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SPECIE INSURANCE CLAIMS

NON-DISCLOSURE/MISREPRESENTATION

KEY CONSIDERATIONS FOR

UNDERWRITERS AND CLAIMS HANDLERS

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INTRODUCTION

As with many types of insurance, underwriters providing cover to jewellers, "cash for gold" companies, coin and bullion dealers and other companies requiring a specie policy often have strict criteria and specific factors to consider when deciding to accept a risk. However, most, if not all, of the information regarding the 'to be insured' ("proposer") is provided via a broker's standard proposal form ("the proposal form") and in some instances from a surveyor. Proposal forms often include very specific questions, can come with separately attached information sheets and in some instances are not provided until after the cover has commenced.

It is not uncommon for previously unknown information to come to light and/or the accuracy of the information provided to be questioned only when a claim is made under the policy. This article considers the option of the insurer to avoid the policy on grounds of non-disclosure and/or misrepresentation and the key considerations in deciding whether to do so (it does not cover cases of fraudulent misrepresentation which differ slightly).

BACKGROUND

'Avoidance' of a contract of insurance is the process by which both parties may rescind the contract to place themselves in the position as if it had not been made. This involves the insurer returning the premium and the insured being in a position of never having had the benefit of the policy since the commencement date (and therefore unable to make a claim under the policy). For the purposes of this article we are only considering avoidance from an insurer's point of view.

The basic principles governing non-disclosure and misrepresentation are set out in sections 17-20 of the **Marine Insurance Act 1906** ("MIA"), these are equally applicable to both non-marine and marine insurance.

In brief, a proposer is under a duty of utmost good faith to voluntarily disclose all circumstances material to the risk ('material circumstances') before or at the time the contract is concluded. This allows an insurer the opportunity to make an overall assessment of the risk and decide whether to accept it or not. If a circumstance is not disclosed and it satisfies the two stage test below, the insurer may, prima facie, avoid the policy.

Firstly, it must be determined whether the circumstance is, objectively, material. The definition of what defines a circumstance as material is set out in s.18(2) MIA:

"*Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or in determining whether to take the risk*"

This test can usually be satisfied by obtaining a statement from an independent experienced underwriter, insuring similar risks, confirming that the undisclosed information would have been a factor in determining the premium and the terms of the policy or whether or not to accept the risk.

The second, subjective, stage of the test is to determine whether the undisclosed information induced the actual underwriter to enter into the contract on the terms provided. This test of inducement was established in the House of Lords case: **Pan Atlantic Ins Co Ltd .v. Pine Top Ins Co [1995] AC 501** ("Pan Atlantic"). This can usually be satisfied by obtaining a statement from the actual underwriter confirming that had he known the circumstance he would not have accepted the risk and/or would not have written the policy on the same terms or for the same premium.

A circumstance that would only serve to reduce risk is not material and is unlikely to have prevented the underwriter from entering into the contract had he known about it.

WHETHER TO AVOID – KEY CONSIDERATIONS

Once it has been determined that there may be a prima facie ability to avoid the policy, there are a number of other factors to consider prior to exercising the option to avoid. These include, inter alia:

- the proposal form;
- waiver;
- affirmation;
- Insurance: Conduct Of Business Sourcebook ("ICOBS");
- referral to the Financial Ombudsman Services ("FOS") by the insured.

The Proposal Form

It is not uncommon for a proposer to fill in a standard proposal form provided by the broker in order to provide details about the risk. However, questions are not always phrased clearly and ambiguous answers may cause problems (especially with regards to 'waiver' – see below). The first consideration in relation to the proposal form is whether the form or the policy includes a 'basis clause'. This is a clause contained either in the proposal form, the policy or both that makes the insured's answers to the questions in the proposal form the basis of the contract (or a warranty). In this case where an answer is found to be inaccurate, insurers will not face the hurdle of proving materiality and inducement in order to avoid the policy, all that must be shown is that the information provided is inaccurate and/or untrue. A mere statement of truth contained at the end of a proposal form is not sufficient to make the answers therein the basis of the insurance contract.

Please note that when the **Consumer Insurance (Disclosure and Representation) Act 2012** comes into force (which will not be before March 2013), it will not be possible for the truth of the information provided in a proposal form to be converted into a warranty under a basis of contract clause in consumer contracts.

The signature and date of signature on the proposal form should be checked as this may be important to knowledge of the undisclosed circumstance and any attached or further

information must be considered carefully in relation to a possible argument by the insured of waiver, as set out below.

The fact that the questions on the proposal form were phrased in a way that would not have adduced the material circumstance will not prevent the insurer from avoiding a policy. The duty of utmost good faith to disclose all material circumstances remains.

Waiver

Section 18(3)(c) MIA provides that information which has been waived by the insurer need not be disclosed. This can occur when partial information is provided so as to put a careful insurer on notice to enquire further but they fail to do so. This can happen when an ambiguous answer is provided to a question on a proposal form which suggests that further information should be sought about the circumstances. This was illustrated in the case of ***Glencore International AG .v. Alpina Insurance Co. Ltd [2004] 1 Lloyd's Rep 111*** where it was stated that:

"The duty of disclosure requires the insured to place all material information fairly before the underwriter, but the underwriter must also play his part by listening carefully to what is said to him and cannot hold the insured responsible if by failing to do so he does not grasp the full implications of what he has been told."

Affirmation (may also be referred to as waiver of the right to avoid)

Affirmation occurs when an insurer does something that, after becoming aware of an undisclosed material circumstance and before providing a notice of avoidance, affirms the contract of insurance and prevents him from subsequently avoiding the policy. Examples of an act capable of affirming a contract include: accepting a further instalment of premium, making a payment under the policy, approving security measures to protect the subject matter of the policy or a lapse of time from the date of becoming aware of undisclosed information without taking sufficient steps to clearly and unambiguously avoid the policy so as to either cause prejudice to the insured or to indicate insurers in truth decided to accept liability.

Affirmation may, in some instances, be prevented by issuing a **Reservation of Rights ("ROR")**. This involves the insurer notifying the insured of their wish to reserve their rights to refuse an indemnity. There is no prescribed wording but the typical language may be as follows:

"*Pending its investigation and consideration of the matter, the insurer's position has to be and is fully reserved in relation to coverage for the notified claim [reference] under policy no. [number] and at law"*

This ROR should be given and repeated in every communication during the period in which insurers continue to investigate and take advice themselves. Despite being a useful tool, a ROR can sometimes have the effect of reducing the insured's level of cooperation and also insurers must be careful not to over rely on the protection given by a ROR.

ICOBS

ICOBS are applicable to claims handling and should be considered prior to exercising the right to avoid. The reason is because paragraph 8.1.1 states:

"An insurer must:
…(3) not unreasonably reject a claim (including by terminating or avoiding a policy)…

This is qualified further in paragraph 8.1.2, which states:

"A rejection of a consumer policyholder's claim is unreasonable, except where there is evidence of fraud, if it is for:

(1) non-disclosure of a fact material to the risk which the policy holder could not reasonably be expected to have disclosed; or

(2) non-negligent misrepresentation of a fact material to the risk…"

Paragraph 8.1.2 prescribes the circumstances, in relation to non-disclosure and misrepresentation, where avoidance of a policy would be unreasonable and thereby prevents an insurer from avoiding in those circumstances. However, paragraph 8.1.2 (above) is only applicable to 'consumers' as defined in paragraph 2.11 of ICOBS.

Financial Services Ombudsmen

Prior to avoiding a policy, it is important to consider whether an insured, under the avoided policy, would be eligible to bring a complaint to the FOS against the insurer. The FOS determines complaints based on what, in their opinion, is fair and reasonable in all the circumstances in the case. Although the law, regulations, guidance and codes of practice are taken into account in arriving at this opinion, the FOS are not restricted to following the strict legal position in their determination of what is fair and reasonable as a court would be.

An insured may only take a complaint to the FOS if they lodge their complaint within the required time limits, they are asking for an award of a sum less than £150,000 and they are a consumer or a 'micro-enterprise'. A 'micro-enterprise' for these purposes is defined in the FSA Dispute Resolution: Complaints handbook ("DISP") as an enterprise that employs fewer than 10 persons **and** has a turnover or annual balance sheet that does not exceed EURO 2 million.

LAW REFORM

In 2012 the Law Commission carried out consultation and review on insurance contract law with a focus on the insured's duty of disclosure (LCCP 204, June 2012) (the "Consultation"). As mentioned above, some progress has already been made with regard to consumer policies under the **Consumer Insurance (Disclosure and Representation) Act 2012,** however, the Consultation specifically looks at the position vis-à-vis business insurance.

In general the Consultation acknowledges the importance of a frank exchange of information between a proposer and an insurer. However, it suggests that proposers have a lack of knowledge/understanding about their legal duty of disclosure and that the consequence of failure in that duty (avoidance) is too harsh.

Helpfully, the Consultation proposes to clarify the definition of whose knowledge counts as the knowledge of a corporate entity, this problem can arise in very large entities where one person carries out the proposal process.

The Consultation ultimately proposes a set of new remedies (for conduct which is not dishonest), which are outlined as being more

proportionate on the basis that they aim to put the insurer into the position it would have been had full and accurate information been provided. These include, inter alia:

(1) where the insurer would have accepted the risk but included another contract term, the contract should be treated as if it included that term;

(2) where the insurer would have charged a greater premium, the claim should be reduced proportionately. For example, if the insurer would have charged double the premium, it need only pay half the claim.

CONCLUSION

Until the law is changed the protection of being able to avoid the policy, where full and frank disclosure has not taken place, remains available to insurers. Ultimately it is the insured that has the greater knowledge of the risk and the insurer is entitled to a fair opportunity to assess that risk without having to ask any questions. However, where information is discovered which suggests that there may be a defence of non-disclosure and/or misrepresentation it is prudent for insurers to consider a number of factors at an early stage when considering the options available to them and in order to protect their position with regards to their legal rights.

This article is intended only to give general guidance and you should always consult a lawyer with any particular problem you may have.

Ben Macfarlane & Co is a small maritime and insurance law practice with over the 25 years' experience. We provide an efficient, effective and value for money service for all of your maritime and insurance law matters. Please see www.bjm-co.com for more details or call us on +44 (0) 207 190 2988.

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December 2012