

# **Advisory Guidelines of the Financial Supervision Authority**

## **General requirements to insurance contracts**

These Advisory Guidelines were established by Resolution No 89 of the Management Board of the Financial Supervision Authority of 1 November 2006.

### **1. Competence**

According to § 3 of the Financial Supervision Authority Act (hereinafter FIS), the Financial Supervision Authority conducts state financial supervision in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system.

According to FIS § 57 (1), the Financial Supervision Authority has the right to issue advisory guidelines to explain legislation regulating the activities of the financial sector and to provide guidance to subjects of financial supervision.

### **2. Purpose and scope**

#### **2.1. Purpose**

The purpose of these guidelines is to protect policyholders' interests by giving advisory instructions to insurers in respect of drafting and publishing of insurance contracts (including standard conditions). These instructions should ensure clear and easily legible insurance terms and conditions and provide policyholders with greater possibility to assess the extent and conditions of insurance cover, accompanying the conclusion of insurance contracts, and the conformity of insurance cover to insurable interest.

These guidelines aim at creating a market situation where policyholders can obtain easily comparable insurance contracts, in order to ensure a reasonable possibility to find the most favorable insurance contract among those corresponding to insurable interest.

Clear and unambiguous insurance terms and conditions establish better preconditions for preventing potential disputes in good faith while both insurers and policyholders exercise their contractual rights and perform obligations.

These guidelines are aimed at raising the reliability and transparency of insurance sector.

#### **2.2. Scope**

The guidelines are addressed to insurers offering services in Estonia. In particular, the scope of these guidelines includes consumer contracts, in order to ensure the protection of interests of consumers, i.e. natural persons who act outside their business or professional activity when concluding the contract. Guidelines are based on the fact that such a person should be treated as a more vulnerable counterparty to insurance relationship, both in respect of his/her financial capacity as well as his/her insurance-related knowledge and experience.

The application of these guidelines by insurers is not limited to consumer contracts because clear and easily legible insurance terms and conditions convey the interests of transparency and reliability of the whole insurance sector. These interests should be in the focus of insurers' activities.

The scope of these guidelines includes primarily non-life insurance contracts, but also life insurance contracts, taking into account the differences of life insurance contracts.

Application of these guidelines should take into account the requirements of law, as well as other advisory guidelines<sup>1</sup> of the Financial Supervision Authority. Where the legislation provides for imperative requirements, these shall be followed. The guidelines should be applied and any interpretation problems solved, following the principle of reasonability, taking into account the purpose of these guidelines and acting in good faith with the duty of diligence expected of an insurer.

### **3. General**

#### **3.1. Requirements to information provided in insurance contracts**

- 3.1.1. Composition and content of a contract must be in conformity with legal requirements.
- 3.1.2. Information disclosed in a contract must be correct, accurate, unambiguous and not misleading, and the contract must not miss any information that may have a significant effect on the content or meaning of presented data or on the comprehension thereof, taking into account the principle of reasonability.
- 3.1.3. Disclosure of information in a contract and choice of its presentation must be based on the assumption that policyholders have no insurance-related expertise, including no knowledge of insurance terminology.
- 3.1.4. A contract must not include any hidden clause which placement or presentation may render it difficult for a policyholder to understand circumstances related to the contract or can contribute to erroneous understanding of circumstances related to the contract.
- 3.1.5. Standard conditions, if used, must include a clear reference to the date when specific conditions will be put into effect.

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<sup>1</sup> Advisory Guidelines of the Financial Supervision Authority „Life assurance policies – disclosure of information to policyholders”; Advisory Guidelines of the Financial Supervision Authority „Unit linked life assurance policies – components, underlying assets and disclosure to policyholders”.

### **3.2. Requirements to the structure of insurance contracts (including standard conditions)**

- 3.2.1. Structure of a contract must be logical and have a comprehensive division which would allow a policyholder to find easily all necessary information on relevant circumstances, taking into account *inter alia* other specific requirements to insurance contracts established by these guidelines.
- 3.2.2. Headings of subdivisions of a contract must be clear and distinguishable from the rest of the text, as well as refer to information presented in the subdivision. One section of a contract must cover one subject in a complex manner, preventing dispersed coverage of a subject. Contracts must not be burdened with insignificant information.
- 3.2.3. A contract must not include a reference to a paragraph that itself contains a reference (prohibition of transmission).
- 3.2.4. A contract must distinguish between general requirements to insurance relationship and specific requirements to a specific insurance class. This can be ensured by using different documents (general conditions and specific conditions) or through specific insurance contracts (general part and specific part of a contract).
- 3.2.5. A contract must include a reference to all requirements or documents in respect of insurance relationship, and policyholders must have a reasonable possibility to access such conditions or documents.

Such a reference must be clear and presented in a notably manner. It is not allowed to use hidden references, including references in footnotes or using small font.

- 3.2.6. It is advisable for an insurer to use a uniform structure of insurance contracts within those classes of insurance it offers.

## **4. Requirements to the content of insurance contracts**

### **4.1. Definitions**

Relevant definitions used in terms and conditions must be defined in a single section of a contract in a complex manner. As an alternative, definitions may be defined in a complex manner also in a specific subdivision, based on definitions used in that subdivision and ensuring the visual distinctness of definitions from the rest of the text. Definitions must be used in insurance contracts in a consistent manner (within all terms and conditions of an insurer, if possible).

### **4.2. Insurable interest**

- 4.2.1. A contract must accurately, clearly and unambiguously define an insured person or an insured object. In cases where a set of objects is insured, special

attention must be paid to defining and/or limiting this set. The number of objects belonging into this set or under insurance coverage may be increased or decreased during the validity period of insurance contract.

- 4.2.2. In limiting an insurable object within a legal relationship, an insurer must assume that the customer has broader interest in insuring the property and follow its duty of diligence in finding out the customer's actual insurable interest for more specific limitation of an insurable object.

### **4.3. Beneficiary**

- 4.3.1. A contract must accurately and clearly define a beneficiary and his/her rights and obligations together with procedures for exercising these rights and performing these obligations.
- 4.3.2. A contract must include provisions on possibilities and procedures for substituting a beneficiary.

### **4.4. Insurance premium**

- 4.4.1. A contract must specify the amount and payment order of insurance premium. In cases where insurance relationship includes several separate insurance contracts, amounts of separate insurance premiums must be specified.
- 4.4.2. A contract must specify consequences of delay in premium payment or of non-payment, as well as related rights and obligations of parties and procedures for executing these rights and obligations.

### **4.5. Insured event**

- 4.5.1. A contract must accurately and clearly define an insured event and insured risks. An insured event and insured risks must be defined as far as possible through positive features and not through negative features, i.e. exclusions. Where exclusions are used, the contract must include an exhausting and final list of exclusions.
- 4.5.2. Where exclusions are used, they must be clear and stand logically and comprehensively next to the respective positive definition of an insured event or insured risks. Exclusions must be reasonable, taking into account the objective of an insurance contract. The use of hidden exclusions is prohibited.
- 4.5.3. An insurance policy must include all insured risks covered by the insurance contract, together with an exact reference to the clause of the contract (terms and conditions) where exclusions are listed. Definition of an insured risk presented on the policy must correspond to the content of insured risk. It must not be misleading in respect of the actual extent of insurance cover.
- 4.5.4. If a specific insurance contract does not cover an insured risk defined in standard conditions that are applied to the insurance relationship, this exclusion must be mentioned also on the insurance policy.

- 4.5.5. In limiting an insured event and insured risks within a legal relationship, an insurer must assume that the customer has broader interest in insuring the property and follow its duty of diligence in finding out the customer's actual insurable interest for more specific limitation of insured events and insured risks covered by the contract.
- 4.5.6. A contract must define policyholder's rights and obligations in case of the occurrence of an anticipated insured event, as well as consequences of the failure to perform or of unsatisfactory performance. Sanctions for or consequences of the failure to perform or unsatisfactory performance must be proportional, taking into account the relevance of the specific infringement to insurer's obligation to perform.
- 4.5.7. A contract must specify circumstances related to the validity of insurance contract and extent of insurance cover after the occurrence of an insured event.

#### **4.6. Indemnification**

- 4.6.1. A contract must accurately and clearly define a sum insured and an insurable value, as well as principles for calculating the indemnity upon the occurrence of an insured event and indemnification limits; also, grounds for reducing the indemnity or denying the indemnification upon the occurrence of an insured event must be exhaustively listed.

Grounds for denying the indemnification upon the occurrence of an insured event may include the non-performance by the policyholder. As a rule, this non-performance must influence the occurrence of an insured event or the extent of loss. Grounds for and the extent of reducing the indemnity or denying the indemnification must be proportional, taking into account the objective of insurance contract, as well as mutual relationship between the potential loss and grounds for reducing the indemnity or denying the indemnification.

- 4.6.2. A contract must define over-insurance and under-insurance as well as its effects to policyholder's rights and obligations, and also a relevant plan of actions for such a situation.
- 4.6.3. A contract must present a general description of operations for the determination of insurer's obligations and their extent upon the occurrence of an anticipated insured event. It is advisable to make a general remark that a loss adjustment procedure is performed after learning about an anticipated insured event, in order to determine whether the event is actually an insured event as well as the existence and extent of insurer's obligation to indemnify for loss. A contract must also specify the person who will perform respective operations.
- 4.6.4. A contract must include a sample (not exhaustive) list of information and document which an insurer may require from a policyholder in order to determine its obligation to perform.

- 4.6.5. A contract must define general principles for the determination of the amount of indemnity, rights and obligations of parties in this procedure (including the use of an expert), as well as procedures for compensating potential loss adjustment expenses.
- 4.6.6. Considering the principle that loss adjustment must be performed effectively and as quickly as possible and it must not be aimed at delaying the payment of indemnity, it is advisable that a contract specifies a limitation period for loss adjustment, starting from the day of learning about an anticipated insured event. A contract must allow an overrun of the deadline only with good reasons and an insurer must be able to justify these reasons adequately.
- 4.6.7. A contract must clearly define the limitation period for filing a claim for indemnification, indemnification procedures and methods (pecuniary indemnity, restoration or replacement of an item, etc.). A contract must specify a fine for delay in the payment of indemnity.
- 4.6.8. A contract must specify a transfer of claim to an insurer after policyholder's performance upon the occurrence of an insured event.

#### **4.7. Insurer's and policyholder's rights and obligations**

- 4.7.1. A contract must define all relevant rights and obligations of insurer and policyholder (including principal obligations and accessory obligations) at least within the extent provided by legislation, taking into account *inter alia* the nature and objective of the contract, practices developed between parties, practices established in insurer's area of activity, as well as principles of good faith and reasonability (including reasonable duty of diligence of parties).
- 4.7.2. A contract must define reasonable deadlines for performing respective obligations, as well as the liability of parties and consequences of unsatisfactory performance. Consequences of and sanctions for unsatisfactory performance must be proportional, taking into account the nature of obligations and potential consequences of unsatisfactory performance. Consequences and sanctions must not be more burdensome for an insurer than legal provisions.
- 4.7.3. A contract must cover at least the following rights and obligations of an insurer:
  - 4.7.3.1. Upon the occurrence of an insured event, an obligation to indemnify for loss incurred because of the insured event or to pay an agreed amount either as a lump sum or in installments or to carry out the contract in another agreed way (insurer's obligation to perform). This includes also insurer's obligation to perform in cases of co-insurance and multiple insurance;
  - 4.7.3.2. Insurer's obligations to inform (both substantive and formal requirements upon the conclusion of a contract as well as during its validity period, etc.);

4.7.3.3. An obligation to issue to a policyholder a replacement policy and a copy of declarations of intentions made by a policyholder in a format which can be reproduced in writing. An insurer must also issue to a policyholder upon the respective request all data and copies of documents which are in its possession and which may affect policyholder's contractual rights or obligations, unless such an action is contrary to imperative legal requirements;

4.7.3.4. Insurer's right of withdrawal from an insurance contract.

4.7.4. A contract must cover at least the following rights and obligations of a policyholder:

4.7.4.1. An obligation to pay insurance premiums in the extent and pursuant to the procedure agreed beforehand;

4.7.4.2. Policyholder's obligations to inform (both substantive and formal requirements upon the conclusion of a contract as well as during its validity period<sup>2</sup>, upon the occurrence of an insured event);

4.7.4.3. An obligation to abstain from increasing the probability of an insured risk;

4.7.4.4. An obligation to prevent and minimize the loss, as well as to ensure the opportunity to ascertain the loss;

4.7.4.5. A right to withdraw from an insurance contract;

4.7.4.6. A right to require the issuance of a replacement policy, a copy of declarations of intentions made by him/her in a format which can be reproduced in writing and other data and copies of documents which are in insurer's possession and which may affect his/her contractual rights and obligations;

4.7.4.7. Rights and obligations in case of multiple insurance.

#### **4.8. Validity, amendment and termination of a contract**

4.8.1. A contract must specify the date of entry into force and the validity period of the contract.

4.8.2. A contract must clearly and unambiguously specify the date of commencement of insurance cover and its duration. If the commencement date of insurance cover is different for different insured risks, the respective dates must be specified risk by risk. A contract must also explain the grounds and conditions for the suspension or termination of insurance cover.

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<sup>2</sup> E.g. informing about an increase in the probability of an insured risk; informing about the conclusion of a new insurance contract, etc.

- 4.8.3. A contract must specify conditions of, procedures for and consequences of the amendment of an insurance contract, as well as related rights and obligations of parties.
- 4.8.4. A contract must specify conditions of, procedures for and consequences of the expiry and ordinary/extraordinary termination of an insurance contract (including withdrawal from a contract and cancellation of a contract), as well as related rights and obligations of parties.

#### **4.9. Settlement of disputes**

- 4.9.1. A contract must unambiguously define conditions of and procedures for the settlement of disputes. Procedures for the settlement of disputes established in a contract must not be unreasonably burdensome for a policyholder.
- 4.9.2. A contract must include a clause that a party is entitled to have recourse to the courts or to the Insurance Court of Arbitration, in order to settle disputes arising from a contract, under the conditions and according to procedures provided by legislation. Financial Supervision Authority exercises supervision over the conformity of insurers' activities with legislation. Financial Supervision Authority does not settle contractual disputes between policyholders and insurers.
- 4.9.2. In case of compulsory insurance, a contract must include a clause that a policyholder may file a claim against an insurer, arising from a compulsory insurance contract, to the Insurance Court of Arbitration attached to the Estonian Traffic Insurance Fund, where an insurer is obligated to participate in the proceeding of the claim, adding a reference to the website of the Estonian Traffic Insurance Fund providing information on the grounds of the activities of the respective Court of Arbitration.

#### **5. Publication**

Insurer's website must disclose all insurer's terms and conditions and other documents which are referred to in terms and conditions and which form a part of an insurance contract.

#### **6. Entry into force**

These guidelines shall enter into force from 1 June 2007.