ADR ’06 in OZ

28 - 31 August 2006

FRAUD AND FRAUDULENT NON-DISCLOSURE AND MORE GENERAL NON-DISCLOSURE ISSUES

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LARGELY COMMON GROUND

- In 1985 the highest court in South Africa rejected the notion that *"uberrima fides"* was a super-norm suffusing the entire contract of insurance in South Africa.
- Non-disclosure is simply seen as an instance of pre-contractual (new, renew, vary) misrepresentation *per omissionem*.
- The insurer's principal remedy, on discovering the non-disclosure, is to avoid the policy and resist any claim.
- Fraud, if established, entitles the insurer to claim, in addition, delictual damages.

- **Since rescission takes effect *"ex tunc"* it follows that the insurer was never at risk and that all premiums received would have to be refunded.**

- **A clause in the policy (that premiums are forfeited) is a penalty clause which, in terms of South African legislation, is only enforceable to the extent that it is not disproportionate to the harm suffered by the insurer as the innocent party.**

- **Our office requires an insurer, purporting to rely on such a clause, to adduce proof of any additional harm it would suffer if the policy should be rescinded and premiums be refunded.**

- **The office would only allow the insurer to retain so much of the premiums paid as would neutralise the loss; the balance is to be repaid to the policyholder or premium-payer.**

MATERIALITY

- **Section 59(1)(a) of the Long-term Insurance Act 1998 (as amended) provides:**

"Notwithstanding anything to the contrary contained in a long-term policy, whether entered into before or after the commencement of this Act, but subject to subsection (2)-

(i) the policy shall not be invalidated;

(ii) the obligation of the long-term insurer thereunder shall not be excluded or limited: and

(iii) the obligations of the policyholder shall not be increased, on account of any representation made to the insurer which is not true, or failure to disclose information, whether or not the representation or disclosure has been warranted to be true and correct, unless that representation or non-disclosure is such as to be likely to have materially affected the assessment of the risk under the policy concerned at the time of its issue or at the time of any variation thereof."

- **Section 59(1)(b) of the Act provides:**

  "The representation or non-disclosure shall be regarded as material if a reasonable, prudent person would consider that the particular information constituting the representation or which was not disclosed, as the case may be, should have been correctly disclosed to the insurer so that the insurer could form its own view as to the effect of such information on the assessment of the relevant risk."

(Section 59(2)) is not relevant for present purposes).

- The section distinguishes conceptually between “a reasonable prudent person” and “the insurer”.

- Our office has interpreted this to mean that the “reasonable prudent person” is:

  - neither the actual applicant nor the actual underwriter but

  - a hypothetical person standing in the shoes of the insurance proposer

  - with the knowledge and appreciation that such a reasonable person would possess

  - of the factors an underwriter would take into account in assessing the risk.

- This test is more generous to the insured than the postulate of a reasonable underwriter.
- It would exclude matters that the insurer might regard as important (e.g. actuarial considerations and pricing policies) but the insured would consider to be immaterial.
- The distinction between the reasonable underwriter and the reasonable proposer is not simply a matter of semantics and is not always appreciated by unreasonable underwriters.

RECONSTRUCTING THE POLICY

- The insurer is entitled, on discovering a material non-disclosure, to resist the claim and to rescind the policy.

- That is because the insurer, if it had not been misled, would have deferred or refused the application for insurance.

- But what if it can be established (by the insurer's admission or on the probabilities or as a fact found at a hearing) that:

  the insurer would in fact have accepted the risk if full disclosure had been made

  but on terms less favourable to the insured e.g:

  - by loading the premiums or
  - by reducing the benefits or
  - by an appropriate exclusion clause or waiting period?

- An example:
  - the proposer omitted to disclose that he suffered from (and was treated for) major depression;
  - had he disclosed it the insurer would have
    - accepted the proposal;
    - excluded cover for disability;
    - loaded the premiums for life cover;
  - afterwards the policyholder is badly injured in an industrial accident which had nothing to do with his state of mind at the time;
  - the insurer, on discovering the non-disclosure, repudiates liability and rescinds the policy.
- Is that fair?

- Some insurers, while not admitting the claim, would reconstruct the policy as it would have read if proper disclosure had been made at the time of contract.

- The disability claim would thus be rejected but life cover would continue with an appropriate adjustment to the premium.

- Other insurers would refuse to do so.

- This demonstrates the difference in approach between insurers who are anxious to meet deserving claims and those who seek reasons to repudiate them.

- Our office has engaged with the LOA (the trade organisation of long-term insurers) in an attempt to persuade all its members to adopt this practice as voluntary industry norm.

- The response was polite rather than enthusiastic.

- A legislative intervention along the lines of the Australian model is not imminent.

- Our office is thus obliged to engage with individual insurers with a view to individual settlements, failing which, determinations in terms of our equity jurisdiction.

- A fair solution may well be a proportionate scaling down of the benefits.

THE MODIFICATION OF THE DUTY OF DISCLOSURE

- The duty is *displaced* when no questions are asked of the prospective policyholder and no underwriting occurs
  - e.g. group risk policies and direct and across-the-counter marketing of low level insurance such as funeral policies.
- Insurers protect themselves
  - by inserting e.g.
    - waiting periods,
    - exclusion clauses;
  - in the case of exclusion clauses a causal connection must be established between
    - the excluded circumstance (e.g. medical condition/suicide) and
    - the insured event (death/disability).

- **The duty may be *curtailed* when specific questions are asked of the proposer:**

  - **specific questions may imply, not as a matter of law but as a matter of fact, a waiver of disclosures falling outside the scope of the questions posed;**

  - **so too when the proposer:**

    - **leaves questions incomplete or**
    - **furnishes patently inadequate responses and**
    - **the insurer does not react.**

- **Absent the duty of disclosure, absent the defence of non-disclosure.**