Did you know?

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Life Insurance and Duty of Disclosure

The Financial Ombudsman Service (FOS) stated that most of the 903 complaints regarding life insurance related to claim payments or failure to disclose prior medical history (22 October 2012). Most of these complaints could have been avoided if the life insured had disclosed all relevant medical information when they applied for the policy. This brings us to a very important issue: the duty of disclosure.

The life insurance company is required to inform the insured of their duty of disclosure in writing, which is normally done on the life insurance application or proposal form (s22 ICA 1984). What is the insured required to disclose. Section 21 of the Insurance Contracts Act states that, "… an insured has a duty to disclose to the insurer, before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that: (a) the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms; or (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant." There are exceptions to the duty, including that disclosure is not required of matters that the insurer knows or ought to know, or where the insurer has waived compliance with the duty to disclose.

Insurers have the responsibility of proving what information is relevant to their decision to accept the risk. An insurer may prove this by reference to its underwriting guidelines, which usually set out risks that will be accepted and the relevant premium and conditions attaching to that risk. The undisclosed matter must be relevant to that insurer for the cover being applied for.

In the past, advisers have debated whether or not it is appropriate to complete an application form or proposal on behalf of the client. Any statement that is made by or attributable to the insured is deemed to have been made by the insured themselves (ss24-25 ICA 1984). This means that whether or not the insured completes the application form or proposal themselves, or has an adviser or someone else complete the application form or proposal on their behalf, the duty of disclosure remains the same.

In the event that a statement by the insured was factually incorrect, but the insured believed the statement to be correct when they applied for the life insurance, then the legislation provides some leniency. Provided that a reasonable person in the circumstances would have provided the same information, then the statement shall not be deemed to amount to a misrepresentation (ss26 ICA 1984)

Alternatively where the insured does not disclose information and a reasonable person in the circumstances could not be expected to have known that the information would have been relevant to the decision of the insurer whether to accept the risk, then the omission shall not be deemed to be a breach of the life insured's duty of disclosure (s21 ICA 1984). The result is that there are significant ramifications where an insured does not disclose their relevant medical details.

When does the duty of disclosure end? It ends once the policy is entered into. Where a person applies for life insurance cover, and between the proposal date and the date of issue of the policy, additional medical information arises that is relevant to the assessment of the risk of the policy, the insured is required to disclose this new information to the life insurance company.

Where this new information is not disclosed and it is deemed to be relevant in the assessment of the insurance risk, the life insurance company has the right to avoid a claim (SUMMERTON & ORS v SGIC LIFE LIMITED No. SCGRG-97-1630 Judgment No. S121 [1999] SASC 121 (26 March 1999)).

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The duty of disclosure is also owed again at the time prior to the extension or variation of a contract of life insurance.

What are the options available to the life insurance company if the insured breaches their duty of disclosure or makes a misrepresentation? If the non-disclosure was fraudulent or the misrepresentation was made fraudulently, the insurer may avoid the contract at any time. If there is no fraud and the insurer would not have been prepared to enter into a contract of life insurance with the insured on any terms if the duty of disclosure had been complied with or the misrepresentation had not been made, the insurer may, within 3 years after the contract was entered into, avoid the contract. If the insurer has not avoided the contract, the insurer may, by notice in writing given to the insured before the expiration of 3 years after the contract was entered into, vary the sum insured (s29 ICA 1984). It is important to disclose that the legal position stated in this paragraph changes for policies issued after 28 June 2014.

The insurance company is under an obligation to prove that the information that was misrepresented or was not disclosed by the insured was material in the assessment of the risks (Schaffer v Royal & Sun Alliance Life Assurance Australia Ltd [2003] QCA 182, Queensland Court of Appeal). In this case, the insured failed to disclose prior episodes of breathlessness when she applied for a TPD policy. The insured later claimed on her TPD policy due to severe breathlessness caused by stress. The courts stated that where an insurer seeks to exercise a right to avoid, it is important that it produce evidence to show that it would have declined the cover on any terms [to avoid pursuant to s29(3)] or that it would have offered cover but on different terms [to avoid pursuant to s29(2)]. The avoidance was overturned by the Court and the claim was ordered to be paid.

In the past, if the insured failed to disclose relevant information on a combined policy (i.e. Death and TPD, or Death and Trauma), then the life insurance company was forced to avoid all parts of the combined life insurance policy. On 28 June 2013, an amendment to the Insurance Contracts Act received Royal Assent amending this antiquated provision. In the event of non-disclosure by the insured, the life insurance company now has the ability to assess whether or not they would have accepted the risk on each component as though it was a separate individual policy (s27A ICA 1984). Where a life insured has a combined policy it prevents a “double-jeopardy” situation where the information omitted which was only relevant to the assessment of a TPD (or Trauma) insurance risk, will not preclude the life insured from retaining their death cover (provided the non-disclosure had no bearing on the assessment of the death cover risk).

Summary

It is important to remind clients who are applying for life insurance to disclose everything. If they are not sure, disclose it. Appropriate disclosure at policy application prevents confusion and disappointment at claim time.

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