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Some issues related to the content of the policyholder's pre-contractual duty of disclosure – general view

UDC: 347.4:368

Received: 25. 2. 2016.

Accepted: 8. 3. 2016.

Systematic scientific work

Abstract

The borderlines of the pre-contractual duty of disclosure imposed on the policyholder had been fixed first by Lord Mansfield some 250 years ago. During a long period of time the pre-contractual disclosure was the weak point of the policyholders since insurers could easily escape liability by availing themselves of the breach of duty. Indeed this was certainly the most breached duty given the fact that legal rules or court decisions placed on the policyholder the risk of correctly guessing what they were expected to disclose. In addition, the sanction to apply against the policyholder was very harsh (avoidance) and was not excluded in case of innocent breach. This situation detrimental to the policyholders changed only at the beginning of the new millennium. Nowadays the sanctions that may be applied are balanced. They include variation, decrease of the insurance money and termination; avoidance being totally excluded or permitted only in case of intentional breach. On the other hand negligent breach is a basic requirement and insurers are not anymore in a position to apply a sanction where the policyholder cannot be attributed any negligence in breaching the duty of disclosure. Parallel to those new solutions, the content of the duty did also undergo changes. Insurers are required to ask questions in order to learn about points relevant for their decision whether to accept the risk. If they don't put questions in respect of some point, that point will be deemed "not relevant". In the article below we will try to highlight some issues relating to the content of the pre-contractual disclosure duty still of utmost importance today.

Key words: duty, disclosure, sanctions, breach

1. INTRODUCTION

In his famous decision (*Carter v. Boehm*¹) 250 years ago, about the pre-contractual duty of disclosure imposed on the policyholder, Lord Mansfield underlined the following:

- 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 keeping back such facts is a fraud and therefore the policy is void;
- Where the suppression happens through mistake, the underwriter is deceived too and the policy is void also in such case (because the risk run is really different from the risk understood and intended to be run at the time of the agreement).

After a long period of practice, the duty to disclose still constitutes one of the most debated issues in insurance law. Below we will examine this duty as to its content.

2. CONTENT OF THE PRE-CONTRACTUAL DUTY OF DISCLOSURE

Policyholder's duty of disclosure is aimed to enable the insurers to decide whether to enter into an insurance contract and if the answer to this question is affirmative, on what terms.

2.1. Legal character

The pre-contractual duty of disclosure is a "duty" and not an "obligation." The non-performance of the duty does not entitle the insurers to claim losses or the performance of the duty. The only result of the breach is the total or partial loss of rights, depending

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¹ 1766 [S.C. 1 Bl.593.] 3 BURR. 1905.

on the choice of the legislator. The law can provide a direct consequence (for example in following terms: “the insurers are relieved from liability in case of gross negligently breach”) or a consequence that is triggered by the initiative of the insurers (for example in following terms: “the insurers can avoid the contract in case of intentional breach”). The policyholder will not be deemed to have guaranteed the accuracy or existence of the facts disclosed. The disclosure is only a statement occurred at the pre-contractual stage.

The disclosure is not a declaration of will but a declaration of knowledge.

The aim of the disclosure is to enable the insurers to determine “whether” and if so “on what terms” they will cover a risk (Meixner, Steinbeck, 2011, § 6 Rn. 45).

2.2. How much information needs to be disclosed?

The answer to this question depends of the insurance cover requested and must be examined separately for each concrete case.

As a general rule, the extent of the disclosure will be determined with regards to the risk to be transferred to the insurers.

In legal systems where the so-called “risk of prognostic” lies with the intending (or prospective) policyholder, that person will have to correctly guess the relevant facts important for the insurers and disclose them accurately and completely.

In legal systems where the insurers must ask what they need to know, the prospective policyholder's duty will be limited to the questions put by the insurers.

Another solution consists of a combined system: Where the insurers may but are not obliged to put questions, in case they choose to do so the duty of disclosure may be limited to accurate and complete answers to those questions and if they don't put any question, all the relevant facts that may have any impact on the insurers decision to take over the risk at all or on different terms (i.e. higher premium, with more excluded cases or with more contractual duties imposed on the policyholder) all those facts must be realistically foreseen and disclosed.

For interim (or preliminary) cover the duty of disclosure may be as extensive as in the case of an application for a usual insurance (Pynt, 2015, 8.4).

2.3. Information known to the prospective policyholder

An important problem arisen in respect of the pre-contractual disclosure concerns to know whether the prospective policyholder will be under the duty to act

diligently in order to be aware of some relevant facts (and consequently to disclose them).

Legal systems may limit the extent of the duty of disclosure to what is actually known or enhance the scope and include within the duty also what should be known.

In case the scope is enlarged, the following question must be answered: Will the prospective policyholder be considered in breach if he does not disclose anything he should be aware of or will he be in breach only in case of Nelsonian blindness (putting the telescope to the blind eye i.e. intentional refusal to become aware of something)? PEICL have opted for the former and German Insurance Contract Act (VVG) for the latter.

A matter is not known (yet) if the policyholder is only believing something to be true or strongly suspecting something.

2.4. Principle of fair presentation of the facts

The prospective policyholder's duty of disclosure is based upon the principle of “fairness.” Even if the insurers have expressly limited the scope of the duty imposed on the contractual partner (for example the insurers in their questionnaire ask only for driving records related to last five years), the principle of fair dealing and good faith would require that the intended policyholder disclose three major offenses occurred consecutively in the previous seventh and sixth years.

2.5. Answers to questions put by the Insurers

The meaning of an answer given by the prospective policyholder must be construed objectively, considering the question and answer together (Pynt, 2015, 8.8). With regards to the question, the understanding of a reasonable policyholder is decisive. If his answer is tailored in the light of that reasonable understanding and is accurate and complete, the insurers cannot challenge it.

If the prospective policyholder gives a vague or incomplete answer to a question but the insurers nevertheless grant cover without further inquiries, they may be deemed to have waived the need for additional information (Pynt, 2015, 8.9).² It seems appropriate to impose on the insurers a duty of further inquiry in case the policyholder's answers are unclear or apparently incomplete. If the insurers are aware of the fact that the policyholder did not yet performed his

² Pynt underlines that the courts may also interpret the case as follows: The passive attitude of the insurers may be viewed as evidence of the fact that they confirmed the sufficiency of the information already in their hands.

28

duty of disclosure completely, they should request from the policyholder additional information to comply duly with their task of risk evaluation otherwise they would have behaved against the principle of fair dealing (except when the policyholder acted fraudulently). The reason behind this solution is that the insurers should not be allowed to accomplish an evaluation about the risk later after the materialisation of the insured event; they must have done it at the pre-contractual stage (Looschelders, Pohlmann, 2011, § 19 Rn.50; Römer, Langheid, 2014, §19 Rn.77).

If a question asked by the insurers is not answered, debate exists as to whether this should not be regarded as a denial (negative answer) or as the manifestation of the policyholder's decision to refrain from making any statement (if so, whether such a reticence will trigger the insurer's duty of additional inquiry)? If the insurers insert on their questionnaire or general conditions of business (insurance) a warning that the abstention would be seen as a negative answer, this would be sufficient to dispense the insurers from further inquiry (Looschelders, Pohlmann, 2011, § 19 Rn.51).

In case of crossing out a question in the questionnaire, the insurers may consider this manner of answering as a negative answer (Römer, Langheid, 2014, § 19 Rn.78). However, if this negative answer is in contradiction with another answer given by the policyholder, the insurers may be expected to make further investigation (Looschelders, Pohlmann, 2011, § 19 Rn. 52).

The policyholder may give authority to a third party in respect of answering the questions put by the insurers. This sometimes occurs in the following manner: The policyholder signs in blank the questionnaire prepared by the insurers and leaves the task of answering entirely to the third party who may be (at the same time) a representative of the insurers (for example the insurer agent). If the person who answers the questionnaire blank signed by the policyholder gives false or incomplete answers, the duty of disclosure would be breached and the policyholder would face the consequences of that breach (Römer, Langheid, 2014, § 19 Rn.79).³ Whether the same solution is valid in case the insurance agent (acting on behalf of the insurers) has filled the questionnaire is a matter of interpretation.

³ Langheid cites two court cases in support of the solution: In the first case the policyholder consciously had left the question unanswered and the same question had been later answered (falsely) without policyholder's will and knowledge. In the second case the questionnaire was blank signed by the policyholder and handed over to his representative who later did not give him back for lecture after being filled, the questionnaire was not containing any false statement at the moment when it was signed by the policyholder.

In our view an appropriate reduction can be envisaged to the extent that the incompleteness or incorrectness of the answers are attributable to the policyholder's not actively taking part in the answering process, provided that the agent is empowered only to transmit the application and not evaluate and finalize it on behalf of the insurers.

2.6. Interpretation of the questions

The questions put by the insurers in the questionnaire must be interpreted in accordance with the rules applicable to the interpretation of general conditions of business (insurance). The understanding of a diligent applicant (prospective policyholder) is decisive. Unclear questions will then be detrimental to the insurers and in that respect a narrow interpretation will be adopted (Looschelders, Pohlmann, 2011, § 19 Rn. 24).⁴

2.7. Questions of general nature

Sometimes the insurers put questions of general nature (for example: "sicknesses and complaints during the last five years.") According to a point of view, such questions are not appropriate for evaluating the risk since the answers thereto will also be of general nature. Another view is in the opposite direction: It admits that answers given to questions of general character may also be relevant for the decision of the insurers. Therefore the policyholder should not be allowed to avail himself of the defence that specific illnesses are not asked. However the questions should not be so unclear that they cannot actually trigger the duty of disclosure (Römer, Langheid, 2014, § 19 Rn. 24; Looschelders, Pohlmann, 2011, § 19 Rn. 23).

The question "habitual intake of medicines, alcohol and drogues" was found by a court to be unclear because the notion "habitual" appears too ambiguous⁵.

2.8. No need to disclose what the insurers already know

A fact material for the conclusion of the insurance contract needs not to be disclosed if known to the

⁴ Looschelders gives the following example (taken from a decision rendered by OLG Hamm, VersR 1996, 441-442): If the insurers ask about recommended surgeries, the policyholder will not be under the duty to disclose surgeries that the medical doctor did not recommend based on medical grounds (but undergone because the policyholder so desired).

⁵ OLG Oldenburg VersR 1994, 1169 cited in Looschelders, Pohlmann, 2011, § 19 Rn. 25.

insurers. The same is true for information that the insurers ought to know (from publicly available sources or as being insurers of a particular class of business).

2.9. Aggravation of the risk during the insurance period

The aggravation of the risk after the contract is concluded fall outside of the pre-contractual duty of disclosure. The notification of the aggravation is usually another duty regulated separately. However if an aggravation is not notified to the insurers, after the expiry of the initial insurance contract, at the renewal stage, this fact (if still relevant) must be disclosed in the context of the pre-contractual disclosure duty before the new contract covering the new insurance period is entered into.

2.10. Variation or renewal of the insurance contract

The pre-contractual duty of disclosure must be complied with in case of variation or renewal. An important issue is the impact of the duty in case of variation. Will the breach of duty produce consequences in respect of the variation only or will it affect the entire contract (Pynt, 2015, 8.11)?⁶ We think the entire contract would be affected if the insurers would not maintain the contract without the variation.⁷

2.11. Relevant or material facts

To know whether a fact is relevant or material for the decision of the insurers to take the risk or to take it under different terms the following test may be applied:

- At first step to determine whether a fact not disclosed is apt to influence the insurers,⁸
- At second step to determine whether in the concrete case the actual insurers have accepted the risk

⁶ Pynt refers to a case where it was decided that the breach would only affect the variation ('Mercandian Continent' [2001] EWCA Civ 1275).

⁷ The result may be depending on the sanction. If the breach gives rise to the decrease only of the insurance money to be paid, it may not make sense to discuss whether it affects the variation or the entire contract. However if the insurers are entitled to avoid or terminate, there may be room for debate to know whether the entire contract or only the variation would come to an end.

⁸ In that respect the subjective conceptions should not be decisive. A fact may be important and relevant for a given insurer but this is not sufficient to conclude that the fact in question must be disclosed. An objectivised test must apply i.e. the fact must be relevant generally for insurers covering the risks of that kind (Meixner, Steinbeck, 2011 § 6 Rn.53).

and made the contract (as it stands) in reliance on the non-existence of the undisclosed fact.

Where the insurers would have delayed their decision (in order to make further inquiries), had they known the relevant fact, this may be regarded as an indication of materiality. However, it seems that a second condition would be required: The inquiries would have led (with high probability?) to the rejection of the application.

The undisclosed fact may not be the only cause that led the insurers to decide to accept the risk. It suffices that the fact not declared constitutes an effective cause. In that respect the pre-determined (and notified to sales network) criteria by the actual insurers for the acceptance of risks may be relevant.

The onus of proof will be on the insurers to demonstrate that a fact was relevant to their decision.

Amongst the facts that are relevant for the insurers' decision are also the so-called "moral hazard" (similar to what German circles call "contract risk.") This expression refers to the danger engendered for the insurers covering the risk, to face later unfounded or exaggerated claims. It is directly linked to the personal values of the policyholder (probity, integrity). Although the physical hazard (the probability that the subject matter insured be lost or damaged) in property insurances can be observed and scientifically measured, such a possibility does not exist for moral hazard (Meixner, Steinbeck, 2011, § 6 Rn.59).⁹

In addition to physical and moral hazard, the doctrine underlines a third category of facts relevant for the decision of the insurers: For example the previous convictions for road traffic offences (showing the propensity of the policyholder to infringe rules which is a fact material for the risk to be transferred to the insurers) (Pynt, 2015, 8.21).

The policyholder's duty to disclose previous criminal offenses may be restricted by legal rules. Examples: If the law prohibits discrimination against an applicant on the basis of "irrelevant criminal record", this would mean that the disclosure of the "irrelevant record" would not be required. For "spent convictions" (record erased after a certain period of time under certain conditions) the same solution may apply (Pynt, 2015, 8.22).

Rumours (even if later they reveal to be unfounded) must be disclosed provided their appearances are not unreasonable. The insurers must be informed on serious

⁹ Meixner and Steinbeck underline that previous insurance contracts and previous losses or damages, other applications made simultaneously; rejected applications are relevant for the so-called "contract risk."

allegations (even if the policyholder is in possession of evidence refuting them) (Pynt, 2015, 8.23).

Threats to injure or damage is a relevant matter.

Suspicious facts as well as marginal and temporary facts are not to be disclosed.

Minimisation is not allowed and the policyholder must give a complete answer about the facts asked by the insurers (however sicknesses that are manifestly of no significance may be omitted). If, from the standpoint of the policyholder (who may not be an expert), a fact is thought to be relevant for the insurers (or is not clearly identified as without significance), that fact must be disclosed. But, the declaration of sicknesses already faded away will not be required (except where questions about previous illnesses are explicitly put). However a false diagnosis is to be declared (Römer, Langheid, 2014, § 19 Rn. 26).¹⁰

What is relevant for the decision of the insurers must be determined by having regard to the standard they have adopted and to the appreciation of their employees (Römer, Langheid, 2014, § 19 Rn. 27).

The policyholder has to disclose also facts relevant for the exclusions of the cover (Römer, Langheid, 2014, § 19 Rn. 27).

We must also add that the insurers should be informed about the “indicative facts”. These are facts that are not yet attained a sufficient degree for being considered material or relevant but have the ability to become relevant (Meixner, Steinbeck, 2011, § 6 Rn 58).¹¹

2.12. Persons whose knowledge is relevant for the duty of disclosure

An insurance contract may involve several persons at the same time. There may be more than one policyholder and/or insured. These persons may have given authority to somebody else in respect of the contract or the duties to be accomplished under it. The rule is that facts known to any of the persons involved must be disclosed (and not only facts commonly known).

A person is deemed to know something not only when that person has the relevant knowledge in his consciousness but also when he has access to the source of information (For example the number of the driving licence is considered known even if the related person

¹⁰ According to another view, not the false diagnosis but the complaints that led to the diagnosis should be disclosed.

¹¹ Meixner and Steinbeck give the following example: When taking out life insurance the high blood pressure should be announced to the insurers since this may signify a thickening (calcination) of the coronary artery.

does not have it in his mind; it is sufficient that he has the possibility to learn it in the ordinary course of the life without any notable burden) (Pynt, 2015, 8.36).¹² A company will be deemed to know the information contained in its official records or the information known to its CEO (Pynt, 2015, 8.36).¹³

2.13. Genetic tests

An important problem consists to know whether the prospective policyholder can be requested to undergo genetic tests and disclose the results thereof or to declare the results of genetic tests already done. The prevailing approach until recent times was that the insurers should be prevented to impose those tests but they should be allowed to demand that the policyholders disclose the tests previously completed. According to a new solution the results of a predictive genetic test are not to be declared (Looschelders, Pohlmann, 2011, § 19 Rn. 37) whereas the policyholder may be requested to declare the results of the diagnostic genetic tests. The difference between these two types of genetic tests can be explained as follows: The predictive tests allow the detection of the aptitude (predisposition) to develop illnesses in the future (that have not yet manifested clinically). The diagnostic tests are aiming to determine the causes of an existing complaint (Römer, Langheid, 2014, § 19 Rn.13).

2.14. Duty of the policyholder to make necessary inquiries

The policyholder owes a duty of “recall” insofar as this seems possible by remembrance endeavour. He must therefore make the necessary inquiries. Facts forgotten a second time remain outside of the disclosure duty only if it appears reasonable that they could not be remembered despite serious efforts or

¹² However Pynt states that for companies the approach may be different: A newspaper extract in a company’s possession, although it constitutes a source of knowledge accessible, was not considered “known to that company” on the ground that access to a means of knowledge was not sufficient (see the decision cited at footnote 87, p.162). We think that facts made public in newspapers don’t need to be disclosed provided they are notorious. But if they are not notorious, regard should be given as to whether the “alter ego” of the company involved was expected to have read the news for any particular reason (for example because the news are related closely to the business of the company and the newspaper diffusing the news is followed by similar companies for having access to sectorial information).

¹³ Pynt underlines that an employee, director or officer of the company responsible for or involved in arranging the insurance will be considered to be aware of the relevant facts to be disclosed to the insurers.

inquiries (otherwise the policyholder would be free to forget the relevant facts). If his disclosure has gaps he must warn the insurers about them (Römer, Langheid, 2014, § 19 Rn. 28).

2.15. Further examples of facts to be disclosed

We speak about following examples (Römer, Langheid, 2014, § 19 Rn. 29-32):

- reiterated diagnose of slightly fattened liver and bad liver values (although no medical treatment deemed necessary and refrain from alcohol consumption recommended only),
- heart complaints appeared since long ago and necessitated medicament treatment from time to time,
 - daily fever and loss of weight (11 kg in two years),
 - back complaints treated since years,
 - conviction to 7.5 years in jail for arson (building insurance),
 - threat of arson for protection racket,
 - bad financial situation,
 - implying situations (for example high blood pressure as indication of coronary sclerosis).

Generally speaking, in property insurances what is relevant for the insurers is to know whether the property insured is protected sufficiently in order to avoid the materialisation of the risk (i.e. loss or damage or loss of possession). In that respect the classical example with regards to theft insurance is the existence of an alarm device. In personal insurances, the health situation is the most relevant factor.

SUMMARY

The pre-contractual duty of disclosure imposed on the policyholder continues to be the most significant duty as it enables the insurers to have a clear picture of the risk, a necessary element on which the insurers' decision whether to enter into an insurance contract and if yes on what terms. If the policyholder breaches his pre-contractual duty of disclosure, he may partly or wholly lose its rights under the contract of insurance. Therefore the content of the duty is of utmost importance. The article focuses on this issue and is aimed to underline some basic principles that apply with regards to the extent of the policyholders' pre-contractual duty of disclosure. Today the trend is in the direction to limit the extent of the duty to correct and complete answers to the questions put by the insurers. In addition the duty comprises only points that are objectively relevant.

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