

Paula Rebstock heads Insurance & Savings Ombudsman Commission

The Insurance & Savings Ombudsman (“ISO”) Commission appointed Paula Rebstock CNZM as its Chairperson from 1 October 2009, when Alison Timms completed her term.

Ms Timms was appointed as Chairperson of the ISO Commission by the Members of the Commission in March 2005. She chaired the ISO Commission in a reasonably settled period and, as a result, the ISO Scheme was able to make changes and improvements to its operation with Stakeholder support during her appointment. The ISO Commission acknowledges and thanks Ms Timms for her contribution.

Ms Rebstock has been an independent economic consultant, with both public and private sector clients. Her appointments include Deputy Chair of New Zealand Railways Corporation and former Chair of the Commerce Commission and Director of the Foundation for Research, Science and Technology. Ms Rebstock has also held positions as a senior government official, having strategic policy formulation experience with the Treasury, Department of the Prime Minister and Cabinet, and Department of Labour. She was recently awarded the Companion of the New Zealand Order of Merit for public services (CNZM).

Legislation was introduced last year to regulate financial advisers and ensure free dispute resolution is made available to consumers across all financial services by December 2010. The ISO Scheme is pivotal in the Government’s plans to reform the finance sector and provide free and independent consumer redress. After 14 years, the ISO Scheme is a well-established and highly respected dispute resolution service.

The ISO Commission and Board welcome the opportunity to work with Ms Rebstock, whose proven leadership as chairperson of the Commerce Commission will be such an asset for the insurance and savings industry – particularly over the next 18 months.

Strong leadership is also key to how the industry sees its role in the new legislative environment, working in partnership with Government to ensure consumer confidence in the finance sector. Ombudsman, Ms Karen Stevens, is confident the ISO Scheme is well positioned to achieve that goal and is delighted that Ms Rebstock has been chosen to lead the ISO Scheme.

An update for Financial Service Providers

In our previous Assessment Newsletter, we commented on the Government’s requirements for all Financial Service Providers (“FSPs”) to be licensed and to belong to a dispute resolution scheme which has been approved under the provisions of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (“the FSP Act”).

In the intervening period, the ISO Commission has decided to provide an expanded complaints handling service. The expansion will occur through making the ISO Scheme available to other insurance and savings companies and to financial advisers. The ISO Commission believes that offering an expanded complaints handling service within the ISO Scheme will form an important part in enabling related groups to stay together and provide an enhanced service to consumers. A recommendation was

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made by the Commission to the ISO Board on that basis and the ISO Board has agreed to expand the ISO Scheme.

The decision to include financial advisers/brokers/agents in the ISO Scheme reflects the value of an industry-based complaints handling scheme, which is able to deal with complaints about insurance and savings products at every stage of customer interaction.

The ISO Commission and Board are addressing issues surrounding the basis for expanded participation of the ISO Scheme. In particular, consideration is being given to changes to the ISO Scheme Rules and the ISO's Terms of Reference, to give effect to the decision made in principle. This is to allow the expansion to proceed and for the ISO Scheme to seek approval in terms of the Act.

We believe the ISO Scheme, which is well established and provides a robust and proven external disputes resolution process, is likely to be one of the first schemes to apply for approval under the Act.

In the meantime, the ISO Commission and the ISO Board are in consultation with stakeholders about the issues which need to be addressed for the ISO Scheme to be approved as a dispute resolution scheme under the provisions of the FSP Act.

Mechanical Damage

This "Assessment" has focused on 2 types of mechanical breakdown that can cause problems when considering whether a valid claim exists:

- mechanical breakdown caused by an external factor; and
- mechanical breakdown caused by contaminated diesel fuel.

1. Mechanical breakdown caused by an external factor

Recently the ISO has investigated a number of cases involving accidental mechanical breakdown caused by an external factor. In these circumstances, insurers determine initially that accidental damage has occurred. Most policies cover "accidental" damage, usually defined by words such as "sudden, unexpected, unintended and/or unforeseen". If satisfied the damage was accidental, insurers are entitled to consider whether to apply a mechanical breakdown exclusion clause, common to motor vehicle and boat policies. Policies usually exclude "mechanical breakdown or loss" and "corrosion, rust, mould, wear and tear and/or deterioration" or words of a similar nature.

There are 2 ways in which mechanical breakdown exclusion clauses commonly provide limited cover. The first is a list of specified events for which the exclusion does not apply. Such lists vary from insurer to insurer, but generally cover events such as: fire, lightning, immersion in water, collision, overturning, intentional damage, theft or conversion, external impact, earthquake. The second is a limitation of the exclusion to specified systems such as: engine or transmission systems, electrical or electronic systems and mechanically or hydraulically operated systems.

Consideration of mechanical breakdown claims can become complicated because of the increasingly complex nature of modern engines and vehicles, where experts may be unable to agree.

In the course of considering claims for accidental mechanical breakdown, the ISO has checked with a number of insurers about their treatment of such claims. It is apparent insurers generally wish to avoid claims for mechanical failure or breakdown - as a result of an internal failure, malfunctioning, wear and tear or lack of maintenance - without the intervention of a single external factor.

Case Study 1

C insured his boat with P. C was fishing when the outboard motor stopped. He restarted the motor and continued until it stopped again and could not be restarted.

It was found that water had entered the motor's oil injection system and had caused a lubrication failure, damaging bearings, pistons, conrods, engine block, and crankshaft ("the damage"). The water had entered due to the oil cap not being properly closed during torrential rainfall.

C made a claim to P for the damage ("the claim"). P declined the claim, on the basis of the exclusion for mechanical damage to the engine, transmission, mechanical or electrical systems.

Assessment

The exclusion required that the damage to the engine or specified systems must occur "as a result of other damage to [the] boat for which a claim is payable" to be a valid claim. The mechanic who examined the motor advised the damage occurred "due to water in the oil injection system". The motor's manufacturer, referred to the "[l]ubrication system", in the specifications of the motor. P worded the exclusion on the basis of a number of "systems", but not all of the "systems" in a boat or motor.

The Case Manager did not believe the lubrication system clearly came within the list of the excluded systems. The Case Manager considered the list of "systems" was definitive and exhaustive. If P had intended the lubrication system to fall within the exclusion, it should have been specifically included in the list.

Recommendation

P challenged 2 main factual grounds on which the Assessment was based.

P believed the lubrication system and compressor were "sub components of the engine" and were, therefore, subject to the exclusion. P also referred to a dictionary definition of "engine" as "a machine with moving parts that converts power into motion".

The ISO noted the policy distinguished between "engine" and "transmission" systems, clearly indicating that they were different systems. The definition of "engine" P relied on would also include the transmission, which had the function of directing the power generated by the engine. The ISO believed the dictionary definition relied on by P was incorrect when considered in the context of the policy as a whole.

The motor's manufacturer confirmed that the marine industry considered the lubrication system of an outboard motor was separate from the "engine".

They were "ancillary items" and, therefore, the ISO did not believe they were subject to the exclusion. The exclusion required that,

As already discussed, insurers initially determine whether the mechanical breakdown has been caused accidentally and meets the requirements of the insuring clause. However, there are certain types of accidental damage which insurers do not wish to cover and, therefore, they might apply the mechanical breakdown exclusion.

It appears that industry practice varies from case to case. Insurers take into account, as they are entitled to do, the particular circumstances of a case, business held and loss experience in deciding whether to apply the mechanical breakdown exclusion. The fact that claims for, apparently, similar damage events may be accepted or declined, results in uncertainty for the insuring public.

2. Mechanical breakdown caused by contaminated diesel fuel

Diesel fuel can be contaminated by the presence of water or condensation. In many cases, diesel “bug”, a slimy sludge, grows rapidly at the interface between the water and diesel fuel.

Contaminated diesel fuel can cause rapid and severe damage of a rust and corrosive nature to fuel systems of vehicles and boats. The more sophisticated diesel technology, such as common rail, is particularly intolerant to contaminated fuel. Coupled with the increasing number of diesel vehicles and boats, there is a trend of policyholders turning to their insurers to cover claims for damage caused by contaminated fuel, if they are unable to achieve satisfaction through a fuel company.

Fuel companies will consider complaints - subject to proof of purchase - if a breakdown occurs shortly after top-up, multiple incidents occurred at the time of the top-up, and/or the company found its contaminated fuel in the vehicle/boat.

Insurers initially have to decide whether there has been accidental damage and, therefore, that a prima facie claim has been established. This decision is usually complicated by consideration of whether the damage occurred suddenly. As a general guideline, insurers expect claimants to prove the source of the contaminated fuel and the date of the contamination and insurers will usually have a sample of the fuel tested by an independent laboratory. Insurers then decide whether the damage has occurred “suddenly” as a one-off, unexpected event.

If a prima facie claim is established, an insurer is entitled to raise an objection to meeting the claim, through the application of a “mechanical breakdown” and/or “rust, corrosion” exclusion. Where the contaminated fuel has been supplied by a third party fuel outlet, it could be argued there has been accidental damage from an external source. This can make it difficult to interpret the application of a mechanical breakdown exclusion which, by intent, relates to internal, malfunctioning type damage such as caused by wear and tear and lack of maintenance. Often the rust corrosion exclusion is applied, because it is considered to reflect damage by gradual deterioration. However, as already indicated, rust or corrosion can develop rapidly on high grade steel parts i.e. within hours.

We recommend that for mechanical breakdowns caused by external factors, including contaminated diesel fuel, insurers consider the implications, and:

- ensure policy wordings clearly reflect the underwriting intention; and
- have clear and consistent guidelines for handling contaminated fuel claims; and
- carefully consider claims on a case by case basis.

for the damage to the engine to be a valid claim under the policy, it must occur “as a result of other damage to [the] **boat** for which a claim is payable”.

In the case of *Technology Holdings Ltd v IAG New Zealand & Anor* (2009) 15 ANZ Insurance Cases ¶61-786. At pages 77-149 and 77-150, Woodhouse J considered the meaning of the word “damage”, as follows:

“61. In my opinion, ... there are two important requirements when considering whether there has been ‘damage to’ property as opposed to ‘physical damage to’ property. The first, ... is that something has happened in connection with the property which has impaired its ‘value or usefulness’. In *Kelly and Ball*, Principles of Insurance Law, there is a discussion of ‘physical damage’ in insurance policies followed by a separate paragraph on ‘damage’: paras 12.0050.10 and 12.0050.15. The latter paragraph commences as noted at [57] above:

Where the word ‘damage’ is not qualified by the word ‘physical’, it is normally sufficient if the damage is in the form of diminution in value or functionality.

62. This element – a diminution in value or functionality – cannot stand alone. If it did, any loss suffered by an insured party in respect of property, no matter what the cause, would potentially be covered ... Something must happen to the property itself, followed by the impairment of value or usefulness, for damage to occur. That is the factor which excludes from cover cases of pure economic loss; cases where nothing happens to the property itself”.

In this case, water entered the oil supply and contaminated the lubrication system. The ISO believed that the contamination was a physical change to the lubrication system and an impairment of its usefulness, causing “damage” to the lubrication system. This was “other damage to [the] **boat**”, satisfying the policy requirement for P’s acceptance of the claim.

The ISO believed that, even if the lubrication system could be interpreted as being included as part of the “mechanical systems” in the exclusion, it would not be fair and reasonable to apply the exclusion to the claim.

The damage was clearly not the result of an internal mechanical failure. It was the result of an accidental external event; namely, the contamination of the lubrication oil by rainwater due to an improperly closed twist cap and should be regarded as “other damage” to the boat.

Complaint upheld

Annual Report - statistics

Complaints summary

There were 1,974 complaint enquiries (681 in writing), 242 complaints received for investigation and 220 complaints resolved in the 2008/2009 financial year. There were 47 complaints resolved, as a result of involvement of the ISO Office before a formal investigation was undertaken.

Jurisdiction

In the 2008/2009 financial year, we received written enquiries about 98 disputes outside jurisdiction, which required consideration and a written response. We also received 206 telephone enquiries about disputes outside the ISO's jurisdiction.

Timeliness

The average time to close the 220 complaints investigated in the year ended 30 June 2009, was 87 days from receiving the company's file and accepting the complaint.

Get Sorted with Insurance

We are really pleased with the inclusion of practical insurance advice for consumers on the Retirement Commissioner's website – Sorted. Here is an extract from the website www.sorted.org.nz. It looks like an excellent tool to recommend to customers who want to understand more about their insurance needs, before deciding on the products or advice required. Here is an extract:

“Insurance is an important part of managing your money matters. It's a way to protect you (and your family) from financial loss if the unexpected happens to the things you own, your health or your ability to earn an income.

- **What insurance do you need**
Understand more about what insurance you might need.
- **Types of Insurance**
Find out more about the different types of insurance.
- **Tips for buying Insurance**
Consider these tips when you are buying insurance.
- **Tips for changing insurers**
If you're thinking of changing insurers, you need to be aware of the risks as well as the benefits.
- **Where to go for help**
Where to go for help if you need professional advice or feel you have been unfairly treated.
- **Insurance calculator**
Work out what insurance might be right for you and how much this might cost.”

Each of the headings is a link to more in-depth information. Well done to Diana Crossan – the Retirement Commissioner!

Christmas Hours

The ISO Office will close at 5pm on Wednesday, 23 December 2009 and re-open at 8.30am on Monday, 11 January 2010.

On behalf of us all at the ISO Office, we wish you all a
Merry Christmas and a Happy New Year!



Case Study 2

C had a motor vehicle insured with P.

On 12 January 2009, the engine warning light of the vehicle came on and C had the fuel filter replaced. On 2 March 2009, the engine warning light came on again, and the fuel pump was reconditioned.

C made a claim to P for damage caused by water from contaminated diesel fuel. P declined the claim because the damage was the “*result of moisture getting in and causing corrosion to the injection pump. The damage that [had] been caused [was] not sudden and accidental*”.

Assessment

The policy provided cover for “*sudden and accidental loss to the car*”, but excluded “*mechanical loss*” and “*wear and tear or rust*”.

- **Sudden damage?**

The fuel pump reconditioner had confirmed that the rusting process could start overnight. C was unable to establish when the process giving rise to the damage started, because he was unable to establish when the vehicle was topped up with contaminated fuel: either before the first warning light occurrence, or during the 7 weeks and 3,127 kms before the second warning light occurrence.

- **Cover for contaminated fuel**

Damage arising from contaminated fuel must occur suddenly and accidentally for it to be covered by the policy.

- **Source of the contaminated fuel**

If the vehicle had been topped up with contaminated fuel supplied by a third party fuel outlet, consideration could have been given to the possibility of a claim for sudden and accidental damage by an external event.

C had explained it was his usual practice to top up the fuel as and when required, rather than through a regular outlet and C did not have proof of dates or purchases. Therefore, C had not established that the contaminated fuel was supplied by a third party outlet but, even if he had, the policy excluded cover for “*mechanical loss*” and “*rust*”.

The Case Manager believed that the damage did not occur suddenly and, even if the damage had occurred suddenly, cover was excluded for “*mechanical loss*” and “*rust*”.

The Case Manager believed the damage to the fuel pump, more probably than not, arose from rust and, therefore, was excluded from cover under the policy.

Complaint not upheld