Katica Tomić, LL.M.[1]

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THE PRINCIPLE OF GOOD FAITH IN EUROPEAN AND NATIONAL INSURANCE LAW

Abstract

In recent years, insurance markets have become more dynamic due to deregulation of insurance industry, globalization of insurance institutions, increased competition, technological progress, changing customer behavior and regulatory activity, which have greatly intensified in recent years in response to the global financial crisis. In the wake of the global financial crisis, additional measures aimed at enhancing consumer protection were passed in Europe. These include the Insurance Distribution Directive (IDD) and the Markets in Financial Instruments Directive (MiFID II). The IDD contains numerous innovations compared with the Insurance Mediation Directive (IMD Directive 2002/92/EC), including a new conduct requirement for the insurance distributors to „always act honestly, fairly and professionally in accordance with the best interests of the customer". The main concept behind this rule is that an insured shall only be able to make right decision when he is clearly informed on services offered (and their risks) and distributors can only provide services to clients in accordance with clients' best interests once they became fully familiar with a kind of a customer that they are dealing with. Most of the EU Member States have a civil law system, with the general clauses of fairness and good faith. EU Member States shall implement the IDD into national law, therefore it is arguable that they should decide whether these standards are mere synonyms of the existing general clauses, or these standards are different from those clauses.

Keywords: *Insurance Distribution Directive, good faith, utmost good faith, Civil Code, Insurance Contract Act*

[1] Rechtsanwälte BVM, AWA, Vienna; PhD candidate at the Faculty of Law, University of Vienna, Austria and at the Faculty od Law Sciences, University "Apeiron" Banja Luka, Bosnia and Herzegovina; mail: katicatomic123@gmail.com.

1. Introduction

The Insurance distribution directive (IDD)[2] entered into force on February 22, 2016 and all Members States have to transpose it into national laws by February 2018. The IDD is a minimum harmonisation Directive and it is designed to improve EU regulation in the insurance market by ensuring a level playing field for all participants involved in the sale of insurance products. It aims to address the inconsistent implementation of the Insurance Mediation Directive (IMD)[3] across EU Member States and to challenge the increased complexity of the insurance market.

The financial crisis clearly showed that consumer protection in some financial markets was highly deficient in the run-up to financial crisis of 2007/2008. Improved protection on consumers in financial markets is a key preoccupation among policy-makers and IDD is a step towards an increased level of consumer protection and market integration in relation to Directive 2002/92/EC. The new directive, like the Directive 2002/92/EC, is a minimum harmonisation directive, so Member States can adopt stricter provisions if they wish. Therefore, it will not lead to the removal of rules with restrictive requirements in the area of information provision already in place in EU Member States.

Under the IDD, there are two general principles: distributers must always act honestly, fairly and professionally in accordance with the best interest of customers and all information provided by distributers must be fair, clear and not misleading. The IDD aims to harmonize the legislations of the Member States by requiring that the behavior of distributors complies with legal standards of honesty, fairness and professionalism in accordance with the best interest of customers.[4]

This requirement contain IDD and Directive on the Market in Financial Instruments (MiFID II)[5], and it imposes a high standard upon all distributors (including direct sellers and those distributing to professional customers) to consider the interests of customers in their business. MiFID II requires benefits to enhance the quality of the service to the client (and not against the criteria to act honestly, fairly, professionally and in the

[2] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast), OJ L 26, 2.2.2016, p. 19–59 – IDD.

[3] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation, OJ L 009, 15.1.2003, p. 3 - Directive 2002/92/EC.

[4] Article 17 IDD „always act honestly, fairly and professionally in accordance with the best interests of their customers".

[5] Article 24 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12.6.2014, p. 349–496 - MiFID. MiFID II and delegated Regulation is available at *http://ec.europa.eu/finance/securities/isd/mifid2/index_en.htm*.

best interests of the client),[6]IDD allows them, if there is no detrimental impact on the quality of the service and it is not against the criteria, to act honestly, fairly, professionally and in accordance with the best interests of its customers.

This article focuses on a new „general principle" on insurance distributors „to always act honestly, fairly and professionally" in accordance with the best interests of their customers. It's not clear how or if the disclosure of clear, meaningful and relevant information at contract level will impact consumer protection in Europe but it does raise a questions: Are the new principles in financial services related to the old one „ good faith" , or they are totally new? How does it apply to a broker when acting as agent of the insurer? Moreover, does the new rule require distributors to act in the best interests of customers separately from acting honestly, fairly and professionally or if (as of course they should) they act honestly, fairly and professionally, is that in itself in accordance with customers' best interests?

In this paper the author elaborates the lawful regulation of the principle on insurance distributors „to always act honestly, fairly and professionally" and the theory and current praxis of well-known principle of "good faith", which are based both on demandings and practical obedience of the principle. The author especially elaborates contents of the principle „good faith", emphasizes the legal nature and exposes the new Insurance distribution directive provisions on the principle and compares the principle with a new IDD general principle „to always act honestly, fairly and professionally" in accordance with the best interests of their customers.

2. Good faith in theory

Good faith is a key concept in civil law systems and requires parties to enter into relationships 'honestly and fairly' and be guided by truthful motives and purposes. Most civil codes have one or more general good faith provisions.[7] The principle of good faith played a major role in late Roman law,[8] medieval law and the 19th century, period of the first codifications.[9]

[6] Aricle 19 (i) MiFID.

[7] Art. 1134, § 3 and 1135 of the Belgian Civil Code; Art. 113 of the Brazilian Civil Code; Art. 1134 of the French Civil Code; Sec. 242 German Civil Code; Act V of 2013 on the Hungarian Civil Code (Section 1:3 of the Hungarian Civil Code sets out the principle of good faith and fair dealing); art. 1175 of the Italian Civil Code; Art. 3:11 of the Dutch Civil Code.

[8] M.J. Schermaier, „Bona fides in Roman contract law", in: *Good Faith in European Contract Law* (eds. R. Zimmermann, S. Whittaker), Cambridge University Press, Cambridge 2000, 63.

[9] B. Fauvarque-Cosson, D. Mazeaud, *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules*, Munich 2008, 151.

The concept of good faith has been a subject of continuing controversy since it was derived from the Roman legal equivalent "*bonas fides*". Academics' views on and the legal approach of the idea of good faith may often vary across the cultural divides and legal traditions which has caused some uncertainty about the nature of the concept itself and the consequent unpredictability of the outcome of its application.

Good faith is used in two distinct senses and most legal systems make a difference between subjective good faith[10] and objective good faith.[11] Subjective good faith means that a person is subjectively acting to the best of his knowledge, or according to what he should have known. It is of relevance particularly to the law of property (*bona fide acquisition*)[12] rather than to the law of obligations.

Objective good faith means an objective standard by which the behavior of the parties to an obligation is judge. It is usually regarded as a norm for the conduct of contracting parties, acting in accordance with or contrary to good faith. However, this two are not completely separate doctrines, as subjective good faith might have an impact of what objective good faith requires of a party. Moreover, an external, objective standard of behaviour offers a practical measure, but this stands in relation with understandings of good faith as a duty of morality which should be considered subjectively.[13] The contents of good faith may be coloured more subjectively, as in a traditional French view reducing good faith to the absence of bad faith in a subjective sense or may be coloured more objectively as in art. 1175 of the Italian Civil Code.[14]

Objective good faith is usually considered as a normative concept and the highest norm of contract law, or of the law of obligations or even of all private law. It can supplement a contract (where no express contractual provision exists and no statutory provision or custom gives guidance) or derogate from a contractual provision. This means that under specific circumstances an express contractual or even mandatory statutory provision cannot be relied upon. Good faith is often perceived as being the method used to moralize contractual relationships and to be in good faith is to behave loyally, sincerely, honestly; to keep one's word; to keep one's promise without

[10] On subjective good faith, see: S. Waddams, *Principle and Policy in Contract Law: Competing or Complementary Concepts?*, Cambridge 2011, 215.

[11] A. M. Forte, *Good Faith in Contract and Property Law*, Oxford 1990, 199.

[12] E.g. protection of good faith acquirers of movables

[13] C. Willett, *Fairness in Consumer Contracts: The Case of Unfair Terms*, Ashgate, Aldershot, Hants 2007, 2.

[14] Art. 1175 of the Italian Civil Code "*Il debitore e il creditore devono comportarsi secondo le regole della correttezza*" The debtor and the creditor must behave following the rules of honesty. "*Correttezza*" indicates the honesty that should preside over business relationship.

taking unfair advantage of others or holding others to an impossible standard**.** Good faith is required in a wide range of situations, including contracts and business dealings, business law, during mediation, arbitration or settlement negotiations in a personal injury or similar tort case.

Traditionally, three are three different meanings of the term "good faith": 1) good faith is "a criteria of interpretation" which means to interpret a legal text, especially contract text , in accordance with good faith is to interpret it according to its real spirit, and, in case of contract, according to what is acceptable for the parties, and not to interpret it strictly; 2. good faith is often said to be a moral standard itself (a legal-ethical principle)[15]; 3) good faith is always presumed to exist.[16] The theoretical standing of good faith may seem quite unclear since the terminology used by legal authors is far from unitary. Good faith is said to be a norm,[17] a principle,[18] a rule,[19] a maxim,[20] a duty,[21] a rule or standard for conduct,[22] a source of unwritten law,[23] a general clause.[24]

The ongoing debate on the notion of good faith in contract law has typically three dimensions: substantive dimension of justification of good faith duties in terms of (e.g. contractual ethics); a formal dimension

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[15] The Greek philosopher, Aristotle observed two thousand years ago that "if good faith has been taken away, all intercourse among men ceases to exist". Aristotle's statement emphasises the requirement of society upon its members to act in good faith not just with regard to commercial transactions, but also in any other daily intercourse. See: W. Tetley, „Good Faith in Contract: Particularly in the Contracts of Arbitration and Chartering", *Journal of Maritime Law & Commerce*, Vol. 35, 2004, 568.

[16] For example, French Civile Code provides that the good faith is always presumed and that the person who who alleges bad faith must prove it. A similar principle can be found in several other civil law jurisditions, such as Germany and Switzerland. In Austrian law, the principle of good faith and fair dealing is an ethical rule that is recognised as generally applicable (see OGH 29.04.1965 2 Ob 75/65) which is derived from the Imperial declaration in the introduction of the general Civil Code (*Allgemeines bürgerliches Gesetzbuch*-ABGB) of 1thJune 1811, which recognises as the basis of civil law (see OGH 07.10.1974 1 Ob 158/74) the „general principles of justice" expressly mentioned by the Code as a including „good faith", see § 863 and 914 ABGB.

[17] See, e.g., Karl Larenz, *Lehrbuch des Schuldrechts*, *Allgemeiner Teil* , Vol. I, München 1987[14], 129.

[18] See, e.g., A. S. Hartkamp, *Verbintenissenrecht* II (in: Asser series), Nos. 300, 301, 304; D. Medicus, S. Lorenz, *Schuldrecht I Allgemeiner Teil*, München 2008[18], No. 139 („*ein den einzelnen Rechtsvorschriften übergeordnetes Prinzip*").

[19] See, e.g., A. Menezes-Cordeiro, „Rapport portugais", *Travaux de l'association Henri Capitant, Tome XLIII, anne´e 1992. Journe´es louisianaises de Baton-Rouge et La Nouvelle Orle´ans, 'La bonne foi'*, Paris 1994, 338 (règle).

[20] See J. Carbonnier, *Droit Civil, vol. IV Les Obligations,* Paris 2000[22], No. 113 (*maxime*)

[21] See P. Malaurie, L. Aynès, *Cours de droit civil: Les obligations*, Paris 1999[10], No. 622 (devoir).

[22] See C. Massimo Bianca, *Il contratto*, No. 253 (*regola di condotta*).

[23] See A.S. Hartkamp, *Verbintenissenrecht II* (in: Asser series), Wolters Kluwer, No. 305.

[24] See, e.g., K. Zweigert, H. Kötz, *Einführung in die Rechtsvergleichung auf dem Gebiet des Privatrechts*, Tübingen, 1996[3], 149 (*Generalklausel*).

concerned with its structure as a vague standard; an institutional competence dimension raising the question of judicial freedom and constraint in adjudication based on open standards such as good faith. [25]

It is generally agreed that a general good faith clause does not contain a rule, at least not one similar to most other rules in the code. Also, good faith clause is not susceptive to subsumption since neither the facts to which it applies nor the legal effect that it stipulates can be established *a priori*. Good faith is therefore usually said to be an open norm (but still a norm). The content of the norm cannot be established in an abstract way but it depends on the circumstances of the case in which it must be applied, and which must be established through concretisation.[26]

In positive law there still is a substantive dimension in good faith, despite a very broad one (good faith as a very open norm, but still a norm), a substantive dimension negatively limited by the other two dimensions. In positive contract law, a solution will be seen as an application of the good faith principle, if it positively conforms to the open norm (substantive dimension) and does not follow already from another firmly established norm (formal and/or institutional dimension). Once a more specific norm is firmly established, good faith is no longer necessary to justify that rule, but this does not mean that the content of the open norm of good faith can ever be exhausted into more specific norms.

Classical definition of good faith in contract law refers to the need to take into account the legitimate interests of the other party. The court determines what good faith requires in the circumstances of the specific case and the judge has to determine the requirements of good faith in such an objective way as possible.[27] In the Netherlands the principle of good faith has been provided for in article 3:11 of the Dutch Civil Code (DCC) and entails that both parties may rely on the other parties' good faith. This principle is stated in article 3:12, 6:2 and 6:248 DCC and can also be found in case law. For instance, a term of an insurance agreement can be disregarded by the court if this term is, under the given circumstances, unacceptably contrary to the standards of reasonableness and fairness.[28] Stricter rule applies to general provisions (i.e. insurer's standard terms) and such provisions are voidable, if these are unreasonably inconvenient

[25] M. Auer, „Good Faith: A Semiotic Approach", *European Review of Private Law*, 2/2002, 280.
[26] See. *The Principles of European Contract Law and Dutch Law: A Commentary* (eds. D. Busch, E. Hondius, H. J. Van Kooten, W. M. Schelhaas, H. N. Schrama), Kluwer Law International, The Hague-London-New York 2002, 490; M.W. Hesselink, *The New European Private Law- Essays on the Future of Private Law in Europe*, Kluwer Law International, The Hague-London-New York 2002, 215.
[27] K. Larenz, *Lehrbuch des Schuldrechts. Bd. 1. Allgemeiner Teil*, C.H.Beck Verlag 1957, 126ff.
[28] Article 6:248(2) DCC.

for the insured.[29] Both statutory provisions can be used to remedy a breach of the duty of utmost good faith.

In France, article 1134 of the French Civil Code provides that all contracts "must be performed in good faith" and the obligations of the insurer and the insured are mainly set out in the French Insurance Code and the French Civil Code, as interpreted by the courts. In Belgium, the duty of good faith is one of the basic principles and It is provided for in articles 1134, § 3 and 1135 of the Belgian Civil Code, which is basically the same as the French Civil Code (with no difference between "good faith" and "utmost good faith".) In Hungary, section 1:3 of the Hungarian Civil Code sets out the principle of good faith and fair dealing. The parties to a contract (including an insurance contract) and third parties (e.g. beneficiaries) that are linked to a contract are obliged to observe the above principle pre-contractually and post-contractually throughout the existence of the legal relationship. According to the Hungarian Civil Code, the requirement of good faith and fair dealing is considered as breached where a party's exercise of rights is contradictory to his previous actions which the other party had reason to rely on.

3. Insurance distribution directive

In recent years, the European Union has enacted many new insurance regulations aimed at enhancing consumer protection. These include the Insurance Distribution Directive and the Markets in Financial Instruments Directive (MiFID II).

The IDD came into force on 23 February 2016 and must be transposed into the national laws of the EU Member States by 23 February 2018. The IDD have entailed a considerable number of additional obligations as regards documentation and the provision of information and applies to a wider regulation of insurance distributors, i.e. to any person carrying on the activity of „distributing insurance".[30] Notably, it governs the activity of distribution whether carried out directly by an insurer or through an intermediary.

The IDD recognises and applies its rules to three types of distributors, insurance intermediaries, i.e. persons that pursue the activity of insurance distribution for remuneration and who are not ancillary insurance intermediaries; ancillary insurance intermediaries, i.e. persons that pursue the activity of insurance distribution for remuneration but whose principal professional activity is not insurance distribution and

[29] Article 6:233(a) DCC.

[30] The new definition of 'insurance distribution' and 'insurance distributor' appears to encompass a larger number of firms than before.

who only distribute insurance products that are complementary to their goods or services; insurance undertakings.[31]

In the same way as the Markets in Financial Instruments Directive II (MiFID II), which regulates the purchase of investment products, the IDD is also intended to create standardised conditions in the European Union. However, while MiFID II aims at a maximum harmonisation of national regulations, the IDD is designed as a minimum harmonisation directive. That means that Member States have room to manoeuvre in its implementation. The IDD contains less strict provisions than MiFID II, particularly about commissions and the target group. However, Member States can introduce more rigid provisions or decide to make the advisory business subject to an authorisation requirement.

New Directive contains numerous new provisions, including: extending the scope to cover all sales of insurance products; identifying, managing and mitigating conflicts of interest; strengthening administrative sanctions; enhancing the suitability and objectiveness of insurance advice; ensuring that sellers' professional qualifications match the complexity of the products they sell; clarifying the procedure for cross-border market entry.

Article 17(1) of the IDD provides that "insurance distributors [must] always act honestly, fairly and professionally in accordance with the best interests of their customers". It is not clear how this new obligation will fit with the insurance market and what does „act with „fairness" mean?

The „fairness" is the objective element. This objective element is combined with the notion of 'honesty', which is subjective and objective element. The test in determining whether the duty has been breached is an objective test based on subjective facts. In other words, would an objective person (a reasonable person), knowing what the insurer actually knows, act the same way? According to linguistic interpretations it means that distributors honesty, fairness, and professionalism are valued according to best interests of customers, and not according to the objective criteria. Consequently, it could be also interpreted that in any particular case, honesty, fairness and professionalism of distributors have to be valued according to the interest of policyholders.

However, at first glance, it appears straightforward for an insurance broker acting (in a traditional sense) honestly, fairly and professionally in accordance with the best interests of their client, the policyholder. But how does this apply to insurers, where the policyholder is their contractual counterparty?

The exact scope of the Article 17 (1) requirement is unclear and goes beyond existing principal of good faith, which includes the requirement for

[31] This is a key change from IMD which only covered intermediary sales.

both parties to the contract to disclose all material facts and act honestly towards each other without any underhanded behaviour. Interpreted strictly, this could have a potentially far reaching effect in insurance market, so it will be interesting to see how this requirement is implemented in the EU Member States.

4. Good faith in insurance contracts

The principle of utmost good faith, expressed by the Latin maxim *uberrima fidei*, is one of the most important doctrines of insurance law and highest standard of principle good faith. Traditionally this principle requires on both the applicant for insurance and the insurer a duty of utmost good faith in their dealings with each other leading to the issue of a policy.[32] In modern insurance, this principle is used to refer to the insured's duty to disclose facts which are material to the risk and which enable the insurer to form a rational decision whether to accept the risk and, if so, at what premium.

Although this doctrine originated from English insurance law,[33] it is regarded as a fundamental principle which governs insurance contracts. However, the doctrine does not have the same meaning, nor its application is the same way in each legal system in which it has been adopted. Additionally, in some jurisdictions, the principle of utmost good faith is not recognized. For example, the insurance law of some civil law countries refers instead to the civil law concept of "good faith".[34]

The doctrine of utmost good faith requires that the insured act in good faith to disclose relevant information to the insurer when applying for insurance.[35] Originally, the common law duty of utmost good faith applied only at insured's pre-contractual duty.[36] Today, in many jurisdictions that have adopted the principle of utmost good faith, the application of the doctrine has been extended by the requirement that the insured must make to the insurer a fair presentation of the risk and that implies that he either discloses

[32] The principle of utmost good faith makes the application for insurance easier because most insurance companies do not check the facts before they issue the policy.

[33] This doctrine was originated from the case of Lord Mansfield C.J. in *Carter v. Boehm* ((1766) 3 Burr 1905) and his formulation of the disclosure duty is partially codified in the Marine Insurance Act 1906.

[34] See e.g. article 1134 of the French Civil Code; section 1:3 of the Hungarian Civil Code; section 7.1, 1258 Spanish Civil Code; article 2 and 3 of the Turkish Civil Code.

[35] The same provision contains Art 18. IDD. Before the conclusion of the contract, consumers will be provided with clear information about the professional status of the person selling the insurance product and about the nature of remuneration which he will receive. This does not apply for large risks and for reinsurance distribution activities.

[36] G. Blackwood, „The pre-contractual duty of (utmost) good faith the past and the future", *Lloyd's maritime and commercial law quarterly*, 2013, 322.

every material circumstances that he knows or ought to know which would influence the judgement of the insurer in deciding to underwrite the risk or provides information sufficient to put a prudent insurer on notice to enquire further into the cover proposed.

Also, in some of jurisdictions, the scope of this doctrine has been expanded to the exercise of contractual rights and the processing of claims.[37] The duty of disclosure forms part of the principle of utmost good faith and thus, is almost identical, whereas in other jurisdictions it is a separate duty imposed on the insured by statute. The ground for the strong emphasis of the principle of utmost good faith within the insurance relationship is that either party is dependent on support of the other party because of the unequal bargaining position of parties.

The insured is often regarded as being the weaker party[38] and less experienced in legal matters than the other party to the contract and the insurer has superior knowledge of the contract's content and actuarial practice, business, vast expertise. It is not always a case than an insured will be in a weaker negotiating position than the insurer, especially where the insured is a large commercial corporation.

In the following chapter we will review the good faith obligations in insurance contracts in Germany and United Kingdom.

4.1. The Principle of Utmost Good Faith in German Insurance contract Law

In Germany the doctrine of *Treu und Glauben* (literally fidelity and faith) is applicable in insurance contract law and it is generally recognized that the insurance relationship is governed to a special degree by such principle.[39] The principle of utmost good faith apply to all types of insurance contracts (life insurance, general insurance, reinsurance etc.) and particularly on insurance contracts with consumers. Both, the insurer and the insured are subject to the principle of utmost good faith (also an aggrieved party in some respect). The principle of utmost good faith is a constant duty to both insurer and insured throughout the contractual relationship[40] and irrespective of whether or not an actual insurance contract is concluded.

[37] Section 22 of the Danish Insurance Contracts Act.

[38] A reference to a „weaker party" in the EU private international law rules in civil and commercial matters usually relates to consumers, employees and insurance policy holders or other beneficiaries under insurance contracts.

[39] H. Heiss, *Treu und Glauben im Versicherungsvertragsrecht: Eine rechtsvergleichende Untersuchung deutscher und osterreichischer hochstrichterlicher Judikatur*, Wien 1989, 20ff; R. Fischer, „Treu und Glauben im Versicherungsrecht", *Versicherungsrecht – VersR Zeitschrift für Versicherungsrecht, Haftungs und Schadensrecht*, 1965, 197ff.

[40] Insurer's duty to inform and to advise and the insured's duty to disclose.

The principle of good faith is provided in Sec. 242 German Civil Code (*Bürgerliches Gesetzbuch* – BGB).[41] The insured's duty of disclosure which is contained in Sec. 19 German Insurance Contract Act (*Versicherungsvertragsgesetz* – VVG)[42] is the product of the principle of utmost good faith.[43] Sec. 19 VVG provides a detailed set of rules with regard to the insured's duty of disclosure[44] and the legal consequences following a violation of the disclosure.[45]

Where the policyholder deliberately (*vorsätzlich*) or with gross negligence (*grob fahrlässig*) has made incorrect statements, the insurer may withdraw (*zurücktreten*) from the contract.[46] If the policyholder acted without fault or was only guilty of simple negligence in violating these duties, the insurer may terminate (*kündigen*) the contract with one month's notice.[47]

In the event the insurer withdraws from the contract after the occurrence of the insured event, the insurer shall not be obligated to effect payment, unless the breach of the duty of disclosure refers to a circumstance which is neither responsible for the occurrence nor for the establishment of

[41] § 242 BGB „*Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern*." (An obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration).

[42] German insurance contract act (*Versicherungsvertragsgesetz* – VVG 2008) entered into force on 1 January 2008 (for policies concluded prior to that date it took effect as of 1 January 2009).

[43] H.Honsell, *Berliner Kommentar zum Versicherungsvertragsgesetz: Kommentar zum deutschen zum deutschen und österreichischen VVG*, Springer, Berlin-Heidelberg 1998, 2194.

[44] Sect. 19 para. 1 VVG 2008. Pursuant to this rule, the insured shall disclose to the insurer before making his contractual acceptance the risk factors known to him which are relevant to the insurer's decision to conclude the contract with the agreed content and which the insurer has requested in writing. If, after receiving the policyholder's contractual acceptance and before accepting the contract, the insurer asks such questions as are referred to in the first sentence, the policyholder shall also be under the duty of disclosure as regards these questions. If the contract is concluded by a person representing the policyholder, both the representative's knowledge and fraudulent conduct as well as the insured's knowledge and fraudulent conduct shall be taken into account in the application of the above. The insured may only invoke the duty of disclosure not having been breached intentionally or with gross negligence if neither the representative nor the insured has incurred responsibility for intent or gross negligence.

[45] Sec. 16 Austrian Insurance Contract Act (*Versicherungsvertragsgesetz* – VersVG), pre-contractual disclosure concerns every fact of importance for the decision of the insurer to take a risk and If violated the right to rescind the contract; if insurer rescinds it will be free from paying insurance money for insured events which were caused by the circumstance which was not disclosed or misrepresented; Pursuant to art. 931 of the Civil Obligations Act of the Republic of Croatia, on the conclusion of the contract, the policyholder shall report to the insurer all the circumstances that are material for assessing the risk, of which he is aware or of which he should have been aware; Sec. 82-84 Serbian insurance Act, provide the minimum content of the information that an insurer is required to make available prior to the conclusion of the contract to a policyholder.

[46] Sect. 19 para. 2, 3 VVG 2008.

[47] Sect. 19 para. 2 VVG 2008.

the occurrence of the insured event nor for the establishment or the extent of the insurer's liability. If the policyholder has fraudulently breached the duty of disclosure, the insurer is not obliged pay.

The insurer's right of withdrawal or termination, however, is excluded, if, having known of the undisclosed circumstances, he would have concluded the contract, albeit on different terms and conditions (unless the policyholder acted deliberately). In that case the insurer is entitled to modify the policy accordingly. The policyholder must generally provide notice of only those circumstances about which the insurer has queried in text form prior to the conclusion of the contract. The remedies for a breach of the duty of utmost good faith are not provided for in statutory rules.

The duty of utmost good faith applies at the pre-contractual and post-contractual stage. Sec. 19 VVG is primarily applicable but also the principle of utmost good faith applies during the pre-contractual stage.[48] Additionally, Sec. 23 VVG contains rules regarding the aggravation of risk which also constitute the written consequence of the principle of utmost good faith.[49] Sections 6 and 7 VVG prescribe the pre-contractual duty of utmost good faith for the insurer to inform and to advise. In addition, the principle of utmost good faith obliges the insurer to clarify any ambiguities.

As a general rule, under the VVG 2008 the insurer is required to give advice to the policyholder before the conclusion of an insurance contract and this advice must be documented.[50] The information must be provided in a clear and comprehensible manner.[51] Should there be a reason to do so advice must be provided during the term of the policy as well.[52]

The basic remedies for breach of the duty to disclose include the following: insurer's right to withdraw from the contract (if the breach

[48] The principle of utmost good faith nevertheless still is applicable where positive rules do not exist.

[49] Pursuant to this rules,, the insured is obliged to adjust objectively incorrect information if apparent to him and to give voluntary disclosure truthfully.

[50] Sect. 6 para. 1 VVG 2008. The insurer, unlike a broker (*Versicherungsmakler*) owes reasonable advice to the policyholder. In determining the reasonableness of the advice, it is generally accepted that all relevant information of the case including the demands and needs of the policyholder, the nature and complexity of the envisaged insurance contract and the amount of the premium to be paid.

[51] Sect. 6 para. 2 VVG 2008.

[52] Sect. 6 para. 4 VVG 2008. For example, if the policyholder wishes to terminate a life insurance contract, the insurer must inform him about the option to continue the policy without premium payments. The documentation requirement is intended to facilitate the production of evidence for the policyholder (if he claims for damages for inappropriate advice). Policyholders may waive their right to receive advice and/or documentation by issuing a separate written declaration to this effect and such waiver is only valid if the insurer refers in the same document to the disadvantageous effects of the waiver. In this way, policyholders are protected from hasty waivers. More details: W. Rüffer, D. Halbach, P. Schimikowski, *Versicherungsvertragsgesetz: VVG- Handkommentar*, 2008^2, § 6 VVG note 31.

was grossly negligent or intentional), the right to terminate the contract by giving one month's notice (if the breach was not intentional or grossly negligent), and the right to increase the premium (if the insurance contract would have been concluded irrespective of the misstated or omitted information but on different conditions, even if the breach was grossly negligent). However, the remedies for a breach of the duty of utmost good faith are not provided for in statutory rules.

The German regulator (*Bundesanstalt für Finanzdienstleistungsaufsicht* – BaFin)[53] in case of violation of the interests (constant breach by the insurer of its duty of utmost good faith in the form it has been adopted in statutory provisions) will demand from the insurer to remedy such inadequacy and has the authority to issue any order *vis-à-vis* the insurer (or/and insurer's management) which is necessary to remedy the situation.

4.2. The Principle of Good Faith in United Kingdom insurance contract law

The UK insurance and business market has changed significantly during the last 100 years since the Marine Insurance Act 1906 received Royal Assent. Marine Insurance Act 1906 was the leading statute relating to commercial insurance, which, despite its name, also applied to non-marine insurance and reinsurance. Although that Act has served the marine industry well and has stood the test of time, after substantial review, the Law Commission concluded that the current law was out of step with twenty-first century commercial practice.

The Insurance Act 2015 received Royal Assent on 12 February 2015 and came in force on 12 August 2016 and is designed to provide a more up to date framework for commercial insurance in England and Wales, with a focus on transparency and confidence over the rules that govern contracts between commercial policyholders and insurers.[54] However,

[53] Post-Contractual duty of the principle of utmost good faith for insurer: obligation to pay the premium certain obligations regarding the adjustment of the information imbalance between the insurer and the insured/beneficiary as is the case in connection with the aggravation of risk (art. 28 et seqq. ICA), the occurrence of an insured event (art. 38 ICA) or the justification of the insurance claims made under the contract (art. 39 ICA). There is no specific duty at a post-contractual stage for the insurer. However, when insurer is dealing with a claim, he is bound by the general principle of good faith pursuant to art. 2 of the Swiss Civil Code.

[54] The exceptions are the provisions which relate to the amendment of the Third Parties (Rights against Insurers) Act 2010 and the provisions relating to late payment of insurance claims. These provisions were not originally included in the Act but have since been inserted by Part 5 of the Enterprise Act 2016. The 2010 Act came into force on 1 August 2016 and the provisions relating to late payment will come into force on 4 May 2017. The 18 month delay between royal assent and commencement is designed to provide all stakeholders with the opportunity to prepare for the changes to the law and to amend their current practice as necessary.

Insurance Act 2015 will not apply retrospectively to English contracts of insurance entered into prior to 12 August 2016.

The 2015 Insurance Act applies to all commercial contracts of insurance and variations to existing contracts of insurance and represents the biggest reform to insurance contract law in UK for more than a century. Insurance contracts under English law are traditionaly considered contracts of „utmost good faith".[55] English insurance contract law derives from the common law and was partially codified under the Marine Insurance Act 1906. As already mentioned, the principle of utmost good faith first arose through common law in the mid eighteenth century (as expressed by Lord Mansfield in *Carter v Boehm*)and is partially codified through sections 17-20 of the Marine Insurance Act 1906.

The general underlying principle that insurance contracts are based upon utmost good faith remains in the 2015 Insurance Act. However, the Act alters the law in relation to pre-contractual disclosure, creating a new duty of fair presentation of risk.[56] It requires the insured to make to the insurer, a "fair representation of the risk" before the contract is entered into.

This duty is made up of following elements. The insured is required to disclose "every material circumstance"[57] which they "know or ought to know".[58] This replaces the disclosure duty in the Marine Insurance Act 1906. If the insurer is not strictly satisfied, there will be no breach if the insured gives enough information to put a prudent insurer on notice that it should make further enquiries which would reveal material circumstances which the insured know or ought to know. This clause creates a duty not to make misrepresentations. This means where a material representation concerns a matter of fact it must be "substantially correct" and where it concerns a matter of expectation or belief it must be made "in good faith".[59]

The duty of fair presentation under the 2015 Insurance Act and prohibition of "basis of contract" clauses only apply to non-consumer insurance contracts because the duty of fair presentation and prohibition of basis of contract clauses already applies to consumer insurance contracts under the Consumer Insurance (Disclosure and Representations Act 2012). The application of the 2015 Act to consumer insurance contracts is mandatory and cannot be contracted out.

[55] In English law, good faith has been outlined as not simply meaning that the parties should not deceive each other, a principle which any legal system must recognize and its effect is perhaps most suitably conveyed by such metaphorical language phrase s as "playing fair", "coming clean" or "putting one's cards face upwards on the table".

[56] Chapter 4, part 2 The 2015 Insurance Act.

[57] Whether a circumstance is material is defined whether it would influence the judgment of a prudent underwriter in determining whether to take the risk and on what terms.

[58] What an insured "ought to know" will be assessed objectively i.e. what should reasonably be revealed by a reasonable search of information available to the policyholder.

[59] Chapter. 4. part 3, The 2015 Insurance Act.

Duty of utmost good faith, including the duty of disclosure, applies to all types of insurance contracts.[60] This, however, does not necessarily mean that the scope and application of the duty are identical in every type of insurance.[61] The duty will depend upon the circumstances of each case. The Principle of Utmost Good Faith is mutual and apply to both the insured and the insurer at the pre-contractual stage. However, in practice, the duty is significantly more oppressive for the insured than for the insurer. This is because the information relevant to the assessment of a risk has most commonly been in the knowledge of the insured. Furthermore, matters involving the insurer's duty of disclosure are rarely litigated because the remedy available to the insured for non-disclosure, avoidance of the insurance contract, is rarely of benefit to the insured.

The remedy for a pre-contractual breach of the duty of utmost good faith (duty of fair presentation) is set out in Schedule 1 of the 2015 Insurance Act and entitles the insurer If the breach of the duty of fair presentation is deliberate or reckless to avoid the contract and refuse all claims and need not return any of the premiums paid.[62] If the breach is neither deliberate nor reckless and the insurer would not have entered into the contract if aware of all of the information then the insurer may avoid the contract and repay all premiums paid. If the breach is neither deliberate nor reckless and the insurer would have entered into the contract but on different terms then the payment may be reduced in proportion to the difference between the premiums paid and the premiums that would have been payable.

In terms of an insurer's remedy for breach of the duty of fair presentation, the new Act provides for a range of remedies which are intended to be more flexible and proportionate. But, generally speaking under the new framework, where the insurer would have written the policy on different terms and had a fair presentation of the risk been provided, a claim on the policy will be assessed applying those different terms. This is likely to introduce some uncertainty, and potentially disputes, at least until there is clear guidance from the Courts as to how these principles under the Act are to be applied in practice.

At present insurers often rely on so called "basis of contract" clauses as a means of converting pre-contractual statements and information supplied to insurers into warranties. The use of "basis of contract" clauses has been the subject of much criticism, because of their potentially strict consequences. The 2015 Insurance Act now abolishes the use of "basis of contract" clauses in non-consumer insurance as they were abolished

[60] *Godfrey v Britannic. Assurance co* [1963] 2 Lloyds Rep 5151.
[61] *London Assurance v Mansel* (1879) 11 Ch. D. 363.
[62] The requirement that the insured's failure to disclose information was "deliberate or reckless" could be very difficult for insurers to prove.

in consumer insurance by the Consumer Insurance (Disclosure and Representations) Act 2012.

Under past law, a breach of warranty discharges the insurer from all liability under the insurance contract, even if the breach is trivial and has no connection with the insured's loss. This is repealed by the new Act a breach of warranty will not automatically take the insurer off risk. Instead warranties will be of suspensive effect such that an insurer can only rely on a warranty throughout the time the insured is in breach. Insurers will come back on risk if the breach is subsequently remedied (where the breach is capable of being remedied).The Act also provides that insurers cannot rely on a breach of warranty or other terms which are not relevant to the actual loss. Where a loss occurs, and a policy term has not been complied with, insurers will be prevented from relying on the non-compliance to exclude, limit or discharge their liability under the policy if the insured can show that non-compliance with the term did not increase the risk of loss which actually occurred.[63]

Pursuant to 2015 Insurance Act, contracting out, clause 15 makes it clear that in consumer insurance contracts, insurers are prevented from contracting out of any of the provisions in the act to the detriment of the consumer. A policy term that puts the consumer in a worse position than under the Act will be rendered void. At present insurers often rely on so called "basis of contract" clauses as a means of converting pre-contractual statements and information supplied to insurers into warranties. The use of "basis of contract" clauses has been the subject of much criticism, because of their potentially strict consequences. The Act now abolishes the use of "basis of contract" clauses which is a welcome development for policyholders.

As outlined above, the IDD is not 'directly applicable' which means that it must be implemented into domestic law by each EU Member State and the deadline for domestic implementation is 22 February 2018. If the UK leaves the EU, it would of course no longer be required to implement EU directives after it ceases to be an EU member state. However, after Brexit[64], the UK is unlikely to leave the EU until after 22 February 2018, meaning that it would in theory still be under an obligation to implement the IDD into UK law. Assuming that the IDD is implemented into UK law, anyone involved in selling insurance products should take note of the new IDD and its principle.

[63] Chapter 4, part 3. art 10 The 2015 Insurance Act.

[64] Brexit is an abbreviation for „British exit" which refers to the 23 June, 2016, referendum whereby British citizens voted to exit the European Union.

5. Conclusion

Most civil law jurisdictions recognize and enforce a general duty of good faith as one of the basic principles governing the whole life of a contract. In spite of this far reaching acceptance of good faith in the area of substantive law, over the years the duty of good faith has been subject to attack and criticisms on various grounds. One frequent accusation is that the good faith doctrine is ambiguous in nature since there is no definitive answer as to the exact nature of the principle of good faith. Furthermore, notion of fairness is often very difficult to define, great ambiguity follow when trying to assess whether good faith has been employed or not. The principle of good faith does not itself serve as a basis for rights and duties. It is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines. The organizing principle of good faith is a rule or doctrine in general statutory provisions on good faith in civil law legal systems. It is generally accepted that the good faith standard requires subjective honesty from the contracting parties. Provided that parties deal with each other honestly and fairly, however, the good faith doctrine will be assumed to have been executed, yet this is rather difficult to achieve in insurance contracts since the parties are often unaware of their exact rights and duties.

The insurance market has changed considerably in the present time and this classical assertion of insurance law has recently been questioned due to all the technological advancements. Therefore, since it cannot keep pace with modern commercial practice, a classical approach of the doctrine good faith remains at the center of attention and facing further calls for reform in order to cope with the developments in commercial transactions. Based on the solutions inspired by the principle of good faith, new rules and institutions started to emerge, and MiFid and IDD principles are clear proof of that. The IDD introduced two general principles, providing that insurance distributors must "always act honestly, fairly and professionally in accordance with the best interests of customers"; and that all information must be "fair, clear and not misleading". The disclosure of clear, meaningful and relevant information at contract level will help consumers to make informed decisions when purchasing insurance products. Accepting a general principle "to always act honestly, fairly and professionally" does not necessarily mean that parties to insurance contracts will be subject to new or more extensive "good faith" duties. The general organizing principle will not impose a pre-fabricated set of specific legal duties that need to be observed by the parties. Rather, it requires the parties in general terms to perform their contractual duties honestly, fairly and professionally in accordance with

the best interests of customers. As the IDD is a minimum harmonisation Directive, Members States may elect to implement additional measures at national level, if they deem this necessary for the purposes of consumer protection. However, this may lead to unnecessary administrative burden and would have a negative effect on the Single Market. The implementation of the IDD might not change the regulatory landscape in insurance distribution in many Member States because a number of the regulatory requirements that are now being introduced by the IDD are already in place. Bearing in mind the above-mentioned, this leaves some space for a doubt as to what level of harmonisation the IDD will achieve in practice.

Mr Katica Tomić
doktorand Pravnog fakulteta Univerziteta u Beču i
Fakulteta pravnih nauka Univerziteta "Apeiron", Banja Luka

NAČELO DOBRE VJERE U EVROPSKOM I NACIONALNOM ZAKONU O OSIGURANJU

Rezime

U posljednjih nekoliko godina tržišta osiguranja postala su dinamičnija zbog deregulacije tržišta osiguranja, globalizacije osiguravajućih ustanova, povećane tržišne konkurencije, tehnološkog napretka, promjena u ponašanju kupaca kao i aktivnost regulatora , a što se povećalo posljednjih nekoliko godina kao posljedica svjetske financijske krize. U svjetlu svjetske financijske krize, usvojene su dodatne mjere usmjerene na jačanje zaštite potrošača u Europi. To uključuje Direktivu o distribuciji za osiguranje (IDD) i Direktivu o tržištu financijskih instrumenata (MiFID II). IDD sadrži brojne nove odredbe u odnosu na Direktivu o posredovanju u osiguranju (IMD Direktiva 2002/92 / EZ), uključujući i novi princip ponašanja za distributere osiguranja da „uvijek djeluju pošteno, pravedno i profesionalno u skladu s najboljim interesima svojih potrošača". Glavni koncept ovog pravila je da će osiguranik samo biti u mogućnosti donijeti pravu odluku kada je jasno obavješten o uslugama koje se nude (i rizicima), a distributeri mogu pružati usluge u

skladu s najboljim interesima klijenta samo u slučaju ako su u potpunosti upoznati sa vrstom kupaca i njihovim interesima. Većina država članica EU ima pravni sistem civilnog prava , s općom klauzulom o pravičnosti i dobroj vjeri. Države članice Evropske unije moraju implementirati IDD u nacionalna zakonodavstva, stoga je sporno da one same odluče da li je princip ponašanja koje određuje IDD sličan sa postojećim općim odredbama iz nacionalno zakonodavstva, ili je različiti od tih odredbi.

Ključne riječi: Direktiva o distribuciji osiguranja, dobra vjera, krajnje dobra vjera, Građanski zakonik, Zakon o ugovoru o osiguranju.