promotion of Access to Information Act 2* of 2000.

¹⁵² As concluded by Wandt "Transparency as a General Principle" 9.

orientated and transparent. Mistakes cost money. Institutions such as the FAIS Ombud make it possible for aggrieved clients to enforce their rights and over and above civil judgments against services providers, the payment of exorbitant penalties represent the stick, in case the carrot (the promise of satisfied, well-informed clients) was not juicy enough.

The South African legislative framework for financial services providers, although complicated and very detailed, complements common-law rules, and together these rules form a sound platform which should inspire consumer confidence.

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LIST OF ABBREVIATIONS

ASA	Advertising Standards Authority of South Africa
BGHZ	Bundesgerichtshof Zivilsachen
CPA	Consumer Protection Act
FAIS	Financial Advisory and Intermediaries Act
FSB	Financial Services Board
GCC	General Code of Conduct
LTIA	Long-term Insurance Act
PEICL	Principles of European Insurance Contract Law
PER/PELJ	Potchefstroomse Elektroniese Regsblad / Potchefstroom Electronic Law Journal
PPR	Policyholder Protection Rules
SALJ	South African Law Journal
SA Merc LJ	South African Mercantile Law Journal
Stell LR	Stellenbosch Law Review

STIA Short-term Insurance Act

TCF Treating Customers Fairly

**TRANSPARENCY, TRUST AND SECURITY: AN EVALUATION OF THE
INSURER'S PRECONTRACTUAL DUTIES**

D Millard*

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SUMMARY

Transparency in insurance law attaches to the rights and duties of the parties, the relationships between insurers, insurance intermediaries such as agents and brokers, insurance supervisory law and insurance dispute resolution procedures. Regarding the rights and duties of the insurer and the prospective policyholder, it requires insurers to disclose precontractual information in a timely manner that is clear, understandable, legible and unambiguous. Transparency as a value is incredibly important in insurance contracts.

This contribution focuses exclusively on the insurer's duty of disclosure during precontractual negotiations. Although the insured's duty of disclosure has enjoyed more attention in the past, the duty clearly applies to the insurance proposer as well as the insurer. The purpose of this contribution is to evaluate the nature and extent of the insurer's transparency duties as informed by both common and statutory laws.

The insurer's duty is derived primarily from the statutory rights of access to information in accordance with the provisions of the *Constitution of the Republic of South Africa* and the *Promotion of Access to Information Act*. It is furthermore supported by specific insurance consumer protection law found in the detailed provisions on mandatory disclosures in the *Financial Advisory and Intermediary Services Act*, the *Long-term Insurance Act*, the *Short-term Insurance Act* and, finally, the Policyholder Protection Rules issued in accordance with these acts. Strict rules on advertising can be found in the General Code of Conduct issued under the FAIS Act.

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The Act furthermore specifically targets the activities of insurance intermediaries in precontractual disclosures. The fact that insurance products and services have been exempted from the scope of the *Consumer Protection Act* from 28 February 2014 should not diminish the insured's right to rely on universal consumer protection principles as envisaged by South African insurance legislation.

The insurer's duty to disclose is in the last instance also derived from the common law duty not to make misrepresentations by commission or omission. When negotiating an insurance contract, the insurer's duty to speak is not based on a general requirement of *bona fides*, but is recognised as an *ex lege* duty due to the involuntary reliance of the prospective insured on information supplied by insurers in the market. A lack of transparency should lead to the insurer's accountability. A failure to disclose material information or a disclosure of false information that goes to the root of the matter and that induces the prospective policyholder to buy the insurance product is recognised as an actionable misrepresentation. Statutory provisions do not diminish the common-law duty not to make misrepresentations, but provide details of the nature and extent of the information duty to provide clarity and legal certainty in the determination of the standards of transparency required in law.

In addition, statutes provide for enforcement actions by regulators, orders that could affect the licence of the insurer and provide for punishable offences and penalties. In terms of common law, a misrepresentation by omission or commission renders the insurance contract wholly or in part voidable. The policyholder may decide to rescind the contract and claim restitution. He may also, in conjunction with rescission, or as an alternative when deciding to maintain the contract, claim delictual damages or even constitutional damages when judged by a court of law as appropriate relief. Statutory remedies include a monetary award by the Insurance Ombud. Even though such an award is capped at R800 000, it is submitted that it is preferred to a civil law damages claim.

KEYWORDS: Transparency, Insurance Law, Insurer's pre-contractual duties, *Financial Advisory and Intermediary Services Act 37 of 2002*, Policyholder Protection Rules in terms of the *Long-term Insurance Act 52 of 1998* and the *Short-term Insurance Act 53 of 1998*.