NON-DISCLOSURE

This article attempts to look into the duty of disclosure in insurance law with particular emphasis on section 150 of the Insurance Act 1996.[1]

I. THE DUTY OF DISCLOSURE

At common law, insurance contracts are contracts *uberrimae fidei,* that is, contracts of the utmost good faith. In insurance law, utmost good faith has two important aspects - misrepresentation and non-disclosure. It must be pointed out that only non-disclosure is dealt with in this article.[2] Both the insurers and the assured have to observe utmost good faith towards each other.[3] In practice, however, most of the times, the problems that arise in relation thereto involve the assured's duty only. This is because the special facts upon which the contingent chance is to be computed lie most commonly within the knowledge of the assured only. Hence, it is the assured who is required to disclose material facts which are known to him. It is often said that the assured is even under a residual duty to disclose material facts unsolicited by the insurer.[4] In respect of the duty of disclosure, the law requires that the assured

[1]Act 553. This Act repeals its predecessor, the Insurance Act 1963.

[2]For information relating to misrepresentation, see, Nik Ramlah, *Insurance Law In Malaysia,* Butterworths, 1992, pp 71-72.

[3]*Carter* v *Boehm* (1766) 3 Burr. 1905. See, s 17 of the Marine Insurance Act 1906.

[4]*Abu Bakar* v *Oriental Fire and General Insurance Co. Ltd.* [1974] 1 MLJ 149.

must disclose all material facts to the insurer prior to the making of the contract of insurance. The assured needs only disclose material facts which are known to him prior to the making of the contract. At common law, there is no such thing as post-contractual duty of disclosure. In the field of marine insurance, the duty to disclose extends to constructive knowledge of material facts which the assured is deemed or ought to know in the ordinary course of business.[5] As to whether the same also applies to non-marine insurance, it is still an open question.[6] At the most, it is arguable that the same applies to non-marine insurance as well because section 18 of the Marine Insurance Act 1906 codifies the common law position applicable to all insurances.[7] Prior to the passing of the Insurance Act 1996, questions pertaining to non-disclosure in the field of non-marine insurance were governed almost entirely by common law in this country. The marine position until today is governed by statute.[8] For the purpose of disclosure, 'material facts' mean those which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk or not.

The duty of disclosure arises afresh with each renewal of the contract of insurance save in the case of a life policy. In general insurance, each renewal refers to a fresh or new contract usually on terms similar to or identical with those of the previous contract which has expired.

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[5]S 18(1), Marine Insurance Act 1906 (English). The English Act applies here by virtue of s 5 of the Civil Law Act 1956.

[6]McNair J. in *Australia and New Zealand Bank* v *Colonial and Eagle Wharves Ltd.* [1960] 2 Lloyd's Rep 241 at 252.

[7]*Highlands Insurance Co.* v *Continental Insurance Co.* [1987] 1 Lloyd's Rep 109. In life policies, only actual knowledge in respect of matters pertaining to the health of the assured needs to be disclosed - *Joel* v *Law Union & Crown Insurance Co.* [1908] 2 KB 863.

[8]Sections 17 to 19, Marine Insurance Act 1906.

II. THE TEST OF MATERIALITY

A. The common law position

As has been pointed out above that the assured has to disclose material facts which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk. The yardstick or test used to determine materiality is that of the hypothetical prudent insurer, not the particular insurer. The crucial words *'would influence the judgment of a prudent insurer'* in section 18(2) of the Marine Insurance Act 1906 relate to the question of the degree to which a prudent insurer would have been influenced in his conduct had he been in possession of the relevant material facts. They have been subjected to curial interpretation in a number of cases[9] in recent years in the English courts. They mean that the test of materiality is complied with if the insurer could demonstrate that a prudent insurer would have wanted or be interested to know the information in question while considering the proposal made by the assured, and would not necessary have acted any differently as regards the premium or the risk.[10] The word 'judgment' was construed to mean 'the formation of an opinion', not 'the final decision'. It is to be noted that the same test is applicable to non-marine cases.[11] Besides satisfying the prudent insurer test, the insurer must go on to prove that he was induced to enter into the contract before he could succeed on the ground of non-disclosure.[12]

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[9] *CTI (Container Transport International Ltd.* v *Oceanus Mutual Underwriting Association)* [1984] 1 Lloyd's Rep 476 (CA); *Pan Atlantic Insurance Co. Ltd.* v *Pine Top Insurance Co. Ltd.* [1994] 3 All ER 581 (HL); *St Paul Fire & Marine Co. (UK) Ltd.* v *McConnell Dowell Constructors Ltd.* [1995] 2 Lloyd's Rep 116 (CA).

[10] This refers to the adoption of the 'mere influence' test while rejecting the 'decisive influence' test and the 'increased risk' theory.

[11] *Lambert* v *Co-operative Insurance Society* [1975] 2 Lloyd's Rep 485.

[12] *Pan Atlantic Insurance Co. Ltd.* v *Pine Top Insurance Co. Ltd.* [1994] 3 All ER 581. It was held that the requirement arises by implication. The requirement of inducement is part of the general law of representation which is equally applicable to non-disclosure. The Marine Insurance Act 1906 does not seek to deal with the provisions of general law. There is a need for insurance law to comply with the general law.

The prudent insurer test is said to impose 'a heavy and often unjustifiable burden' on the assured or proponent of insurance. It certainly increases the burden on the assured to disclose material facts. Due to the harshness of the prudent insurer test, the 'reasonable insured' test has been mooted as one alternative. But the latter, too, is not free from problems in its operation. It also faces the problem of identification of the hypothetical reasonable person as the adoption of the prudent insurer test. Moreover, not all the assured may measure up to the standard required of a hypothetical reasonable assured.

B. The Australian and Malaysian Position in Non-marine Cases : The Concept of Relevance

Due to the problems associated with either the prudent insurer test or the reasonable assured test, Australia has opted for a compromise in its *Insurance Contracts Act 1984 (Cth)*. Section 21(1) thereof provides that:

> Subject to this Act, 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 -
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> (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
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> (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant.

The Malaysian Insurance Act 1996 has abandoned the long-established common law test of materiality. Section 150 thereof has opted to follow the footsteps of the Australian *Insurance Contracts Act 1984*. Section 150(1) has it that:

> Before a contract of insurance is entered into, a proposer shall disclose to the licensed insurer a matter that -

(a) he knows to be relevant to the decision of the licensed insurer on whether to accept the risk or not and the rates and terms to be applied; or

(b) a reasonable person in the circumstances could be expected to know to be relevant.

C. The Concept of Relevance - What is it all about?

Section 150(1) of the Malaysian Act starts off by imposing a pre-contractual duty of disclosure on the part of the assured. It is to be noted that this is a statutory provision which also coincides with that imposed by common law. Para (a) disposes of the common law requirement of materiality. The obligation of the assured to disclose is now confined to matters which the assured knows to be relevant to the decision of the insurer whether to accept the risk and also matters which might affect the rates and terms upon which the risk is accepted. It does not extend to constructive knowledge, that is, matters which the assured ought to know in the ordinary course of business. However, it has been held that a belief or suspicion, reasonably entertained by the assured, was a matter that should have been disclosed to an insurer who provided house owner's and householder's insurance cover.[13] The assured's knowledge of matters required to be disclosed under the section are being made *relevant, not material,* under section 150(1)(a). It could be argued that materiality is now irrelevant thereunder. Authority for this proposition could be found in the Australian case of *Prime Forme Cutting Pty. Ltd.* v *Baltica General Insurance Ltd.*[14] The common law hypothetical prudent insurer is now abandoned in favour

[13] *Khoury* v *G.I.O (N.S.W.),* (1984) 58 A.L.J.R. 502. In *Khoury*, the father believed that one of this sons was or had been systematically stealing money for gambling purposes from the father's business located in the same building as the family residence.

[14] (1991) 6 ANZ Ins Cas 61-028. The Supreme Court of Victoria held that the assured was in breach of s 21 of the Australian Act simply because the assured was aware of the presence of a large amount of inflammable liquid at the insured premises and the relevance of that fact to the particular insurer's decision whether to enter into the contract of insurance or not.

of the particular insurer. Objectivity is still maintained in the said section. The assured is also required to disclose any matter that a reasonable person in the circumstances could be expected to know to be relevant to the insurer even if the assured did not know it was relevant.[15] The shift in focus to the assured is superimposed with an objective element. The requirement of objectivity has extended the assured's duty of disclosure. This test does not equate the reasonable person with the assured. The objective test appears to be what the hypothetical reasonable person would know if he had the state of knowledge which the assured has or ought to possess.[16] The phrase *'a reasonable person in the circumstances'* is intended to oust any personal idiosyncrasies[17] of the assured concerned so as to avoid any finding against materiality in cases where the assured is somehow falling below the standard of a hypothetical reasonable person in respect of the necessary knowledge. This being the case, the court may be inclined to rule in favour of insurers in terms of matters relevant to the decision of an insurer in spite of the fact that the assured is poorly educated or illiterate who is unable to read and answer questions in the proposal form properly.[18] In the case of joint assureds, a matter will be known to the assured for the purposes of the section 150(1) if it is within the collective knowledge of the joint assured, *to wit,* as known to at least one of them.[19]

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[15] S 150(1)(b).

[16] Wickens, *The Law of Life Insurance in Australia,* 1990, paras 3.40-3.50. See also, *Twenty-first Maylux Pty. Ltd.* v *Mercantile Mutual Insurance (Aust) Ltd.* (1990) 6 ANZ Ins Cas 60-954.

[17] Such as stupidity, ignorance and illiteracy.

[18] *China Insurance Co. Ltd.* v *Ngau Ah Kau* [1972] 1 MLJ 52; *Wong Lang Hung v National Employees' Mutual General Insurance* [1972] 2 MLJ 191. It must be noted that the cases cited contained a basis clause. Nevertheless, the principle laid down is relevant to the point under discussion.

[19] *Advance (NSW) Insurance Agencies Pty. Ltd.* v *Matthews* (1989) 5 ANZ Ins Cas 60-910.

Section 150(1) effects significant changes to the common law duty of disclosure on the part of the assured. It will to some extent reduce the burden of disclosure on the assured. The subsection will certainly rid itself of the problems associated with the former common law test of materiality.[20] Section 150(1) abandons the common law test of materiality in relation to the duty of disclosure on the part of the assured. Subject to the provisions of the Act, it leaves the other aspects of the duty of utmost good faith intact. They continue to be governed by common law. The law as to misrepresentation of material facts remains wholly intact. As such, the subsection only represents a partial attempt to remedy the harshness of the common law test of materiality towards the assured as the law on misrepresentation is left intact. As relatively very little time has elapsed since the coming into force of the Insurance Act 1996, the actual impact of the shift of attention to the assured is yet to be seen. It must also be pointed out that the requirement of inducement of the particular insurer is also needed under the Insurance Act 1996 although the Act is silent thereon. The same argument as used in *Pan Atlantic* could also be used here.[21]

III. WHAT CONSTITUTES MATERIAL FACTS?

Material facts relate in general either to the physical or the moral hazards pertaining either to the subject-matter of insurance (in the case of physical hazards) or the insured (in the case of moral hazards).

In *Teh Say Cheng* v *North British and Mercantile Insurance Co.*,[22] the court pointed out that '[t]he physical hazard is determined by the condition of the building and the nature of the stock' in a case involving fire insurance. *Physical hazards* are generally and obviously material. For examples:

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[20]See, the *Pan Atlantic* case, for example.

[21][1994] 3 All ER 581. See, *supra*, n 12.

[22](1921) 2 FMSLR 248.

(a) in property insurance, the nature, construction or use of an industrial building or whether it is particularly exposed to risk like in the case of *Wong Lang Hung* v *National Employees' Mutual General Insurance*[23] where it was held that in a fire insurance on a building the fact that the building insured was attached to other buildings was a material fact for the purposes of non-disclosure and misrepresentation;

(b) in life insurance, age,[24] health or a high risk occupation or hobby are material facts like in the case of *Goh Chooi Leong* v *Public Life Assurance Co. Ltd.*[25] where it was held that in a life policy the fact that the insured had previously been hospitalised and treated for tuberculosis was a material fact which must be disclosed to the insurer; and

(c) in terms of liability insurance, a bad accident record is a material fact.

On the other hand, 'a moral hazard is chiefly a man's standing or general reputation'.[26] The moral integrity, if adverse, is certainly a material fact to the insurers, 'a fact which if known to the insurers might lead them to take the view that the proposers are undesirable persons with whom to have contractual relations'.[27] They may be categorised into:

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[23] [1972] 2 MLJ 191.

[24] For the position in Malaysia in cases of life policies, see *s 147(1), (2) & (3), Insurance Act, 1996*. These provisions effectively obliterate the effects of non-disclosure, breach of warranty and misrepresentation.

[25] [1964] MLJ 5.

[26] *Teh Say Cheng*, *supra*.

[27] *Dictum* of Slesser L.J. in *Locker* v *Woolf* [1936] 1 KB 408.

(a) those relating to the insurance history of the proposer including both previous refusals[28] of the risk and claim history;[29] and

(b) those relating to financial standing such as serious indebtedness[30] or previous criminal convictions[31] of the insured.

IV. FACTS THAT NEED NOT BE DISCLOSED

Subsection (2) of section 150 goes on to provide that the duty of disclosure does not require the disclosure of a matter that:

(a) diminishes the risk to the licensed insurer;

(b) is of common knowledge;

(c) the licensed insurer knows or in the ordinary course of his business ought to know; or

(d) in respect of which the licensed insurer has waived any requirement for disclosure.

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[28] *Locker & Woolf* v *W Australian Insurance Co. Ltd.* [1936] 1 KB 406; *Ong Eng Chai* v *China Insurance Co. Ltd.* [1974] 1 MLJ 82, a previous cancellation of policy by another insurer was a material fact.

[29] *China Insurance* v *Ngau Ah Kau, supra.* Whether the claim history of the insured is a material fact or not depends on the nature of the questions in the proposal form - *Tan Kang Hwa* v *Safety Insurance Co. Ltd.* [1973] 1 MLJ 6; *Ewer* v *National Employers' Mutual General Insurance Association* [1937] 2 All ER 193.

[30] *Teh Say Cheng, supra.*

[31] *Taylor & Anor* v *Eagle Star Insurance* [1940] 67 Ll LR 136, where the Court of Appeal held that drinking convictions were material to an application for a motor insurance policy; *Lambert, supra*, in an "All Risks" policy covering the insured's and her husband's jewellery, it was held that the previous convictions of the husband for offences of dishonesty had to be disclosed. Not all previous convictions must be disclosed but only those having a bearing on the risk being undertaken by the insurer. An ancient and trivial offence need not be disclosed. See, Birds, *Modern Insurance Law*, 3rd ed., 1993, pp 104-106.

Subsection (2) is nothing but a codification of the common law exceptions to the duty of disclosure. The Marine Insurance Act 1906 more or less contains similar provisions.[32]

Subsection (3) of section 150 goes further to provide for a waiver of the duty of disclosure:

> Where a proposer fails to answer or gives an incomplete or irrelevant answer to a question contained in the proposal form or asked by the licensed insurer and the matter was not pursued further by the insurer, compliance with the duty of disclosure in respect of the matter shall be deemed to have been waived by the insurer.

This subsection is undoubtedly based on s 21(3) of the Australian Act. It is an attempt to codify part of the common law in relation to waiver of the duty of disclosure.[33]

V. BREACH AND REMEDY

In a case where the assured is in breach of the duty of disclosure, the insurer has the right to avoid the contract of insurance which is voidable, not void. The avoidance operates *ab initio*. Premium has to be returned to the assured save in a case where there is fraud on the part of the assured or where a clause in the contract specifically provides for the

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[32] S 18(3)(a) - (d).

[33] For further reading on section 150, refer to the following:

(a) A. A. Tarr & Liew, *Australian Insurance Law*, 2nd ed., The Law Book Co. Ltd, Sydney, Chapter 4.

(b) Kelly & Ball, *Principles of Insurance Law in Australia and New Zealand*, Butterworths, 1991, Chapter 3.

(c) Kelly & Ball, *Insurance Legislation Manual*, 3rd ed., Butterworths, 1995, pp 105-109.

forfeiture of premium even in the absence of fraud. It must also be pointed out that any breach of the duty of disclosure by the insurer does not sound in damages.[34] The assured is entitled to avoid the contract and recover the premium paid.

VI. CONTINUING DUTY OF UTMOST GOOD FAITH?

At common law, there is no duty to disclose material facts which arise during the currency of a contract of insurance after the formation of the contract. However, it is open to the parties to a contract of insurance to insert an express clause or provision in the contract requiring disclosure during the contract. The contractual provision which imposes such a duty is usually, though not necessarily, a promissory warranty.[35] Such a contractual term clearly imposes a duty of disclosure analogous to that imposed by the doctrine of *uberrimae fidei*. On the other hand, the *general duty of utmost good faith* continues throughout the contract of insurance. For example, the assured is under an obligation to observe utmost good faith in the making of claims. He cannot make fraudulent claims.[36]

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[34] *Banque Keyser Ullman SA* v *Skandia (UK) Insurance Co. Ltd.* [1987] 2 All ER 923; [1989] 2 All ER 952; [1990] 2 All ER 947.

[35] For the effect of a breach of a promissory warranty, see s 33(3), Marine Insurance Act 1906 - *'the insurer is discharged from liability as from the date of the breach'*. This is confirmed by *The Good Luck* [1990] 2 WLR 547, 579-585 (HL). See, Birds, *Modern Insurance Law*, 3rd ed., 1993, pp 119-123.

[36] *The Litsion Pride* [1985] 1 Lloyd's Rep 437. See, Birds, *Modern Insurance Law*, 3rd ed., 1993, pp 243-244, particularly on the effect of a breach of such a duty.