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REFORMING NON-DISCLOSURE RULES

The legal requirement that anyone seeking insurance cover must lay his cards face-up on the table is entirely logical. An underwriter has access to statistical information but for knowledge of facts specific to a particular proposal he is dependant on the proponent, the member of the public seeking cover. Insurers can go some way towards levelling the information imbalance by including in the proposal form appropriate questions, but this is not a complete solution. While insurers no doubt know the questions appropriate to a typical fact situation, they are entitled to be protected from an insured who is aware of but did not disclose an imminent and atypical circumstance that is outside the scope of what an insurer can be expected to foresee. Consider for example the man who seeks to insure his life because he has just received a death-threat, taken a job in Iraq, or been told by his doctor that he has only a month to live. Consider the man who seeks by telephone to insure against flood damage but without disclosing that as he speaks the river at the bottom of his garden is rising fast.

The non-disclosure rules require reform not because the obligation to lay one's cards on the table is unfair but for three other reasons. First the average person seeking insurance cover is unaware of the obligation to volunteer disclosure. Secondly even if he is aware of the obligation he is unlikely to appreciate its extent, the obligation being measured by what a prudent insurer would regard as material. This is a substantial source of problems particularly in relation to so-called "moral risk." Thirdly, should the insured get it wrong and fail to disclose what he should disclose then the avoidance of the insurance cover dates back to its commencement so it is only after the loss is suffered, after the house is burnt down for example or the vehicle is written off that the consumer discovers that contrary to his belief he is not covered.

There is I believe general agreement that for these reasons there is need for reform. But views are not unanimous on the shape which reform should take.

If it is correct that insurers are entitled to protection from the insured who keeps mum about an ascertained imminent loss then it would be wrong simply to abolish the disclosure obligation either entirely or (as has found favour in North America) in respect of certain classes of consumer contracts. This is so even though non-disclosure is not so common that such abolition would result in any sharp rise in premium rates. Simply to abolish the rule is to reward cheats.

Perhaps warnings, on proposal forms for example, of the existence of the obligation would do some good, but defining the extent of the obligation in a way that would convey an unequivocal message to a non-expert is likely to defeat even the most accomplished wordsmith.

To change the rule that avoidance of the insurance contract dates back to its commencement would swing the pendulum too far in favour of the insured. Where as is usual the non-disclosure comes to light only after the loss, to say that the insurer must indemnify against the loss that has preceded such discovery would be effectively to deprive the insurer of any remedy for the insured's breach of obligation.

A solution adopted in Australia in relation to misrepresentation as well as non-disclosure is to ask what the insurer would have done if he had known the truth. If he can demonstrate that he would have declined the proposal altogether the insured has no claim. But if a judge decides that the insurer would have accepted the proposal but on different terms, the insured is entitled to recover as if those terms had in fact been agreed. This approach works where it is simply a question of recategorising the risk in some set table of ratings. This is for example precisely the solution adopted by the Insurance Law Reform Act 1977, section 7 which provides that a life policy may never be avoided on the basis of a misstatement of the age of the life insured, any such problem being met by adjusting the relevant actuarial calculation. But in other cases rewriting the insurance contract after the event is an imprecise process productive of much litigation and not one that should find favour with reformers in this jurisdiction.

It is against that background that in May 1998 the Law Commission published a report, *Some Insurance Law Problems* the first chapter of which recommended reforming the law as to non-disclosure by way of a section to be inserted as section 7A of the Insurance Law Reform Act 1977. The change that it proposed was to confine the rights of the insurer to backdate its avoidance of a policy on the grounds of non-disclosure to these situations:

- Reinsurance contracts - because the insured under a contract of reinsurance is by definition itself an insurer, the insured cannot sensibly claim to lack a precise awareness of its obligations.
- Cancellation within 10 working days of the risk first attaching – this is another very technical exception intended to preserve existing practices in relation to temporary cover.
- Where the non-disclosure is blameworthy which it is only if the insured knew (or a reasonable person would in the circumstances have been expected to know) that the non-disclosure would affect the insurer's decision. This embraces for example the death threat and raging torrent examples already mentioned. The change would not help the smart Alec who takes out insurance when the forest fire is fast approaching but does help the young man from West Auckland who insures his motorcycle not understanding that he needed to volunteer disclosure of some minor youthful criminal conviction.
- Where the failure to disclose has the consequence that the answer to a specific proposal question is wrong.

I hope it is not besotted paternal adoration of my own brainchild that leads me to claim this to be a neat and workable solution.

I have been asked to comment on why there has been no action on the Law Commission's recommendation. The Law Commission proposes, the Government disposes. It is not my understanding that this the non-action is a reflection on the merits of the particular proposal. Rather it is an example of a chronic and hopeless

systemic failure to progress law reform proposals attributable to a number of causes including

- The post MMP clogging of the parliamentary system.
- The reluctance of successive governments to accept any obligation to find parliamentary resources for law reform measures lacking obvious electoral appeal and conforming to no doctrinaire agenda
- Departmental preference for filling such gaps in the parliamentary programme as there are with their own favoured projects
- The complete absence in the relevant ministries of any expertise in many fields of law (including insurance law) and a track record of poor selection by departments of extra-departmental advisers (witness the hopelessly watered down and ineffective Retirement Villages legislation and the much-amended Personal Property Securities Act with its bizarre reference to such purely Canadian phenomena as an account receivable from the sale of minerals at the mine-head)

I still firmly believe (to answer the other question the Ombudsman asked me to deal with) that reform in the sense advocated by the Law Commission is very badly needed.

It is the squeaking wheel that gets attention. If the Insurance & Savings Ombudsman or the Insurance Council or the Consumer Institute want attention to this reform then some loud squeaking is called for, whether in unison or in harmony is up to them.