ICS Column

Consumer Insurance Contract – Non-disclosure

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Among different types of insurance, marine insurance is one of the earliest types to be found in the market. It is believed that a form of mutual insurance was practised in China around 4000 BC, but there is no evidence of any private underwriters offering cover at that time. The principle of utmost good faith is applicable to all classes of insurance and it involves the duty of disclosure of the assured, the agent of the assured, the underwriter and the underwriter's agent.

Lord Mansfield in *Carter v Boehm* ((1766) 3 Burr. 1905, 1909) stated: 'Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed lie most commonly in the knowledge of the insured only; the underwriter trusts to his representation and proceeds upon confidence that he does not keep back any circumstance in his knowledge to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk as if it did not exist. … Good faith forbids either party, by concealing what he privately knows to draw the other into a bargain from his ignorance of the fact, and his believing the contrary.'

The consequence is that the duty tends to be unevenly heavier on the applicant for insurance than on the underwriter or insurer. In many areas the balance of knowledge in relation to risks between the insured and the insurer has drastically altered in the last 250 years since the comments made by Lord Mansfield.

If a party to an insurance contract does not comply with the duty of utmost good faith, the other party may avoid the contract from the beginning of the contract on an all or nothing basis. The contract is treated as if it never existed and it is applicable to breach of fraudulent, negligent or innocent nature.

The English Law Commission issued a Report on the issues of non-disclosure and breach of warranty in October 1980. It concluded that the law relating to non-disclosure and breach of warranty is undoubtedly in need of reform, and this reform has been too long delayed. Unfortunately the Report excluded marine, aviation and transport (MAT) insurance from its recommendations. The MAT insurances are covered later by another Report issued by the Law Commission and Scottish Law Commission in 2006. A consumer, for example a family buying an insurance policy for a set of furniture which is shipped from Hong Kong to Vancouver, B.C., in the shipping market has to follow the requirement of disclosure in insurance.

It may come as a surprise to many policyholders, particularly consumers, that they are expected to disclose information about which they have not been asked. Professor Malcolm Clarke (Clarke, M.A. (2005), *Policies and Perceptions of Insurance Law in the Twenty-first Century*, Oxford; New York: Oxford University Press, p. 103) criticised the current position:

> Applicants in England may complete the form with scrupulous care, but still find that there was something else material to prudent insurers which, apparently, the particular insurer did not think to ask about but which, nonetheless, the applicant was expected to think of and disclose.

In the U.K., the result of the Statements of Practice issued by the Association of British Insurers, the Conduct of Business (COB) and Insurance Conduct of Business (ICOB) Rules in the Financial Services Authority (FSA) Handbook and above all the FOS scheme (the dispute resolution service of the Financial Ombudsman Service) mean that consumer insurance is subject to an additional set of rules that should go some way to improving the consumer's position so far as misrepresentation or non-disclosure is concerned.

There are reasons of substance that may make it sensible to treat consumer insurance separately. Consumers might be thought to deserve more favourable treatment under the law than, say, large businesses because:

(1) Consumers will almost always contract on standard policy terms which they lack the bargaining power to alter.

(2) Consumers are unlikely to have access to the level of expert advice which will be available to large businesses whether in-house or externally.

(3) Consumers are typically less able to understand the technicalities of insurance contract law particularly if it does not meet their reasonable expectations. FOS has pointed out that consumers may not even be aware that there is an issue of law to be considered.

There are two problems for consumers; firstly they do not know that there are issues of insurance contract law and secondly, in the unlikely event that they do, they are less likely to understand them than a business advised by its broker or in-house specialists.

This problem is compounded by the fact that an expert broker or intermediary advice is hard to find for consumers and there is little understanding of the need to obtain this given the ignorance of the pitfalls in insurance contract law. In this regard it is important to bear in mind that the reasonable expectations of the consumer may well be based upon their expectation of the law in relation to all, or nearly all, other consumer transactions that they may enter into. Applying for an insurance contract may be the only transaction

to acquire goods or services that they enter into in any year in which they are expected in law to assume duties and responsibilities that are not known or explained to them and, where they are not required to seek expert assistance for their own benefit.

Where misrepresentation or non-disclosure is alleged, the ABI (Association of British Insurers) Statements and FSA Rules may be of assistance to a well-informed consumer. However, it is the FOS which ultimately offers the consumer the most valuable protection. In particular, it addresses the harshness of the law in three important ways:

(1) The FOS treats consumers as if there is no residual duty of disclosure. Neither the Statements nor the Rules have this effect.

(2) The FOS will require an insurer to settle claims on a proportionate basis where there has been "inadvertent" misrepresentation and the insurer, had it been aware of the truth, would simply have accepted the application at an increased premium. In contrast, both Statements and Rules allow avoidance for "negligent" misrepresentation.

(3) The FOS does not offer an insurer any remedy in cases of innocent misrepresentation. It appears to take this line regardless whether there has been a claim or not whereas corresponding provisions in the Statements and Rules only apply where a claim has been made.

The Law Commission's 1980 report and the others that followed it identified a number of ways in which the law is unfair. It is not suggested that insureds are being cheated; the market for insurance is highly competitive and no doubt they get value for money. What seems unfair about the law is that it defeats the reasonable expectations of consumers. Insurance is intended to be an effective risk-transfer mechanism, bringing peace of mind to the purchaser. The consumer exchanges the risk of a loss of unknown amount for the payment of a known premium. This process performs a valuable function in enabling consumers to plan their financial affairs prudently. The present system is unsatisfactory in four ways:

(1) It fails to prevent some insurers avoiding policies inappropriately. Insurers may repudiate claims for negligent misstatements that have nothing to do with the claim in issue.

(2) It is inaccessible and obscure. To understand how the current law works, insurers and consumer advisers need to work through multiple layers of law, self-regulation, regulation and ombudsman case law. Not only do the rules differ but the meaning of some of the individual rules, and thus the differences intended, are unclear. It is hardly surprising that insurers often do not understand the rules that govern this area, and attempt to avoid policies inappropriately.

(3) Consumers are deprived of a genuine choice between the FOS and the courts. Except in limited circumstances, no well-advised consumer would choose to take a case to court, because a court would be forced to apply the full rigour of the law.

(4) It requires the FOS to exercise undue discretion. Instead of using its discretion to supplement the law, the FOS has been required to develop its approach almost from first principles. The FSA Rules provide little assistance as COB and ICOB do not and are not intended to deal with anything like the breadth and extent of disputes that arise in insurance policies.

The Law Commission concluded that the time has come to state clearly what rights and obligations a consumer insured should have. It believes that a new statute should replace the current patchwork by a single system that is coherent and clear, and that is fair in that it meets the reasonable expectations of both consumers and insurers. In December 2009 a report, Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation, and draft Bill was issued and addressed specifically at the area causing the greatest problem in the law of consumer insurance and the Bill applies only to consumers, not to business. It is not sure what is the next step which Hong Kong might take after the publication of the Issue Paper 1 in 2006 and report “Consumer Insurance Law: Pre-contract Disclosure and Misrepresentation” by the Law Commission in 2009.