Natmed Medical Defence (Pty) Ltd
Phone:(086) 062-8633

29 Sixth Street
Parkhurst, Randburg
2193
www.MedicalDefence.mobi

Understanding non-disclosure

It is sometimes, incorrectly, thought that mere non-disclosure by an insured of any fact/s entitles the insurer to avoid the insurance policy. That is not so.

The non-disclosure, or if it is a positive false disclosure, a misrepresentation, must be wrongful. It is not sufficient that it is simply false or misleads.

The non-disclosure must be material.

There is not an all-embracing duty on a Proposer for insurance to disclose all facts. There is a duty to disclose all material facts.

The requirement of materiality goes to the non-disclosure itself, not its untruthfulness or incorrectness.

Our law has developed, including directly through legislative intervention.

In 2003 a statutory test for materiality was introduced. The test for materiality is that of the reasonable person. The test is objective. Would the facts have influenced the notional insurer, on a balance of probabilities, to enter into the contract of insurance on the terms it did?

The views of what the actual insurer considered or would have been considered is irrelevant or would have considered material are largely irrelevant. Nor is the view of the proposer as to what they considered or would have considered material decisive.

In applying the reasonable person test to the question of materiality the court does not favour the interest of one of the parties to the insurance contract above the other.

The party alleging the non-disclosure has the burden of proof to establish its materiality.

Some facts are so obviously material that evidence of their materiality is not required. For instance, if the facts indicate an unusual exposure to risk, for example where the person or objects insured are exposed to a risk making them particularly vulnerable; the proposer's previous record of insurance and contracts; and subjective factors affecting risk for example financial or business integrity, or facts indicating an improper or dishonest motive for acquiring the insurance.

The non-disclosure may be made negligently, fraudulently or innocently. In the latter case no blame attaches to the proposer. Even if made fraudulently it does not matter for purposes on avoidance if the proposer lied about a patently immaterial fact.

Once materiality is established state of mind in making the non-disclosure is relevant to the remedies available. Where there is fault, in the form of negligence or intent, the policy may not only be avoided but damages claimed, for example with the costs of investigating and detecting the fraudulent non-disclosure. Fault is not however required to be proved by the insurer to successfully avoid the policy, if the non-disclosure is material.

The material non-disclosure must however have induced the insurer to enter into the insurance contract on the terms it did when it would not have done so had it not been misled.

A non-disclosure must not only be material, as discussed in above, but must have induced the insurer to enter into the insurance contract, or to agree the particular term/s of that contract.

And the insurer would not have done so but for the material non-disclosure.

The onus is on the insurer to prove that the material non-disclosure caused the insurer to contract as it did, although the non-disclosure need not be the sole cause of that contracting. It is sufficient to prove that the non-disclosure was one of the operative causes which induced the insurer to contract as it did.

So, unlike the test for materiality which is objective the test for causation is subjective.

It does not matter that on the facts a reasonable insurer may have been induced to contract as the insurer did. If subjectively the insurer in question, on the facts, was not induced by the non-disclosure to contract an avoidance of the contract, if challenged, will fail. That is why it is very important when considering whether to avoid a policy or not to obtain the views of the underwriter involved. Their evidence will be required in court, if challenged, not on the question of materiality, but whether in the particular case the underwriter would have contracted even if aware of the non-disclosure/s. In that sense materiality is often confused. Inducement follows proof of materiality. Objectively the non-disclosure may be material, but the particular underwriter considered it irrelevant and was or would have been prepared to contract even if they had known all of the facts. The test for inducement is the reaction of the particular insurer and not the reasonable insurer. That information is patently material may however create a rebuttable presumption of inducement.

The test for causation is the usual two-part test: factual and legal.

Once non-disclosure, materiality, and inducement have all been established the insurer needs to consider the relief open to it and make an election.

Once not only a non-disclosure but also materiality and causation are established an affected insurer has a number of remedies available to it.

The most common remedy available is to avoid the contract of insurance.

This involves, as soon as possible after discovery of the material non-disclosure, taking steps to rescind the contract, setting aside its legal consequences and obtaining a refund of premiums.

Once there is a material non-disclosure inducing the contract or its terms there is no consensus between the parties making the contract voidable. It is not automatically void.

Even if a contract is induced by a material non-disclosure it remains valid and enforceable until avoided by the insurer.

The insurer needs to elect by way of an informed and unequivocal choice to avoid and communicate that election to the insured. That election is usually done by raising the non-disclosure as a defence to a claim under the policy, although it may also be through the insurer instituting its own action.

Avoidance terminates the contract of insurance with retrospective effect from inception. As a consequence, subject to certain exceptions, discussed below), the status quo must be restored. Each party must return their performance. The insurer must return the premium paid and the insured any benefit received under the avoided policy, for example a previous claim paid under the avoided policy.

An insurer cannot however recover any performance from a third party to whom the claim was ceded and paid.

Where the terms of a policy provide that in the event of a material non-disclosure the insurance will be null and void and premiums paid to the insurer are forfeit, the amount to be refunded will be determined in the context of what is equitable in the circumstance and The Conventional Penalties Act.

If, with the knowledge which would entitle the insurer to avoid for material non-disclosure, the insurer nevertheless does anything which constitutes a waiver to rely on that non-disclosure, such as acceptance of a premium paid, or reliance on contractual terms of defence under the policy, avoidance is no longer open to the insurer. So, an insurer needs to properly consider as soon as possible the possibility of avoidance and interrogate the facts on which it may be based.

If there are also contractual defences to the insurance claim those defences should only be raised as an alternative to avoidance and only if the avoidance is not upheld by a court. A reliance on policy defences to the claim as the primary defence would waive any right of avoidance.

The option of avoiding the contract of insurance for material non-disclosure assumes the non-disclosure was innocent.

If the non-disclosure was fraudulent, or negligent, damages may be recovered in addition to, or in lieu of the rescission of the contract. Damages are rarely claimed, and even more rarely recovered, in practice. There are no reported judgments in South Africa were that has taken place. In the latter instance, damages being the difference between the premium actually charged and that which would have been agreed but for the non-disclosure could be claimed. Nowadays some policies provide contractually that in such circumstances, where the cover but for the non-disclosure would have been written but at a higher premium, that the policy does respond but the difference in the premium is deducted from policy benefit paid out. In contracting on that basis, the insurer foregoes its right to avoid the contract. It doesn’t forego the right to avoid the policy if it would not have contracted at all if it had known of the non-disclosures.

Where fraud is involved damages may also include the costs of investigating and discovering the non-disclosure.

Remember however that proof of fault in the form of fraud or negligence is not required to avoid a policy. Fault goes to the availability of the additional remedy of damages to the insurer.

The insurer may of course want to keep the contract alive and not avoid. Remember that the material non-disclosure doesn’t make the contract void, only voidable. The quantum of the claim triggering the discovery of the non-disclosure may for example be miniscule compared to the premium paid. Other, broader, relationship issues may also be against an avoidance. Once the election is made not to avoid there is no second bite at the cherry on the same facts. The insurer cannot later change its mind and decide to avoid.

The duty of disclosure exists until the time the contract of insurance is concluded. So, if at the time of completing a proposal there exist no material facts not disclosed, but those arise post the proposal but before the contract of insurance is concluded those facts must be disclosed. A new duty to disclose arises at the time of renewal, or variation of the policy because in law a new contract is concluded on each such occasion.

Absent policy terms there is no ongoing duty of disclosure. Often policies do require an insured to disclose facts to the insurer material to the risk underwritten which came to the insured attention after the policy was contracted.

Earlier, I discussed briefly legislative intervention and the introduction of a statutory test of materiality. Section 53 of the Short -Term Insurance Act, and the corresponding Long-term Act provisions removed from the insurers arsenal the common law remedy for breach of warranty where the non-disclosure (or misrepresentation) was not likely to have materially affected the assessment of the risk under the policy. Materiality refers to the non-disclosure itself, not to its untruthfulness or incorrectness. That test refers not only to the scope of the risk and premium but also the decision whether the risk would be underwritten at all.

The sub-section to Section 53 refines materiality and the test of materiality stating that the non-disclosure is to be regarded as material if a reasonable prudent person would consider that the particular information not disclosed should have correctly been disclosed to the insurer to enable the insurer to form its own view as to the effect of that information on the assessment of the relevant risk. Our courts have held that in the case of non-disclosure the statutory test for materiality does not differ in substance from the common law test for non-disclosure discussed in previous Parts. The test is objective, based on the probabilities materiality relates to the effect on the assessment of the risk, and the assessment is by the insurer.

The Insurance Act of 2017 repeals S53. In its original drafting the legislature forgot to replace the section. The then FSB belatedly sought to remedy the gap by including in its most recent proposed amendments to the Policyholder Protection Rules, as Rule 20 provisions regarding misrepresentation.

Sections of the Insurance Act have now come into effect. Because the coming into operation of the PPR rule 20 is delayed, the legislature avoided repealing S53 for now.

The proposed PPR20 doesn’t mirror verbatim S53. The sub-section definition of materiality, S53(1)(b), is not repeated. The S53(1)(a) wording is used except that the wording is now … ‘likely to have materially affected the insurer’s ability to assess the risk under the policy concerned at the time of the representation of non-disclosure’.

That tinkering, if it becomes law in final form, focuses not on the assessment of the risk but the ability to assess. Our courts may find that it is no different to the effect of the S53 subsection.

I suspect this is all smoke and mirrors and our courts will continue to apply the well-worn tests for materiality as have been developed over time.

If and when PPR rule 20 comes into force it will of course only apply to insureds who have the benefit of the Rules- policyholders who are natural persons and juristic persons with an asset value or annual turnover less than the value determined in terms of section 6(1) of the Consumer Protection Act (which is currently R2 million). So, the common law position on non-disclosure and warranties will apply to all other policyholders. That will be no hardship for those insureds in so far as non-disclosure is concerned because as has been discussed the law is well developed and clear and in effect the same as the statutory position. When it comes to warranties however those insureds will now be exposed because at common law materiality plays no role in an insurer’s entitlement to rely on a breach of warranty.

Donald Dinnie
CEO of Natmed Medical Defence (Pty) Ltd