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**RETHINKING THE MATERIALITY
REQUIREMENT FOR NON-DISCLOSURE AND
MISREPRESENTATION IN INSURANCE
CONTRACTS**

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Access to private insurance funds has become increasingly important in the neo-liberal state. Accurate risk assessment and actuarial equity are essential for ensuring the viability of insurance as a mechanism for managing risks, which in turn depends on proper disclosure of material risks. This article examines the purpose and scope of the disclosure duty, and remedies for breach of that duty in the context of personal insurance contracts. The current position in Canadian common law jurisdictions may be detrimental to the interests of insureds and beneficiaries. The article proposes reforms to the test for materiality and remedies for breach aimed at protecting the interests of insurers and the reasonable expectations of insureds.

L'accès à des fonds d'assurance privée est devenu de plus en plus important au sein de l'État néo-libéral. L'évaluation précise des risques et l'équité actuarielle sont essentielles afin d'assurer la viabilité de l'assurance comme mécanisme de gestion des risques qui, pour sa part, dépend d'une divulgation adéquate des risques importants. Cet article examine l'objectif et la portée de l'obligation de renseignement, ainsi que

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les recours en cas de manquement à cette obligation dans le contexte des contrats d'assurance de personnes. La situation actuelle dans les ressorts canadiens de common law aurait un effet néfaste sur les intérêts des assurés et des bénéficiaires. L'article propose de réformer le critère de pertinence, ainsi que les recours en cas de manquement, dans le but de protéger les intérêts des assureurs et les attentes raisonnables des assurés.

...the purchase of insurance...represents a "purchase" of the greatest importance. The failure of this "purchase" will in most cases involve far more serious results for the "purchaser" than is likely to be true in the event of any other defective goods or commodity the insured acquires.¹

1. Introduction

Unfortunate events such as sickness, accident, disability or death are unavoidable, although it is often uncertain if or when such events may occur. The financial consequences of such events can be devastating for many individuals, families and organizations. Governments, institutions and individuals often plan to minimize the potentially disruptive effect of such occurrences. This is embedded in the notion of embracing risk.² With the shift from collective to individual responsibility in modern societies, private insurance has become an important mechanism for managing risk and ensuring financial security for individuals by pooling together persons (natural and legal) who face a common risk and spreading the risk of losses among them through the payment of premiums. In return, the insurer undertakes to pay policyholders the insured amount should the insured risk materialize. Thus, private insurance, especially life insurance, is no longer perceived as gambling in modern society³ but rather as a form of social and collective responsibility and mutual interdependence; it creates what has been described as moral opportunity.⁴ On an individual level, the purchase

¹ RA Hasson, "The Doctrine of *Uberrima Fides* in Insurance Law – A Critical Evaluation" (1969) 32 Mod L Rev 615 at 634.

² See Tom Baker and Jonathan Simon, "Embracing Risk" in Tom Baker and Jonathan Simon, eds, *Embracing Risk: The Changing Culture of Insurance and Responsibility* (Chicago and London: University of Chicago Press, 2002) 1.

³ See Geoffrey Clark, "Embracing Fatality through Life Insurance in Eighteenth Century England" in Baker and Simon, *ibid* at 80; Viviana A Zelizer, *Morals and Markets: The Development of Life Insurance in the United States* (New York: Columbia University Press, 1979).

⁴ See Tom Baker, "Risk, Insurance, and the Social Construction of Responsibility" in Baker and Simon, *supra* note 2, 33 at 35-8 [Baker, "Social Construction"]; Deborah Stone, "Beyond Moral Hazard: Insurance as Moral

of insurance is considered an act of self-reliance, a responsible way to protect the insured and her or his dependants against potentially disruptive effects of misfortune, and hence a source of empowerment.⁵ It also provides the opportunity to create and enhance wealth. This new form of governmentality is intended to enhance the actualization of the liberal subject by encouraging her or him to be self-reliant.⁶ In fact, life insurance has become vital for personal, business and estate planning and avoiding, or at least minimizing, the moral hazard of social dependence.⁷ Hence, access to insurance funds has a direct impact on people's ability to cope with the financial consequences of adverse events and on their meaningful participation in society.⁸ The neo-liberal perspective would likely take this idea a step further and argue that individuals are responsible for choosing

Opportunity" in Baker and Simon, *ibid.*, 52 at 53–55; Pat O'Malley, "Introduction: Configurations of Risk" (2000) 29 *Economy and Society* 457 at 457.

⁵ Richard Ericson, Dean Barry and Aaron Doyle, "The Moral Hazards of Neo-Liberalism: Lessons from the Private Insurance Industry" (2000) 29 *Economy and Society* 532 at 533, 550–51; Chris Armstrong, "Equality, Risk and Responsibility: Dworkin on the Insurance Market" (2005) 34 *Economy and Society* 451 at 452.

⁶ Armstrong, *ibid.*

⁷ See Canadian Life and Health Insurance Association, *A Guide to Life Insurance*, online: <http://www.clhia.ca/download/brochures/Brochure_Guide_To_Life_ENG.pdf>; Banks McDowell, "The Misrepresentation Defense in Insurance: A Problem for Contract Theory" (1984) 16 *Conn L Rev* 513 at 524; Kenneth S Abraham, *Distributing Risk* (New Haven and London: Yale University Press, 1986) at 1–2; Pat O'Malley, "Imagining Insurance: Risk, Thrift, and Life Insurance in Britain" in Baker and Simon, *supra* note 2, 97 at 109–10; Tom Baker, "Insuring Morality" (2000) 29 *Economy and Society* 559 at 566. Financial security in the aftermath of unfortunate events may be ensured through social security programs such as pension benefits, workers' compensation schemes and welfare benefits. However, not everyone may benefit from these schemes because, among other things, they are based on contributions and/or are employment-related benefits. As well, the amount of benefits may be inadequate for the beneficiaries' needs. Hence, individuals and families are increasingly resorting to private arrangements such as insurance to meet their financial needs in the event of adverse events. According to the Canadian Life and Health Insurance Association (CLHIA), by the end of 2007, over 20 million Canadians had life insurance to ensure financial security for their dependents, with average insured amounts of \$156,200 for individuals and \$312,200 for households. An increasing number of Canadians also rely on supplementary health and disability income insurance for income security in case of unexpected illnesses or accidents. By the end of 2007, 9.9 million Canadians depended on private health insurance plans for income security due to disability, 21.3 million had extended health care and 12 million had dental coverage. In 2007, insurers paid a total of \$26.6 billion under life insurance and extended health benefit plans; see CLHIA, "Key Statistics," online: <http://www.clhia.ca/download/KeyStats2008_EN.pdf>.

⁸ See Stone, *supra* note 4 at 54.

which risks to insure and, by extension, must assume responsibility for those choices if an uninsured risk materializes.⁹

Insurance institutions are concerned about moral hazards, focusing on the tendency of individuals to act in their self-interest in the form of adverse selection. Self-interest may give rise to a temptation to mislead insurers to provide coverage in circumstances where they would otherwise not do so or would have done so on different terms, or provide an incentive to engineer loss. Because of this, providers of insurance products have developed policies under which they divide the population into “good” and “bad” and deny coverage for the latter, or classify them as high risk to justify higher premiums or stringent terms. Efficient regulation by insurers also requires having complete information about proposed risks in order to adequately assess them before making underwriting decisions such as how to classify a risk or to exclude it altogether to achieve actuarial fairness.¹⁰ Moral regulation by insurance institutions also entails a cost-benefit analysis motivated by the need for economic efficiency and increased profitability given that insurance is ultimately a business. The insurance system is designed to avoid or at least minimize moral hazards in order not to undermine actuarial fairness and the overall sustainability of the insurance system. The materiality requirement by which applicants for insurance are required to disclose and not to misrepresent material facts is one such mechanism to counteract moral hazard.

The focus of this paper is the materiality requirement in the context of personal insurance contracts – life, accident and sickness. I argue that the nature and scope of the disclosure duty, the construction of materiality (including the presumption of materiality), and the remedy for breach of the disclosure duty (nullification), can constitute an unfortunate trap for unsuspecting insureds and threaten the supposed peace of mind and self-reliance promised by insurance contracts. Such an outcome may be devastating for individuals and families who are socio-economically marginalized with limited or no non-insured assets to rely on at a time when they are most vulnerable and can expect little or no assistance from the state. The nullification remedy is drastic, especially in cases in which insurers might still have provided coverage albeit on different terms. The unfairness of this result is compounded given that the breach is often innocent and insuring oneself is generally viewed as a responsible measure. Several jurisdictions have recognized the need for change and have adopted legislation, policies and practices to ensure better protection for insureds while preserving the sustainability of the insurance industry.

⁹ Pat O'Malley, *Risk, Uncertainty and Government* (London: GlassHouse Press, 2004) at 73; Armstrong, *supra* note 5 at 454.

¹⁰ See Baker, “Insuring Morality,” *supra* note 7 at 565, 566, 570.

Drawing from the law on other types of insurance contracts in common law jurisdictions in Canada and the law in other jurisdictions, I make suggestions for reforming the disclosure duty, the determination of materiality and the remedies for breach in the context of personal insurance. These suggested reforms are aimed at promoting the objectives of insurance, to preserve the importance of the disclosure duty and foster confidence in the insurance industry.

The paper begins with an examination of the disclosure duty, focusing on factors such as the basis, rationale for and scope of the duty, as well as on how an applicant for insurance may discharge the duty and what constitutes breach of the disclosure duty. In Part 3, I discuss the nature and scope of the presumption of materiality. This is followed by a discussion of the remedies for breach of the disclosure duty in Part 4, noting the unsatisfactory nature of those remedies. In Part 5, I discuss some proposed solutions to the issues I have raised. The paper ends with a discussion in Part 6 of lessons that can be learned from other jurisdictions to minimize the effect of remedies for breach of the disclosure duty for insureds in Canada.

2. Disclosure Duty in Insurance Contracts

A) Basis and Purpose of the Disclosure Duty

Insurance contracts are contracts *uberrimae fidei*, that is, contracts of utmost good faith. Hence the principle of *caveat emptor*, which is generally applicable to parties in a commercial contract, is inapplicable in the insurance context.¹¹ Applicants for life, accident and sickness insurance, and persons whose lives are to be insured, have a positive duty to fully disclose and to not misrepresent material facts within their knowledge relating to the proposed risk. The disclosure duty in insurance contracts is absolute. In the context of personal insurance contracts, breach of the disclosure duty through non-disclosure or misrepresentation entitles the insurer to void the contract. It is irrelevant whether misrepresentation or concealment was innocent, negligent, wilful, or fraudulent.¹² An insurer's

¹¹ See *London General Omnibus Co Ltd v Holloway*, [1912] 2 KB 72 (CA) at 84-85. The UK Law Commission has described insurance contracts as the most important contract of utmost good faith. The Law Commission, *Insurance Law: Non-Disclosure and Breach of Warranty*, Law Com No 104 (London: Her Majesty's Stationery Office, 1980) at 19. See also Nicholas Legh-Jones *et al*, eds, *MacGillivray on Insurance Law Relating to All Risks Other than Marine*, 10th ed (London: Sweet and Maxwell, 2003) at paras 17-1 [409] [*MacGillivray on Insurance Law*].

¹² See *Carter v Boehm* (1766), 3 Burr 1905, 97 ER 1162 [*Carter* cited to ER]; *Tanner Estate v Toronto Dominion Bank* (2002), 212 Nfld & PEIR 211 (PEISC) at paras

right of nullification upon breach is subject only to the principle of incontestability¹³ or a successful defence of waiver and estoppel.¹⁴ Intention to deceive the insurer is not required; even an innocent omission or misrepresentation is sufficient to render the contract voidable by the

23-29; *Cameron v Cooperants Mutual Life Insurance Society* (1992), 118 NSR (2d) 64 (CA) at 73; *Gulay v Temple*, 2000 MBQB 184, (2000), 31 CCLI (3d) 212 at para 15; *Silva v Sizoo* (1997), 50 CCLI (2d) 293 (Ont Ct J (Gen Div)), at 304-05 [*Silva*]; *Hoffart v Paul Revere Life Insurance Co* (1995), 136 Sask R 233 (QB) at 236 [*Hoffart*]; *White v Continental General Ins. Co.*, 831 F Supp 1545, at 1553-54 (D Wyo 1993) [*White*]; *In re Epic Mort Ins Litigation*, 701 F Supp 1192 at 1245 (E D Va 1988) [*re Epic Mort*]; David Norwood and John P Weir, *Norwood on Life Insurance Law in Canada*, 3rd ed. (Toronto: Carswell, 2002) at 89; *MacGillivray on Insurance Law*, *supra* note 11 at paras 17-16 [415 - 416]. The insured's state of mind may be relevant in determining breach of the disclosure duty in the context of some insurance contracts, for example, fire and auto. See *infra* Part 4 - Remedies.

¹³ An insurer is not entitled to void an insurance contract for accident and sickness for breach of the disclosure duty after the contract has been in effect for two continuous years, or in the case of life insurance where the contract has been in effect for at least two years prior to the death of the life insured, unless the misrepresentation or concealment was fraudulent. Thus, applicants or insureds who breach the disclosure duty innocently or negligently, that is, without bad faith, are protected when the policy has been in place for over two years. The onus is on the insurer asserting breach of the disclosure duty to prove actual fraud on the part of the insured. See *Insurance Act*, RSBC 1996, c 226, s 42(2), s 98(1); *Insurance Act*, RSA 2000, c I-3, s 568(2); *Insurance Act*, CCSM, c 140, s 161(2); *Insurance Act*, RSO 1990, c I.8, s 184(2); *Insurance Act*, RSNS 1989, c 231, s 83(1)(a). See *Belley v Paul Revere Life Insurance Co* (1999), 16 CCLI (3d) 305 (Ont Sup Ct J) at para 69; *Kruska v Manufacturers Life Insurance Co* (1984), 54 BCLR 343 (SC), *aff'd* (1985), 63 BCLR 209, 11 CCLI 197 (CA); *Metcalf v Manufacturers Life Insurance Co* (2004), 34 BCLR (4th) 101 (SC), *aff'd* 2005 BCCA 473, 51 BCLR (4th) 65. See also Mark E P Cavanaugh, "Misrepresentation and Non-Disclosure on Applications for Disability Insurance" (1999) 22 Adv Q 249 at 257-59.

¹⁴ Where there is evidence that an insurer had actual or constructive knowledge of misrepresentation or non-disclosure on the part of the insured at or after the time of application, but before any loss occurred, and the insurer turned a blind eye, for example by not making further inquiries where a reasonable insurer would have done so and/or by exercising its right to void the contract, the insurer will be prevented from doing so after the insured risk has materialized on the basis of having waived the breach, or estopped from raising it as a defence to a claim under the contract. See Norwood and Weir, *supra* note 12 at 403; Barbara Billingsley, *General Principles of Canadian Insurance Law*, 1st ed (Markham, Ont: LexisNexis, 2008) at 198 - 200; *Fidei Estate v Sun Life Assurance Co of Canada* (1991), 5 CCLI (2d) 224 (Ont Ct (Gen Div)); *Blouin v Maritime Life Assurance Co* (1988), 88 NSR (2d) 23 (SCTD); *Philadelphia Indemnity Ins Co v Horowitz, Greener & Strengel, LLP*, 379 F Supp 2d 442 (SDNY 2005) [*Horowitz*]; *Justofin v Metropolitan Life Ins Co* 372 F 3d 517 at 525 (CA 3d Cir. 2004). Given that the undisclosed or misrepresented facts often come to light after loss has occurred and during the investigation process, waiver and estoppel may be of limited benefit to the insured or beneficiaries in the context of personal insurance contracts.

insurer.¹⁵ Further, it is irrelevant that there was no causal relationship between the misrepresented or undisclosed facts and the loss. It is also irrelevant that an insurer would have provided some coverage, albeit on different terms, if it had been fully aware of the information in question.

The purpose of the disclosure duty is to enable the insurer to fairly assess the risk entailed in the proposal for insurance.¹⁶ This requirement is particularly important given that the relevant information, such as the insured's health status, may be known only to the applicant or the prospective insured.¹⁷ Disclosure promotes honesty and fair dealing in insurance contracts by remedying the informational imbalance between insureds and insurers and protects the latter from assuming unreasonable risks. In *Carter v Boehm*,¹⁸ Lord Mansfield stated:

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 underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risk, as if it did not exist. The keeping back [of] such circumstances is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the underwriter is deceived, and the policy is void; because the risk run is really different from the risk understood and intended to be run, at the time of the agreement.¹⁹

¹⁵ In some jurisdictions, intent to deceive the insurer is a condition precedent for rescission on the basis of misrepresentation or non-disclosure; see *White, supra* note 12 at 1553; *City Nat Bank and Trust Co v Jackson Nat Life Ins*, 804 P 2d 463 at 466 (Okla App 1990). See also the discussion of the UK Financial Ombudsman Services (FOS), *infra* note 32, which has jurisdiction over insurance disputes where the claim against the insurer does not exceed £100,000, where adjudicators consider the insured's state of mind before an insurer can void an insurance contract for misrepresentation. The FOS allows nullification only in respect of intentional or reckless misrepresentation; see Financial Ombudsman Service, "Non-Disclosure in Insurance Cases" June 2005, 46 Ombudsman News; Financial Ombudsman Service, "Insurance Case Studies – Non-Disclosure, Recklessness or Inadvertent?" April/May 2007, 61 Ombudsman News, online: <http://www.financial-ombudsman.org.uk/publications/ombudsman.htm>. There is more detailed discussion under Remedies below.

¹⁶ See *Insurance Act, supra* note 13, c 226, ss 41, 97.

¹⁷ Norwood and Weir, *supra* note 12 at 376.

¹⁸ *Carter, supra* note 12. See also *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*, [1994] 2 Lloyd's Rep 427 (HL) at 447 [*Pan Atlantic Insurance*]; Billingsley, *supra* note 14 at 82.

¹⁹ *Carter, ibid* at 1164. See also *Rozanes v Bowen* (1928), 32 Ll L Rep 98 at 102 (CA); *Pan Atlantic Insurance, ibid* at 447; *Hoffart, supra* note 14 at 235-36; Christopher Tay, "The Duty of Disclosure and Materiality in Insurance Contracts – A True

Disclosure is also aimed at ensuring actuarial equity among policyholders, preserving the viability of the insurance industry and protecting the reasonable expectations of consumers.²⁰ As well, it is administratively efficient and cheaper for the insured to disclose material information rather than leaving the insurer to guess or search for the same. It is important, however, not to lose sight of the potential prejudice to insureds from a strict application of the disclosure duty and from an insurer's right of avoidance even in respect of innocent breaches.²¹

B) Impact of Disclosure Duty on Access to Private Insurance

Insureds may be disadvantaged by the scope of the disclosure duty, by constructions of materiality based on the prudent insurer test and by a presumption of materiality, all of which tend to favour insurers. The average insured might not appreciate the materiality of certain information, especially when he or she has fully and truthfully answered all questions specifically asked in the application process. The vulnerability of applicants or insureds may be amplified by insurance companies' advertisements promising coverage after a few simple questions and no need for medical examination. The increasing availability of on-line applications where prospective insureds may complete forms without the assistance of experts or the opportunity to seek clarification of ambiguous questions, and requirements to provide additional information not specifically requested also pose a further risk of insurance contracts being nullified for breach of the disclosure duty.²²

Full disclosure of material information at the outset is important because it would be impractical and costly for insurers to verify all

Descendant of the Duty of Utmost Good Faith?" (2002) 13 Ins L J 183 at 183-85.

²⁰ Other policyholders should not pay disproportionately high premiums relative to their risk to subsidize insureds who misrepresent or conceal the real risk they bring to the insurance pool.

²¹ See Australian Law Reform Commission, *Insurance Contracts* (Canberra: Australian Government Publishing Service, 1982) at para 175, online: <<http://www.austlii.edu.au/au/other/alrc/publications/reports/20/chap9.pdf>> [ALRC 20]; William R Vance and Buist M Anderson, *Vance on Insurance*, 3rd ed. (St Paul, Minn.: West Publishing, 1951) at 368-72 [*Vance on Insurance*]; Tay, *supra* note 19 at 193.

²² Applicants are rarely told prior to completing the forms that they can call for assistance. Applicants may be able to call a toll-free number but the number may not be prominently displayed. For example, see the following online insurance applications; see Sun Life Financial, online: <<https://www.sunnet.sunlife.com/Buyonline/phi/application.asp>>; Manulife Financial, online: <<https://secure.lhplans.com/LH/CoverMe/Consumer/AppTermsOfPurchase.jsp?lang=E&MKT=MFC&module=P>>; and Canadian Tire, online: <https://quote.ctlife.ca/termife_quoter>.

representations in an application form before providing coverage. As well, such an expectation will undermine the duty of utmost good faith in the insured-insurer relationship. Breaches will often only be discovered after a loss has occurred when the insured no longer has the opportunity to seek alternative protection from the same or another insurer.²³ Meanwhile, good faith is not a defence to a claim of breach of the disclosure duty in Canada. While the traditional conception of the disclosure duty was justifiable given the relative vulnerability of insurers when it was developed, its unqualified application can result in harsh consequences in some contemporary contexts. Insurers are now more likely to be knowledgeable about the types of information needed to fairly assess risks than many insureds. The disclosure duty should be cognizant of the significant knowledge imbalance between insurers and insureds, the vulnerability of insureds and the need to protect the latter from the former.

C) Nature and Scope of the Disclosure Duty

The disclosure duty is limited to material facts.²⁴ The materiality requirement protects the competing interests of insurers and insureds. It ensures that an insured does not withhold from the insurer information crucial to the proposed risk, while also preventing the insurer from nullifying the contract for non-disclosure of facts not essential for determining insurability. Insurers are not obliged to inform applicants about the disclosure duty or what information is deemed material in particular circumstances. Insureds may glean existence of the duty and its scope from questions in the application process. As will be shown below, however, the disclosure duty is not limited to honest and complete responses to specific questions but includes all material information affecting insurability whether specifically requested or not.

1) Determining Nondisclosure or Misrepresentation

The onus is on an insurer alleging breach of the disclosure duty to prove that the applicant or prospective insured misrepresented or failed to disclose material information about the risk. In such cases, the insurer alleges the information in question would have influenced its underwriting

²³ It has been observed that in many cases insurers do not thoroughly assess risks until a claim is made; see Herman Cousy, "The Principles of European Insurance Contract Law: The Duty of Disclosure and the Aggravation of Risk" (2008) 9 ERA-Forum, S119, at 120, online: <<http://www.springerlink.com/content/3883231240147246/fulltext.pdf>> .

²⁴ See *BC Insurance Act*, *supra* note 13, ss 3 and 13; *Alberta Insurance Act*, *supra* note 13, s 513(8); *Ontario Insurance Act*, *supra* note 13, ss 124(5) and (6); *Turner v British Columbia Mutual Benefit Association*, [1927] 4 DLR 541 (BCCA) [*Turner*].

decision: it would either not have provided coverage or would have done so on different terms had it known the truth.²⁵ Although a given situation may be characterized in the alternative, allegations of non-disclosure and misrepresentation present different considerations. Non-disclosure arises where the applicant or prospective insured fails to disclose facts within her or his knowledge that are material to the proposed risk, whereas misrepresentation arises where the person provides inaccurate or misleading responses to direct questions relating to the risk.²⁶ Characterization of a particular situation as non-disclosure or misrepresentation often depends on the nature of the insured's response.

Allegations of non-disclosure can arise in relation either to information expressly required on an application form or information that the law says must be disclosed. Generally, the former does not pose problems except where the questions are ambiguous. In such cases, courts have tended to rule in favour of the vulnerable party, the insured, based on the principle of *contra proferentem*.²⁷ In *Ontario Metal Products Co v Mutual Life Insurance Co of New York*, Anglin J stated:

It is well established law that the preparation of the form of policy and application being in the hands of the insurers, it is but equitable that the questions to which they demand answers should, if their scope and purview be at all dubious, either in themselves or by reason of context, be construed in favour of the insured ... The insurers put such questions and in such form as they please, but they "are bound so to

²⁵ See *Murphy v Sun Life Assurance Co of Canada* (1964), 44 DLR (2d) 369 (Alta TD), aff'd (1964) 49 DLR (2d) 412 (Alta CA); *Kehoe v British Columbia Insurance Co* (1993), 79 BCLR (2d) 241 (CA) [*Kehoe*]; *Wells v Canadian Northern Shield Insurance Co*, 2007 BCSC 1844 (2007), 76 BCLR (4th) 384 (SC) at 393-94 [*Wells*]; Leon Trakman, "Mysteries Surrounding Material Disclosure in Insurance Law" (1984) 34 UTLJ 421 at 421, 423-24.

²⁶ In claims based on non-disclosure, the issue is whether the omitted information fell within the scope of the disclosure duty and ought to have been disclosed. When information is provided and an insurer makes an argument based on misrepresentation, the question becomes whether the statement provided by the insured was in fact false.

²⁷ [1924] SCR 35, aff'd [1925] AC 344, [1925] 1 DLR 583 [*Ontario Metal Products*]. See also *Consolidated Bathurst Export Ltd v Mutual Boiler and Machinery Insurance Co*, [1980] 1 SCR 888, at 900; *Turner*, *supra* note 24; *Dineen v General Acc Ins of Philadelphia*, 126 AD 167, 110 NYS 344 at 346 (NYAD 1908) [*Dineen*]; *Indemnity Insurance Co of North America v Excel Cleaning Service*, [1954] SCR 169; *National Bank of Greece (Canada) v Katsikonouris*, [1990] 2 SCR 1029 at 1046-47; *Hoult Estate v First Canadian Insurance Corp* (1994), 25 CCLI (2d) 255 (BCSC) [*Hoult Estate*]; *Taylor v National Life Assurance Co of Canada* (1990), 7 CCLI (2d) 146 (BCCA) [*Taylor BCCA*]; *Caverhill Estate v Bank of Montreal* (1994), 153 NBR (2d) 195 (QB) at para 25, aff'd (1995), 161 NBR (2d) 78 (CA) [*Caverhill Estate*].

express them as to leave no room for ambiguity.” To such a case the rule *contra proferentem* is eminently applicable.²⁸

Providing full and complete answers to questions in the application process will not necessarily be sufficient to discharge the disclosure duty. Even absent specific questions on the subject or where no written application is required, the applicant is still obliged to disclose all facts within her or his knowledge that are material to the proposed risk.²⁹ It is irrelevant that the particular applicant or prospective insured did not subjectively consider such facts material to the risk; it will suffice that a reasonable person would know that such facts may impact her or his insurability and would be something a prudent insurer would consider in making its underwriting decision.³⁰ While this seems unfair to applicants, who must guess what facts are material, the law is intended to encourage applicants to err on the side of caution. The principle encourages disclosure, as opposed to omission, when in doubt about materiality. The obligation to disclose all material facts, even if information is not specifically requested, is also consistent with the duty of utmost good faith that underlies insurance contract.³¹

Potential hardship to insureds may be tempered given that the nature of specific questions and the context in which they are posed may determine the scope of the disclosure duty in the particular circumstances

²⁸ *Ontario Metal Products*, *ibid* at para 19.

²⁹ See *Joel v Law Union and Crown Insurance*, [1908] 2 KB 863 at 883-84 (CA) [*Joel*]; *Journey v Railway Passengers Assurance Co* (1923), 50 NBR 501(SC (AD)) at 517; *Federal Insurance Co v Westchester Fire Insurance Co* (1929), 24 Alta LR 330 (SC (AD)); *Alliance Insurance Co of Philadelphia v Laurentian Colonies and Hotels Ltd*, 1952 CarswellQue 252 (BR) at para 54 [*Laurentian Colonies*]; *Vrbancic v London Life Insurance Co* (1995), 25 OR (3d) 710 (CA) at 727 [*Vrbancic*]; *Gregory v Jolley* (2001), 54 OR (3d) 481 (CA) [*Gregory*]; *WH Stuart Mutuals Ltd v London Guarantee Ins Co* (2004), 16 CCLI (4th) 192 (Ont CA) at 194, leave to appeal refused, [2005] SCCA No 86 [*WH Stuart Mutuals Ltd*]; *Phillips v ING Life Limited*, [2009] FCA 283 (Federal Court of Australia) [*Phillips*]; *MacGillivray on Insurance Law*, *supra* note 11 at para 17-17 [416]. See also *Schoolman v Hall*, [1951] 1 Lloyd's Rep 139, 141-43 (Eng CA), where the Court came to a similar conclusion notwithstanding that the application for insurance contained a “basis of the insurance clause.” For a critique of this decision, see Hasson, *supra* note 1 at 626.

³⁰ See *Gregory*, *ibid* at 493-94; *Horne v Poland*, [1922] 2 KB 364 at 367 [*Horne*].

³¹ See *Coronation Insurance Co v Taku Air Transport Ltd*, [1991] 3 SCR 622 at 636-63. Hasson criticizes the basis of the onerous disclosure duty grounded in the alleged superiority of knowledge on the part of the insured. He notes that more knowledge actually disadvantages the insured, who often does not know what an insurer considers relevant and risks nullification for failure to disclose material information; see *supra* note 1 at 633-34.

and resolve doubts about materiality. Where an insurer has asked specific questions on a particular subject, it may be assumed that it has waived its right to information on that subject matter outside the scope of the question or other related matters, or that it does not consider such facts as material. The view of Anglin J in *Ontario Metal Products* is apposite. He stated:

... by its requisitions for information the company elected to relieve the insured from any duty to disclose matters in regard to his past health which its questions did not cover (having by an express provision of its policy agreed that only the statements contained in the written application should avail it as a matter of defence ...)...³²

This principle might give insurers an incentive not to ask certain questions at all to avoid findings of waiver of right to information on related matters.

To rely on a misrepresentation to void an insurance contract, the question must be clear and intelligible to a reasonable person. An applicant must carefully read the questions and consider her or his answers to ensure accuracy in the responses.³³ However, a finding of misrepresentation will not be made where the responses are consistent with a reasonable understanding of the inquiry or are truthful under a reasonable construction of the question.³⁴

2) *Facts Within the Insured's Knowledge*

The disclosure duty obliges applicants and proposed insureds to disclose material facts within their knowledge. This encompasses what the person actually knows, as well as what she or he can be presumed to know as material to the proposed risk, that is, what a reasonable person in the

³² *Ontario Metal Products*, *supra* note 27 at 49; see also *Laurentian Colonies*, *supra* note 29 at para 55; *Taylor BCCA*, *supra* note 27 at 151-52; *Fleet v Federated Life Insurance Co of Canada* (2009), 279 NSR (2d) 372 (CA) at 384-85; *Sagl v Cosburn, Griffiths & Brandham Insurance Brokers Ltd*, 2009 ONCA 388, (2009), 249 OAC 234 at para 63 [Sagl]; *Vrbancic*, *supra* note 29 at 727; *Caverhill Estate*, *supra* note 27 at 206-07; *Kong v Manulife Financial Services Inc*, 2008 BCSC 65, (2008) 56 CCLI (4th) 196 at 203, *aff'd* 2009 BCCA 90, 71 CCLI (4th) 170; *Stewart v Canada Life Assurance Co*, [1999] OJ No 2842 (QL), 100 OTC 93 at para 52, *aff'd* [2000] OJ No 2970 (QL) (CA) [Stewart]; *DeKoning v Vector Insurance Network (Ontario) Ltd*, [2009] ILR I-4881 (Sup Ct J) [DeKoning]; *Schoolman v Hall*, *supra* note 29 at 143; *MacGillivray on Insurance Law*, *supra* note 11 at para 17-19, 20 [416-17]; ALRC 20, *supra* note 21 at 97-8 [para 161].

³³ *Stewart*, *ibid* at para 54, *aff'd* [2000] OJ No 2970 (QL) (CA).

³⁴ See *Dineen*, *supra* note 27 at 346; *Garcia v American General Life Ins Co of New York*, 164 AD 2d 808, 695 NYS 2d 420 (NYAD); *MacGillivray on Insurance Law*, *supra* note 11 at para 19-17 [416-17].

applicant's circumstances would know to be relevant in the circumstances. There is no obligation, however, to disclose facts that the applicant or insured did not know, had no means of knowing or had no reason to suspect.³⁵ In *Zimmerman v Northern Life Assurance Co of Canada*,³⁶ the insured had previously attended a hospital with what was later determined to be symptoms of kidney stones, but the insured was not informed of the diagnosis nor had he ever previously suffered from that condition. The insured gave a negative response to a question in his application for insurance about previous illness or diseases and previous troubling medical opinions. The Court held that the response did not constitute breach of the disclosure duty since there was nothing to suggest to him that he had a serious medical condition that affected his insurability. Casting the duty in this way avoids placing an onerous burden on the insured, by excusing ignorance about a condition where it is genuine, but not when the person deliberately ignores conditions that should be obvious to reasonable people.

A prospective insured is not expected to self diagnose symptoms, secondguess what the insurer might consider important, or determine his or her own insurability. A person's subjective opinion about her or his own condition or the health of the prospective insured does not constitute a fact

³⁵ Joel, *supra* note 29 at 884-85; *WH Stuart Mutuals Ltd*, *supra* note 29 at 194; *Morrison v Economic Mutual Insurance Co* (2000), 14 CCLI (3d) 5 (Alta CA) at 6; Norwood and Weir, *supra* note 12 at 381; ER Hardy Ivamy, *General Principles of Insurance Law*, 5th ed. (London: Butterworths, 1986) at 122-24; *MacGillivray on Insurance Law*, *ibid* at para 17-15 [415]; *Insurance Contracts Act 1984 (ICA)*, Commonwealth Consolidated Acts (Australia), s 21(1). When courts impute to an applicant knowledge of insurability which was not disclosed or was misrepresented, it might be that they doubt the truthfulness of the testimony about the applicant's/insured's knowledge in the particular circumstances, or see it as a situation of willful blindness because a reasonable person would have known of the condition given the state of affairs or should have made reasonable inquiries to obtain further information. Both situations give rise to breach of the disclosure duty. See *Hagey v Colonia Life Insurance Co* (1997), 7 CCLI (3d) 45 (Ont Ct J (Gen Div)) at 53-54 [Hagey]; James A Rendall, Annotation to *Garand v Mutual of Omaha Insurance Co* (2001), 296 AR 257 (QB). It is also conceivable that the person genuinely did not appreciate the importance of the facts in question, for instance, due to their lack of intelligence, sophistication, etc. Yet, like the reasonable person standard in tort law, people are penalized for their unique characteristics that prevent them from operating at the normative standard of the mythical prudent person. For a critique of the Australian position regarding constructive knowledge, see Tay, *supra* note 19.

³⁶ [1931] 2 DLR 489 (SC (HCJ)) [Zimmerman]. See also *Zeller v British Caymanian Insurance Co Ltd.*, [2008] UKPC 4, [2008] Lloyd's Rep IR 545 (PC – Cayman Islands); *Keating v New Ireland Assurance Co* 1990 WL 755350 (Sup Ct (Irl)), [1990] 2 IR 383; *MacGillivray on Insurance Law*, *supra* note 11 at para 17-10 [413].

within her or his knowledge that must be disclosed. The insured must disclose facts such as symptoms, hospital visits, doctors consulted or referred to, or diagnostic tests undergone, regardless of whether the applicant, prospective insured, or a health care professional considers them significant to insurability or not. It is for the insurer to determine the relevance of any fact to the person's insurability.³⁷ This principle is based on an objective standard that requires the prospective insured to provide information that a reasonably intelligent person would know and does not include knowledge of the human anatomy, physiology or medicine not readily apparent to lay persons.³⁸

Difficulties arise when the insured exhibited symptoms of a medical condition that would have been considered material to insurability, but was undiagnosed at the time of application either because she or he did not consult a medical professional or those consulted did not make the right diagnosis. Some courts have held that neither failure to seek treatment nor an undiagnosed condition should affect the disclosure duty or exclusion of liability due to a pre-existing medical condition.³⁹ In *Van Maele v Alberta Blue Cross Benefits Corp*, the Court noted that to hold otherwise would undermine "the underlying commercial purpose of insurance by making the defendant [insurer] a surety rather than a calculated risk taker who bases premiums on the risk undertaken... [and would] permit unequal treatment of claimants simply on the basis of the competency and skill of their diagnosticians."⁴⁰ Other courts have taken a contrary view when the person sought medical attention but the condition was undiagnosed before the policy became effective. The latter position avoids penalizing the insured for the lack of diagnosis, especially when they consulted more than one physician, and all were of the view that the symptoms were not indicative of any serious medical condition and could otherwise be explained.⁴¹ As well, the insured may be excused where the insurer did not

³⁷ See *Sandhu Estate v Fidelity Life Assurance* (1987), 28 CCLI 108 (BCSC); *Silva*, *supra* note 12 at 306; *Hoffart*, *supra* note 12 at 236; *Fernandes v RBC Life Insurance Co* (2008), 66 CCLI (4th) 115 (Ont Sup Ct J) at 123, 125 [*Fernandes*]; *Vrbancic*, *supra* note 29 at 726; *Hagey*, *supra* note 35 at paras 35-36; *MacGillivray on Insurance Law*, *supra* note 11 at paras 17-37- 17-38 [426-7], 17-45 [429]; *Norwood and Weir*, *supra* note 12 at 382-83.

³⁸ *Stewart*, *supra* note 32 at para 52.

³⁹ (2004), 355 AR 186 (QB); *Hoult Estate*, *supra* note 27 (the Court ultimately ruled in the insured's favour because the exclusion clause was ambiguous and the ambiguity was resolved in the plaintiff's favour); *Ellis Estate v Cigna Life Insurance Co of Canada* (2005), 234 NSR (2d) 72 (SC).

⁴⁰ *Van Maele*, *ibid* at para 37.

⁴¹ As is discussed below, the insured is nonetheless required to disclose to the insurer any symptoms she or he may be experiencing that could indicate an adverse

specifically request information about those symptoms.⁴² In *Duke v Clarica Life Ins Co*,⁴³ the plaintiff had complained of what doctors later concluded to be symptoms of Parkinson's disease. The plaintiff did not consider the symptoms significant based on doctors' opinions and associated them with the process of aging. The insurer did not request information about those symptoms. In holding that the insurer was not entitled to deny coverage, the Court noted that not only was the insured not asked about the symptoms, but there was also no intention to misrepresent his condition or deceive the insurer.

Courts have also relaxed the strict disclosure duty through narrow interpretations of questions on insurance application forms regarding whether the applicant has suffered or is suffering from a medical condition, or has been treated by a physician. For instance, hospital visits for minor conditions such as colds and influenza that do not indicate the need for any further medical attention, or isolated incidents not indicative of ongoing ill health, have been excluded from pre-existing medical conditions.⁴⁴ This, together with the principle of *contra proferentem*, limits the scope of the disclosure duty and circumstances in which insurers can nullify insurance contracts for its breach. It also recognizes the power imbalance between insurers and insureds and the vulnerability of the latter. More analysis needs to be done, however, to fully appreciate the power differential between insurers and insureds and to better protect the interests of consumers.

3) Do Insurers Have a Duty of Due Diligence?

As a contract of utmost good faith, an insurer is entitled to trust that information provided by an applicant or prospective insured is accurate

health condition even absent any diagnosis. However, it is questionable whether the duty should extend to situations where the person has reported symptoms to more than one health care professional and none made a diagnosis of any disease that could affect insurability.

⁴² Although the insured has a positive duty to disclose symptoms and conditions that could affect insurability even if such information is not requested, perhaps this should not include symptoms that are considered innocent by physicians.

⁴³ 2007 ABQB 233, (2007), 72 Alta LR 255 at 269, aff'd 2008 ABCA 301, 437 AR 185.

⁴⁴ See *Hoult Estate*, *supra* note 27; *Katrichak v National Life Assurance* (1992), 7 CCLI (2d) 195 (BCSC) (a single episode of heart problems was not indicative of chronic health conditions as requested on application form); *Zimmerman*, *supra* note 36; *Turner*, *supra* note 24; *Ontario Metal Products*, *supra* note 27.

and complete.⁴⁵ Hence, there is no obligation for insurers to verify such information or conduct further investigations about insurability unless statements in the application process would alert a reasonable insurer of the need to make further inquiries.⁴⁶ In *Silva v Sizoo*, Lane J stated:

There is a duty on an insurer not to close his eyes to the obvious, to that which is tantamount to notice; and not to refrain from asking because he prefers not to know the answer to a question which stares him in the face ... But there is no general duty owed by an underwriter to an applicant for coverage to conduct a reasonable investigation.⁴⁷

An insurer's failure to make inquiries in the face of obvious red flags is contrary to its duty of good faith and could disentitle it from voiding a contract for breach of the disclosure duty.⁴⁸ In *Ipapo Estate v Citadel Life Insurance Co*, Twaddle JA noted:

An insurer may be under a duty to make further inquiries of the insured's doctor if the facts disclosed by the insured are such as would alert a reasonably prudent insurer of the need to do so. If the insurer, in those circumstances, failed to make further inquiry it might be argued that it could not rely on the insured's failure to make fuller disclosure.⁴⁹

This principle may be particularly important in the context of personal insurance contracts in which many applicants and prospective insureds are laypersons, and may be unaware of the implications of certain diagnosis. It will be up to insurers to make further inquiries, by asking the prospective insured, for example, to undergo further examination or tests. This does not excuse the applicant or prospective insured from disclosing what they actually know to be relevant to their insurability and it is more efficient for

⁴⁵ See 35445 *Alberta Ltd v Transamerica Life Insurance Co of Canada* (1996), 188 AR 94 (QB) at para 23, aff'd (1998), 216 AR 22 (CA) at para 10.

⁴⁶ See *Pereira v Hamilton Township Farmers' Mutual Fire Insurance* (2006), 36 CCLI (4th) 11, 267 DLR (4th) 690 (Ont CA) at 708-09 DLR; *Silva*, supra note 12 at 325-27; *Ipapo Estate v Citadel Life Insurance Co* (1989), 37 CCLI 259 (Man CA) [*Ipapo Estate*]; *White*, supra note 12 at 1552-53; *Burlington Insurance Co v Okie Dokie, Inc.*, 398 F Supp 2d 147 at 157 (Dist Ct DC 2005); *Mitchell v United National Ins Co*, 127 Cal App 4th 457, 25 Cal Rptr 3d 627, 640 (Cal App 2d Dist 2005). See also *ICA*, supra note 35, s 21(3), which states that where an applicant fails to answer or provides clearly incomplete or inaccurate responses to questions on an application form and the insurer issues a policy without first following up, the insurer is deemed to have waived its right to disclosure on that issue. Presumably, the standard for waiver will be determined by what a prudent insurer would have done in the circumstances. See also *Roberts v Avon Insurance Co*, [1956] 2 Lloyd's Rep 240 at 249 (QBD).

⁴⁷ Supra note 12 at 327.

⁴⁸ See *Sagl*, supra note 32 at para 62.

⁴⁹ *Ipapo Estate*, supra note 46 at 265; see also *DeKoning*, supra note 32.

them to provide such information rather than have insurer's spend time and money to uncover the same. The need for further investigation is assessed based on the sufficiency of information disclosed,⁵⁰ and whether the facts in issue were within the applicant or insured's unique knowledge or discoverable by the insurer upon reasonable investigation.⁵¹ For instance, failing to answer, or providing incomplete response to a question, may not oblige the insurer to make further inquiries about the reason for the blank or incomplete response unless a reasonable insurer would have found it necessary to make further inquiries in the circumstances.⁵² To hold otherwise may significantly increase costs for insurers and ultimately consumers, cause delays in providing coverage, and undermine the disclosure duty. There could also be privacy concerns that expecting insurers to fish for information about prospective insureds may result in the former having more information on the latter than is probably necessary in the circumstances.

Thus, the presumed knowledge exception to the disclosure duty is of limited benefit for applicants for personal insurance contracts. Giving insurers permission to access information in applicants' medical files does not replace the duty of utmost good faith, nor does it impose a duty of due diligence on the former to verify statements or investigate missing information in application forms. A duty to make further inquiries may arise, however, where insurers obtain consent to access medical files or details of doctors who have treated the insured. It is not unreasonable for applicants to assume insurers will follow up with their health care professionals before making their underwriting decision and applicants may therefore unwittingly not provide information that may readily be

⁵⁰ See *Armstrong v North West Life Insurance Co of Canada* (1990), 48 BCLR (2d) 131 (CA) at 136-37. In *Ipapo, ibid*, in rejecting a duty on the insurer to have made further inquiries about the deceased's health, the Court noted that the insured did not disclose sufficient facts about her health nor could the agent be said to have known of facts inconsistent with those provided by her in the application form, which would have alerted the defendant of the need for further inquiry; see also *Phillips, supra* note 29 at para 146.

⁵¹ See *MacNeil (Litigation Guardian of) v Bryan* (2009), 77 CCLI (4th) 96 (Ont Sup Ct J); *Schoff v Royal Insurance Co of Canada* (2004), 348 AR 366 (CA) at paras 53-55; *Friere v Woodhouse* (1817), 177 ER 345, Holt NP 572 at 573 (Assizes).

⁵² *Horowitz, supra* note 14 at 453-54. It appears that insurers in Australia have a positive duty of due diligence in the face of absent or incomplete responses to a question on an application form with the expectation to make further inquiries in such a situation before accepting the risk. Failure to do so constitutes waiver of the disclosure duty and disentitles the insurer from voiding the contract for non-disclosure. See *ICA, supra* note 35, s 21(3).

ascertainable from such sources.⁵³ The UK and Scottish Law Commissions have suggested that while it may be unfair to impose a duty of due diligence on insurers to further investigate statements on an application form, a duty to obtain information from a third party may arise where the insurer indicated it would do so and it was reasonable for the insured to think the insurer will follow through with an inquiry to the said source before accepting her or his proposal.⁵⁴ Any such expectation on the part of insureds and the corresponding potential unfairness is often tempered with a warning on application forms that consent for insurers to access a prospective insured's medical records or consult her or his healthcare providers does not guarantee that such action will be taken and that it remains the responsibility of the applicant to provide full and accurate information.⁵⁵ However, insurers are not obliged to include such a warning.⁵⁶ This could potentially disadvantage applicants unaware that insurers do not necessarily follow up with one's health care professionals notwithstanding obtaining their consent to do so. All insurers should include such warnings on application forms as a matter of best practice and consistent with the mutual obligation of good faith by insureds and insurers.

⁵³ Concerning consumers' complaints, see The UK Law Commission Consultation Paper No 182 and the Scottish Law Commission Discussion Paper No 134, *Insurance Contract Law: Misrepresentation, Non-Disclosure and Breach of Warranty, A Joint Consultation Paper* (June 2007), at 4.131, online: <<http://www.lawcom.gov.uk/docs/cp182.pdf>>.

⁵⁴ *Ibid* at 4.143-4. While this may relieve the insured of obligations to disclose facts material to the risk readily obtainable from the third party, this may not extend to misrepresentations.

⁵⁵ The insurance industry in the UK has adopted such a practice; see *ibid* at 4.138. Such a view of the disclosure duty is consistent with the narrow conception of the duty envisaged by Lord Mansfield in *Carter*, *supra* note 12, and subsequent cases in the seventeenth century. See Hasson, *supra* note 1 at 616-18; Tay, *supra* note 19 at 188.

⁵⁶ For example, the first part of the health declaration portion of the application form for life insurance provided by Manulife asks the applicant to provide a physician's name and contact information. The final section of the form also contains authorization to contact health care providers, agencies and persons who may have any information about the applicant's health. Although the Terms and Conditions section warns the applicant of the importance of accurate representations, there is no mention of the need to disclose any health-related or other information not specifically requested, or a statement that there is no guarantee the insurer will consult third parties about the applicant's insurability; see <http://www.coverme.com/pdf/CMeT10TurboAppNat_E.pdf?MKT=manulife.ca>. See also Canadian Life and Health Insurance Association, "A Guide to Life Insurance" at 10, online: <http://www.clhia.ca/download/brochures/Brochure_Guide_To_Life_ENG.pdf>.

4) Test for Materiality: Prudent Insurer Test

Only non-disclosure or misrepresentation of facts material to the insured risk constitutes breach of the disclosure duty. In *Henwood v Prudential Insurance Co of America*, Spence J stated: “to effect the avoidance of [a] policy the non-disclosure or misrepresentation not only must be established but its materiality must be established. The onus of establishing misrepresentation and its materiality is upon the insurer.”⁵⁷ Whether concealed or misrepresented facts are material to the risk in issue is a question of fact based on the prudent insurer test. The question to be asked is “whether, if the matters concealed or misrepresented had been truly disclosed, they would, on a fair consideration of the evidence, have influenced a reasonable insurer to decline the risk or to have stipulated for a higher premium.”⁵⁸ This is an objective test, based on how a reasonable insurer would have behaved in the circumstances if it had fairly considered the facts in issue.⁵⁹ In *Silva*, Lane J stated:

The test of materiality is objective, not subjective or particular to whatever insurer may be involved. If that were not so, it would be open to an insurer to assert, after the event, that it would not have accepted the risk based on its own private internal underwriting considerations however removed from the industry practice they might be. The insurer’s underwriting rules must be shown to be in reasonable conformity with the ordinary standards for measuring insurable risks applied by insurers generally. Materiality, therefore, must be tested in the context of a “reasonable” insurer.⁶⁰

The objective standard ensures that generally an insurer cannot determine information to be material based on its idiosyncratic practices as a reason for nullification where such a position is not objectively sustainable.⁶¹ Claims of subjective materiality must be reasonably grounded.

⁵⁷ *Henwood v Prudential Insurance Co of America*, [1967] SCR 720 at 735, per Spence J (dissenting in result), citing *Joel*, *supra* note 29 and *Ontario Metal Products*, *supra* note 27 [*Henwood*]; see also *Kehoe*, *supra* note 25 at 246.

⁵⁸ *Ontario Metal Products*, *ibid* at 351-52.

⁵⁹ *Ibid* at 350-52; *Shields v North American Life Assurance Co* [1950] 1 WWR 481 (Sask CA) at 488. See also *re Epic Mort*, *supra* note 12 at 1242, *aff’d* in part, *rev’d* in part on other grounds; *Foremost Guar Corp v Meritor Sav Bank*, 910 F Supp 118 (4th Cir 1990).

⁶⁰ *Silva*, *supra* note 12 at 306-07.

⁶¹ *Pusateri’s Ltd v Prudential of America Life Insurance Co (Canada)*, [1999] ILR 1-3703 (Sup Ct J), *aff’d* [2001] ILR 1-3965 (Ont CA); see also *Mayne Nickless Ltd v Pegler*, [1974] 1 NSWLR 228; ALRC 20, *supra* note 21 at para 159.

There is also, however, a recognized subjective element to the test for materiality. In *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*, the House of Lords suggested a two-step approach for determining materiality. The court must determine first whether the prudent insurer will consider the information material (the objective inquiry), and second whether the non-disclosure or misrepresentation induced the particular insurer to enter into a contract. Where notwithstanding the practice of reasonable insurers, this particular insurer would have accepted the risk on the same or different terms even with proper disclosure, the information in question will not be considered material since its absence did not change the insurer's position.⁶²

Information about the insurer's likely behaviour is not always easy to discern. Hence, the standard for assessment is how reasonable insurers would have behaved in similar circumstances had the information in question been disclosed. Following *Ontario Metal Products*, courts demanded a high degree of evidence to discharge the burden of proving materiality. Insurers had to prove that they would reasonably have been influenced by the information in question. Additionally, courts required a clear and reliable statement from the insurer that it would not have accepted the risk or would have done so on different terms had there been accurate disclosure. In *Turner v British Columbia Mutual Benefit Association*,⁶³ the Court upheld a jury verdict in favour of a plaintiff and made a corresponding finding of immateriality. The Court rejected the claim by the defendant insurer's officials that had disclosure occurred they would have insisted on a medical examination and may very well have denied acceptance of the risk.⁶⁴ Further, the Court found that even if an examination had been required, the defendant's medical witnesses only provided evidence to the effect that the insured's underlying condition *might* have been discovered, but such a finding was not certain.⁶⁵ Accordingly, the insurer failed to establish that knowledge of the

⁶² *Pan Atlantic Insurance*, *supra* note 18; see also *Wells*, *supra* note 25 at para 38. For example, in *Ontario Metal Products*, *supra* note 27, although the Privy Council found that the insured's failure to disclose treatment provided by his wife's physician constituted breach of his disclosure duty, that did not entitle the insurer to void the contract because the insurer would not have acted differently even if there had been proper disclosure. The insurer's medical officer testified that he would have still recommended acceptance of the risk if the insured had made a proper disclosure and the insurer would have accepted his recommendation to insure the deceased. Thus, concealment of that information did not influence the insurer's underwriting decision, and hence was not material.

⁶³ *Supra* note 24.

⁶⁴ *Ibid* at para 8.

⁶⁵ *Ibid* at para 5.

concealed facts *would* have influenced its decision to accept the risk in question.⁶⁶

D) Nature and Scope of Disclosure Duty: Critique

There are numerous concerns about the wide scope of the disclosure duty; it is an onerous burden on applicants or prospective insureds, who are usually laypersons and unaware of what reasonable insurers would consider material. Thus, a test that focuses solely on the insurer's perspective with no consideration of what reasonable insureds will consider relevant holds many prospective insureds to an unreasonably high standard and is apt to increase the risk of innocent breaches of the disclosure duty.⁶⁷ One may reasonably conclude that information elicited by specific questions, which may be more detailed in the context of life, accident and sickness insurance, is what the insurer deems relevant in appraising risk for the type of insurance under consideration.⁶⁸ Insureds are also required, however, to provide any other information that may impact the decision to insure, even if it is not specifically requested. This position has the effect of relieving insurers of the obligation to ask questions about factors they deem relevant and yet giving them the right of nullification for non-disclosure. Such a wide scope of the disclosure duty is likely to cause injustice to insureds in many cases, as they may be unaware of the duty to volunteer information or of what an insurer considers relevant when it has not requested information on those factors.⁶⁹

⁶⁶ A similar result was reached in *Johnson v British Canadian Insurance Co*, [1932] SCR 680, where the insurer failed to introduce evidence of materiality of the information in question either from within its own organization or the insurance industry. Faced with a complete lack of evidence, the court found itself unable to make a finding of materiality regarding the information in question.

⁶⁷ See Trakman, *supra* note 25 at 429, 433-4; John Lowry, "Whither the Duty of Good Faith in UK Insurance Contracts" (2009) Conn Ins LJ 97 at 99; The English and Scottish Law Commissions, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (2009), para 2.11, online: <<http://www.lawcom.govuk/docs/lc319.pdf>> [*Consumer Insurance Law*].

⁶⁸ See Hasson, *supra* note 1 at 622, 633. The reasonable insurer test may be contrasted with the reasonable person test for materiality used in a jurisdiction like South Africa, where the focus is on what a reasonable person in the position of the insured would have considered material in the circumstances. Neither the perception on materiality of the particular insurer nor that of the insured is relevant for the determination of materiality; see *Commercial Union Insurance Co of SA Ltd. v Lotter*, [1998] ZASCA 103, 1999 (2) SA 147, [1999] 1 All SA 235 (A), (SCA) at para 13, online: <<http://www.saflii.org/za/cases/ZASCA/1998/103.html>>; JP Van Niekerk, "The Test for Materiality in Insurance Law: The Reasonable Person in Context" (2004) 16 S Afr Mercantile LJ 113. For support of the reasonable insured test, see Tay, *supra* note 19 at 193-4.

⁶⁹ See *Consumer Insurance Law*, *supra* note 67 at para 2.10.

Further, the duty may raise class implications. Educated and sophisticated applicants are more likely to know what an insurer would consider material, even if the information is not specifically requested. This may not be so for illiterate, less educated or unsophisticated applicants, for first-time insureds, or those completing on-line applications with no opportunity to enter additional information not specifically requested.⁷⁰ Meanwhile, there is a presumption of equal knowledge and experience among prospective insureds, and inability to function as the paradigmatic reasonable person is considered a matter of individual failing, not something to be remedied through attention to marginality status or by taking into account inequalities among applicants. Thus, access to insurance may reflect power structures in society and may be a mechanism for constructing and reproducing social hierarchies. The financial security created and legitimized by this process helps to entrench the socio-economic advantage of the privileged and perpetuates the marginality of disadvantaged members of society.⁷¹ Finally, the obligation to disclose information not specifically requested may raise privacy concerns as applicants might reveal personal information that has no bearing on the proposed risk just to avoid potential breach of the disclosure duty.

The continuing justification for an onerous disclosure duty is questionable, especially given the practice of using detailed and long questionnaires that allow insurers to elicit information they deem relevant to particular risks, and that of marketing insurance products to persons and in ways that increase the likelihood of innocent breaches of the disclosure duty.⁷² At the same time, blanket determinations of immateriality regarding information not requested can make application forms complex and cumbersome; insurers will have to include questions to elicit any conceivable information that may affect insurability. Given the variability of human beings as well as conditions, this may be near impossible.⁷³ The increased costs in the application of such a principle will ultimately be

⁷⁰ Tay, *supra* note 19 at 196.

⁷¹ Stone, *supra* note 4 at 57.

⁷² Tay, *supra* note 19 at 193.

⁷³ Insurers will often attempt to obtain disclosure of information not specifically requested by simply including a question regarding residual information not previously provided in other questions. The expectation to disclose information not specifically requested may be justifiable where the applicant is directed to provide information that may be relevant but is not specifically addressed, but arguably not where the insurer does not specifically frame a request for residual information regarding insurability in that way. It is still doubtful whether the use of residual questions will be sufficient to signal to inexperienced applicants information that the insurer deems material in the circumstances.

passed on to consumers. This effect could detrimentally impact affordability and hence access to insurance. Nevertheless, nullification for innocent breaches of the disclosure duty may be particularly unfair vis-à-vis laypersons often unaware of the materiality requirement.⁷⁴ Nullification is, however, justified where there is evidence of bad faith on the part of the insured.

3. Proving Materiality: Presumption of Materiality

As previously mentioned, in a case of non-disclosure or misrepresentation the insurer need not prove that the information in question would have been decisive of its underwriting decision. It will suffice that a prudent insurer would have considered the information in question in making its decision.⁷⁵ The materiality requirement appears to protect insureds by

⁷⁴ The English and Scottish Law Commissions' view was that in the context of personal insurance contracts, the range of factors relevant to assessment of insurability are well-known and readily predictable by insurers such that they should be expected to ask specific questions to elicit that information. The insurance industries in the UK and Scotland reacted to the Commissions' suggestion with concerns that abolishing the requirement that insureds volunteer information would greatly increase the length and complexity of application forms. Presumably, insurers can elicit the relevant information through specific questions in many cases and other information in unique situations may be obtained with catch-all questions asking the applicant or prospective insured to disclose any other facts not already disclosed in response to specific questions. Whether the disclosure duty has been met in such circumstances should be determined based on what a reasonable person would have disclosed in those circumstances.

⁷⁵ See *Pan Atlantic Insurance*, *supra* note 18 at 440-41; *Consumer Insurance Law*, *supra* note 67 at para 2.6; *ICA*, *supra* note 35, s 21(1)(b); *General Accident Insurance Co Australia Ltd v Kelaw Pty Ltd* (1997), 9 ANZ Ins Cas 61-369 at 77-048, BC9702406 (SC Western Aust) at 15, where the Court held that for the purposes of s 21(1), the word "relevant" appears to be used in its "ordinary sense," which suggests a position similar to the test adopted for materiality at common law (i.e. whether the fact "would have reasonably affected the mind of a prudent insurer in determining whether he will accept the insurance, and if so, at what premium and on what conditions"). See also *Tay*, *supra* note 19. But see *Nuvo Electronics v London Assurance* (2000), 49 OR (3d) 374 (Sup Ct J), appeal dismissed by consent – case settled, 2002 OJ No 322 (QL) (CA) at 387-88 [*Nuvo Electronics*], where the Court was critical of the interpretation in *Pan Atlantic Insurance* of the materiality test as not dependent on the undisclosed or misrepresented information having a decisive influence on the insurer's underwriting decision. It is possible that the information in question may be one of several factors to be considered in deciding whether to accept the risk or not and on what terms. A factor standing alone may appear neutral but may be significant in conjunction with some undisclosed or misrepresented factors. Given that materiality is a question of fact, how much weight is to be accorded to specific factors will perhaps vary depending on the circumstances. To insist on the decisive influence test may be too stringent and denies the possibility of otherwise isolated factors cumulatively impacting insurability.

limiting the insurer's right of nullification to situations where the information in question would have been relevant in the insurer's underwriting decision. This is consistent with the general rationale for insurance regulation, which tends to be consumer-friendly.⁷⁶ The actual determination of whether particular facts are material to the insured risk, however, has generally favoured insurers. Courts adopt a presumption of materiality where an insurer asks a question. Where an insurer would have behaved differently by accepting or declining the risk even though other reasonable insurers would have done otherwise or insured the risk on different terms, the issue of materiality will be determined based on the insurer's actual practice.⁷⁷ An insurer's underwriting practice may nevertheless be taken as evidence of the reasonable insurer standard without requiring the insurer to adduce independent evidence of that standard. Further, there need not be a correlation between the concealed or misrepresented fact and materialization of the insured risk.⁷⁸ The rationale is that had there been proper representations, the insurance contract would never have existed and the insurer would not have been liable for the loss.⁷⁹ These insurer-favourable positions undermine consumer protection

⁷⁶ See *Curtis's & Harvey (Canada) Ltd v North British & Mercantile Insurance Co*, [1921] 1 AC 303, 55 DLR 95 (PC) at 99 DLR, where Lord Dunedin stated: "The primary objective of the statutory conditions is to prevent the insurer ... [from] avoiding liability which it is only just and reasonable he should undertake." Although he was referring specifically to technically worded exceptions that were unfairly included in contracts for fire insurance the statement is equally true for insurance regulation generally, including the materiality requirement. See also *Smith v Co-operators General Insurance Co*, 2002 SCC 30, [2002] 2 SCR 129 at 137; Billingsley, *supra* note 14 at 2.

⁷⁷ *Wells*, *supra* note 25 at 394; *Nuvo Electronics*, *supra* note 75 at 387; *Pan Atlantic Insurance*, *supra* note 18 at 447; *Phillips*, *supra* note 29 at paras 145-46, 150-51.

⁷⁸ *Henwood*, *supra* note 57; in this case, the insured failed to disclose she was being treated for depression in an application for life insurance. She died in a car accident totally unrelated to her depression. The insurer successfully avoided liability on the basis of breach of the disclosure duty. See also *Thompson v Maritime Life Assurance Co* 2003 MBQB 229, 5 CCLI (4th) 312, 178 Man R (2d) 299, aff'd (2005) 190 Man R (2d) 130 (CA); *Jones Estate v Cumis Life Insurance Co*, 2003 MBQB 5, 171 Man R (2d) 123, 45 CCLI (3d) 82. Schwartz J has criticized the law on this point because allowing an insurer to void an insurance contract for non-disclosure or misrepresentation where the basis of the claim is unrelated to the breach of the disclosure duty results in injustice to the insured or her or his beneficiary, and he has called on the legislature to amend the law; see *Thompson*, *ibid* at paras 32-35; *Jones Estate*, *ibid* at paras 46-47 (*obiter*). For a response to Schwartz J's concerns and in defence of the law, see James Rendall, Annotation to *Jones Estate*, 45 CCLI (3d) 83-85. See also Billingsley's critique of *Marche v Halifax Insurance Company*, [2005] 1 SCR 47 in Billingsley, *supra* note 14 at 123-26.

⁷⁹ See *Garand v Mutual of Omaha Insurance Co* (2001), 296 AR 257 (QB) at paras 109-112. In defending the insurer's right to void an insurance contract for

and instead exacerbate the power imbalance between insurers and insureds.

Canadian courts may accept an insurer's own practice as *prima facie* evidence of the reasonable insurer standard.⁸⁰ The insurer is presumed to have acted as a reasonable insurer in its underwriting practice, which is assumed to be what other reasonable insurers would do in assessing risks in similar circumstances. Although courts have held that not all information specifically requested in an application process will necessarily be material to the proposed risk, a further presumption of materiality arises where an insurer seeks specific information in the application process.⁸¹ Answers to those questions are deemed material to the insurer's underwriting decision and consistent with the practice of reasonable insurers. Once materiality in relation to concealed or misrepresented facts is established based on the prudent insurer test, "a presumption in favour of a causative effect" arises; that is, absent specific evidence of the insurer's actual practice to the contrary, there is a presumption that the breach induced the insurer to enter into the contract.⁸² Courts may make that determination simply based on evidence of the particular insurer's practices, for example from the testimony of its employees about the company's practices. In *Henwood*, where the only evidence presented and accepted regarding the materiality of the undisclosed information was the testimony of the insurer's own employees on the company's underwriting practices, the majority of the Supreme Court of Canada stated:

misrepresentation of material facts in *Garand*, Watson J noted that it is irrelevant that the insurer might have provided some coverage, albeit for a different risk and/or on different terms, had there been no misrepresentation. The important thing is that the insurer would not have issued the particular contract in question but for the misrepresentation or non-disclosure. See also *Norwood and Weir*, *supra* note 12 at 378.

⁸⁰ See *Henwood*, *supra* note 57. In *Pan Atlantic Insurance*, *supra* note 18, Lord Mustill noted that the particular insurer's practices have no place in the determination of materiality. The court will simply consider how a prudent insurer would have viewed the information in question. However, given the vagueness or the hypothetical nature of the reasonable insurer test, it is conceivable that courts might consider the insurer's underwriting practices in determining materiality, although it would not be the sole determinant of materiality. See also *Abell v Oppenheim*, 2005 BCSC 1715 (the insurer adduced evidence from its own underwriter and an expert as to materiality; insured also provided expert witness, but the expert did *not* contradict the insurer's witness (materiality established)); *Fernandes*, *supra* note 37, *Lohse v Sovereign General Insurance Co*, 2002 BCSC 50, 38 CCLI (3d) 16.

⁸¹ See Fred Hawke, "Managing the Risks of Insurance" (2003) 22 Australian Resources & Energy LJ 163 at 177.

⁸² *Pan Atlantic Insurance*, *supra* note 18 at 453.

Although the evidence of expert witnesses as to whether or not other insurance companies consider a question to be “material,” is admissible and may be relevant in such a case as this, I do not think that when no evidence whatever has been adduced to suggest that the [insurer’s] practice is anything but reasonable, it is seized with the burden of proving the practice of other insurers.⁸³

Materiality, inducement and reasonableness of an insurer’s underwriting practices are presumed unless the claimant proves otherwise, namely that the insurer’s practice is unreasonable or that it is inconsistent with the practice of other insurers.⁸⁴ This may be done, for example, by adducing evidence of an industry standard that is inconsistent with the insurer’s practice and/or evidence of the insurer’s own practice that it does not consider such matters material. Further, the presumption can be rebutted by the insured with evidence that the insurer would have insured the risk notwithstanding that other insurers would not have or would have done so on different terms.

The test for materiality is applied in an abstract way without consideration of an insured’s particular circumstances.⁸⁵ It is assumed that an applicant can appreciate what a reasonable insurer will consider relevant. The Australian Law Reform Commission notes that while applicants for insurance will continue to have superior knowledge about some information material to the risk to be insured, for example in life insurance, there is no doubt that the common law disclosure duty is in need

⁸³ *Henwood*, *supra* note 57 at 726. See also *Kehoe*, *supra* note 25 at 248-49; *Walsh v Allstate Insurance Co* (1998), 169 NSR (2d) 99 (SC) at 102-03; *Webster v Royal Insurance Co of Canada* (1995), 30 Alta LR (3d) 8 (QB) at 10-11. This is the case even in the UK, where the House of Lords has noted that although an insurer’s own underwriting practices cannot be relied on to establish the prudent insurer test, that evidence may be sufficient to prove inducement; see *Pan Atlantic Insurance*, *ibid* at 442.

⁸⁴ See *Henwood*, *ibid* at 726 where Ritchie J indicated that the decision on materiality might have been otherwise had the plaintiff produced evidence from other insurers that contradict the insurer’s opinion regarding materiality. See also *Caverhill Estate*, *supra* note 27, where the insurer adduced evidence from its own underwriter, vice president and chief underwriter, and from its underwriting manual. The insured did not lead any evidence to contradict the insurer’s evidence, that is, to demonstrate the immateriality of the information in question; materiality was established. In *Thompson v Allianz Insurance Co of Canada* (1996), 44 CCLI (2d) 100 (Alta QB) at para 81, *aff’d* (1998), 228 AR 99, 8 CCLI (3d) 280; the insurer adduced evidence from its own underwriter, and underwriter of local agent who actually worked on the policy in question; the insured did not adduce contradictory; materiality was established.

⁸⁵ Trakman notes that the duty to disclose what is within the insured’s knowledge to be material to the proposed risk would suggest a test of materiality from the perspective of the insured but unfortunately materiality is determined from the viewpoint of insurers, either objectively or subjectively; see Trakman, *supra* note 25 at 425.

of modification. The current position requires more than utmost good faith on the part of insureds and penalizes them for not appreciating the materiality of particular information regardless of a prudent insured's perception of the relevance of the information in question.⁸⁶ Again, persons with superior knowledge of the insurance system are likely to know what to disclose. This could lead to the unfortunate situation where a person who has attempted to be responsible by insuring herself and has acted in good faith ends up in a worse position than a person who has not taken such measures, as she will have lost the opportunity to arrange her affairs differently.

The presumption of materiality is problematic and unfair to the insured. It ignores the unequal access to expert evidence between insurers and insureds. Insurers are often in a better position to establish industry standards; they will likely choose their witnesses carefully, usually their own employees or others sympathetic to their position. Some insureds or beneficiaries may be able rebut the presumption of materiality and hence avoid nullification of the contract, for instance where the evidence does not support subjective materiality. Such cases are likely rare.⁸⁷ Corporate or other wealthy insureds, on the other hand, are more likely to be able to afford expert witnesses to contradict the insurer's evidence of reasonableness. This, however, is out of reach for many individuals, especially those from marginalized socio-economic backgrounds. It will often be unrealistic to expect an insured or beneficiary to gather the necessary evidence to contradict the insurer's assertion of the industry standard. Given the protectionist tendency of many industries, it may also be difficult for the insured or beneficiary to actually get industry experts to challenge the insurer's position. As well, it may not be worthwhile, and indeed might be risky, for an insured to try to gather the necessary evidence given that the expense involved can deplete the insurance money awarded even if they are successful in preventing the insurer from voiding the contract. Further hesitation may arise because the insured may be stuck with the substantial costs of such an investigation should its claim ultimately be unsuccessful. The insured or beneficiary is already vulnerable with the materialization of the insured risk and would want to

⁸⁶ ALRC 20, *supra* note 21 at 106 [para 175].

⁸⁷ It is possible that the evidence of the insurer's own witnesses may not support the presumption of materiality, as was the case in *Ontario Metal Products*, *supra* note 27. The insurer's physician testified that the undisclosed information would not have affected his decision to recommend that the applicant be insured and there was evidence that the insurer was deferential to the doctor's recommendations. Hence, the doctor's testimony showed that disclosure would not have affected the insurer's underwriting decision and hence the information could not be regarded as material. Consequently, non-disclosure did not entitle the insurer to avoid its liability notwithstanding its assertion of materiality.

minimize exposure to further risk of financial losses. This means that subjective materiality would often be sufficient to discharge an insurer's burden under the objective insurer test, and that the presumption of materiality will rarely be rebutted, even if the insurer does not adduce evidence of the reasonableness of its underwriting practices.⁸⁸

In many cases, the industry standard, which is often influenced not by the interests of consumers but by the self-interest of insurance companies themselves, is accepted as reasonable practice without actually scrutinizing the reasonableness of that practice. Even assuming there is evidence of the practice of other insurers, and hence an indication of what a reasonable insurer would have done in the circumstances, it is still problematic to presume that the industry practice is reasonable and for a court not to independently determine the reasonableness of that practice. A truly prudent insurer would not necessarily follow an industry standard without thinking about the reasonableness of that practice. This type of reliance on industry standards is inconsistent with the use of customary or professional standards to determine the standard of care in negligence claims. Although courts are generally deferential to professional standards or customs of particular trades, they still need to be convinced that the standard itself is reasonable. There is a feeling that in the insurance context, courts are too deferential to industry standards as evidence of what a prudent insurer would have done, thereby giving an unjustifiably high amount of weight to such practices.⁸⁹ As well, allowing insurers to rely on their own practice as evidence of the industry standard, or to satisfy the reasonable insurer standard, gives undue deference to the underwriting practices of the particular insurer, ignores the inequality between insurers and insureds and effectively turns the objective test of materiality into a subjective one. This is inconsistent with the purpose of the objective test as stated in *Ontario Metal Products*, where the Privy Council noted that the focus of the inquiry should be on how the insurer would have used the undisclosed fact if it had known of it. This position was adopted partly to address the power imbalance between insurers and insureds, bearing in mind that the former propounds the questions.

⁸⁸ This was the case in *Henwood*, although the insurer's two employees who testified about their company's underwriting practice also acknowledged that they were ignorant of underwriting practices of other insurers in relation to the issue in question. Spence J, dissenting in *Henwood*, was of the view that an insurer cannot satisfy the burden of proving that its underwriting practice is objectively reasonable with merely subjective evidence. To do so transforms the objective test into one based on a particular insurer's idiosyncrasy; see *Henwood*, *supra* note 57 at 738.

⁸⁹ *MacGillivray on Insurance Law*, *supra* note 11 at para 17-44 [428].

4. Remedies for Breach of Disclosure Duty

When breach of the disclosure duty is discovered within the first two years of the contract or reinstatement of a life or accident insurance policy, an insurer is entitled to void the contract *ab initio* and return the premiums plus interest. No relief against forfeiture can be granted in respect of breach of the disclosure duty because it does not involve post-loss breaches of contractual terms.⁹⁰ Under the incontestability principle, an insurer is not entitled to nullification after two years of the coming into force or reinstatement of the contract unless fraud is established.⁹¹ An insurer who discovers breach of the disclosure duty within the first two years may also choose to waive the breach and revise the terms of the contract in light of the facts in question, for example, by adjusting premiums or the coverage amount, or by excluding certain risks. Further, an insurer may ignore the breach and continue to provide coverage on the same terms as the original contract as if no breach of the disclosure duty had occurred. The last scenario is highly unlikely to occur but when it does, can give rise to waiver or estoppel. The second scenario is equally unlikely in the context of personal insurance contracts. For the most part, breach of the disclosure duty becomes evident after loss has occurred and a claim is made. Given the option of voiding the contract *ab initio* and limiting the insurer's liability to the return of premiums paid plus interest, it is unlikely an insurer will voluntarily opt for the higher liability by providing benefits based on a revised contract. Thus, the more likely scenario in instances of personal insurance contracts is for insurers to void the contract and avoid any liability.

⁹⁰ See BC *Insurance Act*, *supra* note 13, s 10.

⁹¹ The two-year time limit for voiding an insurance contract for breach of the disclosure duty is justified, among other things, as encouraging timely and careful review of applications to uncover potential problems with insurability. It also works to avoid a false sense of security and disappointment on the part of the insured who would have paid premiums for several years only to realize that the insurer can set up a defence based on a breach of the disclosure duty to nullify the contract; the longer the time between the coming into effect of the contract and materialization of the risk, the less likely breach of the disclosure duty was part of a fraudulent scheme to deceive the insurer; the difficulty of remembering facts relating to insurability at the time of contract and of obtaining evidence to defend the allegation of breach, sometimes after the death of the person insured, are further considerations. See Norwood and Weir, *supra* note 12 at 401; McDowell, *supra* note 7 at 526. See Leon E Trakman, "'Escape Hatches' in Life Insurance Policies: Rights and Fiduciary Responsibilities" (2001-2002) 35 UBC L Rev 91 at 125 ff, who suggests the purpose is to protect insured's reliance on a life policy after two years, while also allowing reasonable opportunity for insurer to evaluate the risk and cancel the policy.

The incontestability principle will often protect insureds against the harshness of nullification in relation to innocent breaches of the disclosure duty. The risk of nullification is real, however, where loss occurs within the first two years of the contract or reinstatement. It has also been argued, at least in one case, that in the context of policies that are renewed annually, a new disclosure duty arises with each renewal, thereby creating a perpetual obligation to disclose changes to insurability.⁹² Thus, the incontestability principle may be of no benefit for insureds where the policy is renewed annually. An argument could be made for requiring a higher standard for nullification, such as fraudulent intent or wilful concealment, when the insurer did not specifically request the information in question and the applicant's silence was not deliberately intended to induce the contract as is the case where a contract has been in effect for at least two years.

Insureds under individual insurance contracts may also be disadvantaged compared to those under group policies. Those insured under group insurance policies do not risk nullification for breach of the disclosure duty in respect of evidence of insurability not specifically requested by the insurer. Coverage may be provided under group policies without the requirement of individual insurability of the lives insured.⁹³ This eliminates the possibility of nullification for misrepresentation or non-disclosure where the insured is eligible for group coverage. Individual insurability would only be relevant in respect of excess insurance beyond that offered by the group policy. An insurer can void the excess coverage for non-disclosure but not the basic coverage provided under the group policy.⁹⁴ Moreover, the contract for excess coverage in respect of that person is not voidable where the breach in question relates to information not specifically requested. The contract is voidable, however, where the evidence of insurability in question was specifically requested, subject to incontestability for contracts that have been in effect for at least two years.⁹⁵ Nothing should preclude application of this principle in relation to individual insurance contracts. The current position raises issues of inequalities as it privileges those insured under group policies, which may

⁹² *Electric ColourFast Printing Corp v Citadel General Assurance Co*, [1999] OJ No 210 (QL), 88 OTC 373 (Ct J (Gen Div)) at para 26.

⁹³ See Canadian Life and Health Insurance Association, *A Guide to Life Insurance*, at 9, online: <http://www.clhia.ca/download/brochures/Brochure_Guide_To_Life_ENG.pdf>.

⁹⁴ See Norwood and Weir, *supra* note 12 at 405.

⁹⁵ See *BC Insurance Act*, *supra* note 13, s 42(3) (life insurance), s 97(3) (accident and sickness); *Alberta Insurance Act*, *supra* note 13, s 568(3); *Manitoba Insurance Act*, *supra* note 13, s 161(3); *Ontario Insurance Act*, *supra* note 13, s 184(3); *Insurance Act*, RSNB 1973, c I-2, ss 145(3), 203(3); *Nova Scotia Insurance Act*, *supra* note 13, s 82(3)

be unavailable to certain members of society such as those from disadvantaged socio-economic backgrounds including persons with non-standard jobs, the unemployed and persons in receipt of income assistance.⁹⁶

Nullification and return of premiums to the insured is intended to restore the parties to the position they would have been in absent the insured's breach of the disclosure duty. While this is technically true, it does not meet the reasonable expectations of insureds or beneficiaries, nor does it reflect the purpose of an insurance contract, where the breach was innocent. Nullification disproportionately benefits insurers to the detriment of insureds. Such an outcome is particularly problematic where the insurer would likely have provided some coverage but on different terms, whether based on the prudent insurer test or subjective materiality. Nonetheless, where no coverage would have been provided with full disclosure or accurate representations, then nullification is unavoidable. As unfortunate as this might be, if no insurer would have insured the risk in question, then this will be the only justifiable solution to avoid endangering the contractual freedom of insurers, actuarial equity and the overall sustainability of the insurance system. The insureds or beneficiaries, who have arguably been responsible by obtaining insurance in the first place, might still be worse off because had they known they could not obtain insurance for the risk in question, they might have arranged their affairs differently to minimize the financial disruption for themselves and their families. The illusion of insurance protection would have robbed them of that opportunity. This could be seen as undermining the social policy in favour of encouraging individuals to insure themselves against risks and a source of disappointment. Notwithstanding this concern, insurance is ultimately a business and insurers should not be compelled to assume risks that they otherwise would not have. Where non-disclosure was innocent and it could have been discovered with due diligence on the part of the insurer, however, the loss of opportunity to find alternative protections should be compensable.

(accident and sickness insurance), s 186(3) (life insurance); *Insurance Act*, RSPEI 1988, c I-4, s 132(3) (life insurance), s 191(3) (accident and sickness); *Saskatchewan Insurance Act*, RSS 1978, c S-26, s 146(3) (life insurance), s 242(3) (accident and sickness insurance).

⁹⁶ Group policies may be available as employment benefits for persons with standard employment or members of professional associations or sporting clubs. Given the rise in non-standard jobs, unemployment and persons in receipt of income assistance, the potential number of people excluded from this benefit can only be expected to grow; see Baker, "Social Construction," *supra* note 4 at 34-35.

5. *Proposed Solutions*

A) Reforming the Materiality Test

Rather than using the reasonable insurer test to determine materiality, Canadian common law should adopt a modified objective test that focuses on the reasonable insured. The question to be asked is how a reasonable person *in the insured's position* – with, for instance, the same level of education, experience with insurance contracts or cultural background – would have understood materiality, and what information would she or he have considered relevant and hence expect to have been disclosed in the circumstances. The determination would be made in light of factors such as the nature of the insurance contract, the circumstances in which protection is sought, and the extent and amount of coverage desired. For instance, where a reasonable person would have sought expert advice on a certain matter, failure to do so would be unreasonable. The onus of proving bad faith should be on an insurer alleging breach.⁹⁷ A consequence of the modified objective standard is that evidence of the insured's actual knowledge or appreciation of the materiality of the information in the particular circumstances would not be ignored. Failure to disclose or make accurate representations of that information would constitute breach of the disclosure duty, but the applicant would not be penalized for not appreciating the materiality of the information where a reasonable person in her or his situation would not have considered it material. Such an approach would be similar to the modified objective test for ascertaining causation in medical malpractice cases.⁹⁸

The reasonable insured test strikes a fair balance between the interests of insureds and insurers by limiting breaches of the disclosure duty to situations where a reasonable insured so placed would have considered the information material. This would include information that the person is subjectively aware would be considered material. Such a position would more accurately reflect the reality of what is known and ought to be expected from applicants for insurance. The objective test would not favour all insureds. It would, however, generally protect those who act reasonably, even if their conduct is not necessarily what the prudent insurer would expect in the circumstances.

B) Remedial Solutions

The nullification remedy is unfair and would appear to undermine the insurer's duty of utmost good faith when there is evidence that prudent

⁹⁷ See Hasson, *supra* note 1 at 635.

⁹⁸ See *Reibl v Hughes*, [1980] 2 SCR 880.

insurers or the particular insurer would have provided some coverage but on different terms, or where the breach was innocent. A more reasonable position would be to vary the coverage provided by taking into account the evidence of insurability now known to the insurer, especially where the breach was innocent even if loss results from the undisclosed risk. This is essentially the approach required by statute with respect to misstatements of age.⁹⁹ This option would be possible even if loss has already occurred. Presumably, where insurers are prevented from voiding the contract, for example due to the incontestability principle, they will likely revise the terms of the contract to reflect what they would have provided had there been no breach of the disclosure duty. Such a position does not undermine the duty of good faith nor does it detrimentally affect the interest of other policyholders and the viability of the insurance industry because the breach at issue was innocent.

Furthermore, the availability of nullification should be limited to cases of fraudulent non-disclosure or misrepresentation out of fairness to insureds. There is precedent for this idea in other areas of insurance. The common law rules of absolute disclosure and nullification for both deliberate and innocent breaches have been modified by statute in relation to certain types of insurance contracts. For example, although misrepresentation in fire insurance entitles the insurer to void the contract regardless of the insured's state of mind, a right of nullification arises in relation to non-disclosure only where the omission was fraudulent. Actual fraud is required.¹⁰⁰ As well, a misrepresentation or non-disclosure in automobile insurance only entitles an insurer to void the contract if the

⁹⁹ In the context of life insurance, where breach of the disclosure duty relates to a misstatement of the age of the insured an insurer must adjust the amount of insurance money, upwards or downwards, to reflect how much it would have provided for the stated premium given the correct age; see e.g. *BC Insurance Act*, *supra* note 13, s 44 (2). However, if coverage would not have been provided at all because there is an age limit for the contract and the insured's correct age at the time of application would have put her or him outside the insurable age, then the contract is voidable during the lifetime of the insured within 60 days upon discovery of the error unless the contract has been in effect for more than 5 years; see *BC Insurance Act*, *ibid*, s 44(3). With respect to accident and sickness insurance contracts, where there has been a misstatement of age, the insurer can vary the amount of insurance money to reflect the correct age and stated premium or maintain the stated insurance amount but vary the premium in light of the correct age; see *BC Insurance Act*, *ibid*, s 101. Note that under s 30 of the Australian *ICA*, both options are available to an insurer for misstatement of age in the context of life insurance.

¹⁰⁰ *BC Insurance Act*, *supra* note 13, s 126(2), stat Cond 1; *Alberta Insurance Act*, *supra* note 13, s 549; *Ontario Insurance Act*, *supra* note 13, s 148; *Taylor v London Life Assurance*, [1935] SCR 422. See also *Nova Scotia Insurance Act*, *supra* note 13, ss 82, 185; *Alberta Insurance Act*, *ibid*, ss 567, 679; *New Brunswick Insurance Act*, *supra* note 95, ss 144, 202; *Ontario Insurance Act*, *ibid*, ss 183, 308.

misstatement was knowingly made or omitted. Although this need not include an intention to deceive the insurer, the insured must have been aware that the information was inaccurate.¹⁰¹ Commenting on the test for automobile insurance, Norwood and Weir note: "...the test goes to the state of mind of the insured in consciously failing to convey facts that the insured knows about to the insurer..."¹⁰²

Critics have expressed concerns about making such a distinction in the context of personal insurance contracts because, among other things, it may not be entirely clear whether a particular situation constitutes non-disclosure or misrepresentation. Some situations may be characterized in the alternative as non-disclosure or misrepresentation, thereby making it difficult to determine when an insurer is entitled to void a contract.¹⁰³ As well, it may be difficult to determine *ex post facto* whether non-disclosure was innocent or fraudulent.¹⁰⁴ This casts an onerous duty on insurers who have to prove fraud. These concerns, however, may not be entirely justified. Since both misrepresentation and fraudulent non-disclosure entitle the insurer to void the contract, the significant inquiry would often be whether there has been an innocent or fraudulent concealment. Some situations will clearly give rise to strong indications of fraud, for example, failure to disclose an obviously material fact. Even in equivocal cases, courts can make inferences from the nature of the information, the type of insurance, as well as the circumstances in question.¹⁰⁵ Courts are able to make the distinction in relation to fire insurance where the nullification option is limited to fraudulent non-disclosure. There is no reason why such a distinction cannot be made in the context of personal insurance contracts.

6. Lessons from Other Jurisdictions

Similar questions regarding the efficacy of the requirement and test of materiality, and the unfairness of the nullification remedy, have arisen in other jurisdictions. In some US jurisdictions, nullification is not available to insurers as a remedy in cases of innocent non-disclosure.¹⁰⁶ Segalla and

¹⁰¹ See BC *Insurance (Vehicle) Act*, RSBC 1996, c 231, s 75(a)(ii); Alberta *Insurance Act*, *ibid*, s 613(a)(a)(ii); Ontario *Insurance Act*, *ibid*, s 233(1)(a)(ii); *Sleigh v Stevenson*, [1947] 4 DLR 433 (Ont CA); *Khun v ICBC*, [1994] BCWLD 2233 (SC); *Wilkins v ICBC*, 2006 BCPC 553.

¹⁰² Norwood and Weir, *supra* note 12 at 382.

¹⁰³ See Billingsley, *supra* note 14 at 100-101.

¹⁰⁴ See concerns expressed by the insurance industry in Australia, ALRC 20, *supra* note 21 at para 177.

¹⁰⁵ ALRC 20, *ibid*, at para 177; *Vance on Insurance*, *supra* note 21 at 373-75.

¹⁰⁶ See *Vance on Insurance*, *ibid* at 370-72; Robert Keeton, *Insurance Law – Basic Text* (St Paul, Minn: West Publishing, 1971) at 327; ALRC 20, *ibid*, at para 177;

Parks have observed that US courts are more sympathetic to plaintiffs in cases of non-disclosure where the insurer did not specifically request the information in question and could have obtained it from other sources.¹⁰⁷ The current law in the UK is similar to the Canadian position in that insurers may void an insurance contract for an innocent breach of the disclosure duty. Yet, in practice, the absolute position may not always prevail. The UK Financial Ombudsman Service (FOS),¹⁰⁸ the agency that hears most consumer insurance disputes, does not insist on a voluntary disclosure duty; there will be no finding of breach of that duty where the insurer did not specifically request that information.¹⁰⁹ Since the FOS does not permit insurers to void contracts for failure to provide information not specifically requested,¹¹⁰ the issue of good or bad faith non-disclosure does not arise. The focus of claims before the FOS is on the nature of responses provided by the insured to questions asked by the insurer in the application process. Even in the context of misrepresentations, the FOS does not adopt an absolute rule. Only deliberate or reckless misrepresentation entitles an insurer to void the contract but not an innocent misstatement. Where misrepresentation was inadvertent, the FOS

Thomas F Segalla and Carrie P Parks, "Misrepresentations in Insurance Applications: Dangers in those Lies" (2006) 73 Def Counsel. J 118 at 123-4; McDowell, *supra* note 7 at 519. An exception exists in the state of California where the law is the same as the general Canadian position whereby an insurer is entitled to void a contract for intentional and unintentional non-disclosure: *California Insurance Code* § 331.

¹⁰⁷ Segalla and Parks, *ibid*.

¹⁰⁸ The Financial Ombudsman Services (FOS) is a statutory agency established under the *Financial Services and Markets Act 2000*, 2000 c 8, Part 16 and Schedule 17. The FOS decides most consumer insurance disputes in the UK. Although the jurisdiction of the FOS is limited to claims not exceeding £100,000, it still considers claims in excess of that amount but the decision in relation to the excess amount is non-binding. In a recent survey by the Law Commissions, they found that many insurers voluntarily pay the excess amounts although the rate of refusals remains uncertain; see *Consumer Insurance Law*, *supra* note 67 at para 3.5. The FOS follows its own rules, being guided by what is fair and reasonable in the circumstances and not necessarily legal rules. The Law Commissions have found that in practical terms, the FOS rules are more important than legal rules. See Financial Ombudsman Service, online <<http://www.financial-ombudsman.org.uk>>; <http://en.wikipedia.org/wiki/Financial_Ombudsman_Service>; UK Law Commission Consultation Paper No 182 and the Scottish Law Commission Discussion Paper No 134, *supra* note 53, at 3.22 -3.25.

¹⁰⁹ The FOS's position, which also reflects the view of the Association of British Insurers (ABI), is that insurers should use their application process to elicit information they find relevant to the type of insurance in question.

¹¹⁰ Similarly, the UK and Scottish Law Commissions have recommended that insureds should not be required to provide information on insurability absent specific requests from insurers in the application process; see the UK Law Commission Consultation Paper No 182 and the Scottish Law Commission Discussion Paper No 134, *supra* note 53.

will order a variation of the contract to reflect the policy that the insurer would have issued absent the misrepresentation.¹¹¹

Furthermore, the Association of British Insurers has urged its members to ask clear questions about factors they consider material in their underwriting process and suggested they should only rely on inaccurate or incomplete answers to those questions to void policies.¹¹² Courts have also noted the unfairness to insureds in allowing insurers to void a contract for non-disclosure of information not specifically requested, noting that insurers should ask for specific information if they consider it important in making their underwriting decision.¹¹³ The England and Scottish Law Commissions support a consumer-favourable regime, as reflected in their recent report and draft Bill on consumer insurance contracts. Among other things, the Commissions recommend abolition of the prudent insurer test for materiality in favour of a reasonable insured test, duty on insured to volunteer information, and adoption of an insured's duty to take reasonable care not to misrepresent information and the proportionality rule in cases of innocent breaches.¹¹⁴ Some courts have also expressed support for the proportionality rule.¹¹⁵

The Australian solution appears sound and worth emulating. The Australian *Insurance Contracts Act (ICA)* codifies the common law duty of disclosure owed by applicants for insurance but narrows the scope of that duty, focusing on what the insured knew or a reasonable person in her or his situation would be expected to know is relevant to the assessment of risk. Section 21 of the *ICA* obliges an insured to disclose "every matter that is known to the insured, being a matter that:

¹¹¹ Financial Ombudsman Service, "Non-Disclosure in Insurance Cases" June 2005, 46 Ombudsman News; Financial Ombudsman Service, "Insurance Case Studies – Non-Disclosure, Recklessness or Inadvertent?" April/May 2007, 61 Ombudsman News, online: <<http://www.financial-ombudsman.org.uk/publications/ombudsman.htm>>; U.K. Law Commission Consultation Paper No 182 and the Scottish Law Commission Discussion Paper No 134, *supra* note 53 at 3.26 – 3.31.

¹¹² See Financial Ombudsman Service, "Non-Disclosure in Insurance Cases" June 2005, 46 Ombudsman News

¹¹³ See *Horne*, *supra* note 30 at 367-68.

¹¹⁴ *Consumer Insurance Law*, *supra* note 67 at Part 6; *Consumer Insurance (Disclosure and Representations) Bill*, Clauses 2, 3, 4. See also Restatement of European Insurance Contract Law, *Principles of European Insurance Contract Law* (August 2009), Article 2:101; Article 2:102(3), online: <<http://www.restatement.info/>>; Cousy, *supra* note 23 at 126.

¹¹⁵ See *Drake Insurance Plc v Provident Insurance Plc* [2003] EWCA Civ 1834, [2004] 2 WLR 530.

- (a) the insured knows to be a matter so 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.”¹¹⁶

In *Permanent Trustee Australia Ltd v Fai General Insurance Co Ltd (in liq)*,¹¹⁷ the High Court of Australia described the effect of section 21 in the following terms:

The first matter to notice about s 21(1)(a) is that “every matter that is known to the insured” is qualified by the expression “being a matter that the insured knows ...”. The word “knows” is a strong word. It means considerably more than “believes” or “suspects” or even “strongly suspects.” And the matter, to answer the description that part (a) of the sub-section states, must be a matter that is not only “relevant to the decision of the insurer whether to accept the risk, and if so, on what terms,” but also one that the insured knows to be such a matter. The alternative for which part (b) of the sub-section provides, is also important: if the insured does not “know,” the question becomes, whether a “reasonable person in the circumstances” would “know [the matter] to be a matter so relevant.”¹¹⁸

The Court in *Permanent Trustee* held that the presence of the words “accept the risk” in s 21(1)(a) instead of phrases such as “to enter into the contract of insurance” or “to renew a contract of insurance” is significant.¹¹⁹ Whereas the common law “was generally concerned with materiality,” the *ICA* “is concerned with relevance.”¹²⁰ In that case, the Court addressed whether the insured was required to disclose its intention not to seek a future renewal of professional indemnity insurance during an initial application for renewal. In holding that the insured had not breached

¹¹⁶ *ICA*, *supra* note 35, s 21. In 2003, the Government of Australia commissioned a review of the *ICA*, and a draft bill incorporating the recommendations of the Review Panel was released in 2007. The Review Panel recommended that s 21(1)(b) be changed in order to read “(b) a reasonable person in the circumstances could be expected to know to be a matter so relevant, having regard to factors including, but not limited to: (i) the nature and extent of the insurance cover to be provided under the relevant contract of insurance; and (ii) the class of persons for whom that kind of insurance cover is provided in the ordinary course of the insurer’s business; and (iii) the circumstances in which the relevant contract of insurance is entered into, including the nature and extent of any questions asked by the insurer.” See <http://icareview.treasury.gov.au/content/_download/draft_legislation/draft_Bill.pdf> and <http://icareview.treasury.gov.au/content/Reports/FinalReport/_downloads/ICAFinalReport.pdf>

¹¹⁷ [2003] HCA 25, 214 CLR 514, 197 ALR 364 [*Permanent Trustee*].

¹¹⁸ *Ibid* at para 30.

¹¹⁹ *Ibid* at para 32.

¹²⁰ *Ibid*.

its disclosure duty, the Court distinguished between matters relevant to an assessment of the insured risk (such as the nature of the business activity) and matters of “commerciality” which have no bearing on the risk but may nonetheless influence the decision of the insurer to enter into the insurance contract.¹²¹ While the facts in *Permanent Trustee* do not involve life, accident or sickness insurance, the majority of the Court made the following statement on the scope of the disclosure duty as defined in the *ICA*:

To require an insured to disclose to an insurer every matter known to the insured, or reasonably knowable by the insured, relevant to the decision of the insurer to enter into a contract of insurance would be to impose an extraordinarily high burden upon an insured, indeed a burden that few insureds could ever fully discharge.¹²²

The *ICA* also limits insurers’ ability to rely on non-disclosure and misrepresentation defences by emphasizing the need for unambiguous questions that are relevant to the proposed risk in application forms. The disclosure duty arises only in relation to specific questions on application forms, including requests to disclose exceptional circumstances within the insured’s actual or constructive knowledge that are known to be relevant to the insurer in assessing the proposed risk.¹²³ As well, insurers are required to “clearly inform the insured in writing of the general nature and effect of the duty of disclosure.”¹²⁴ Failure to comply with this requirement may disentitle the insurer from alleging breach of the disclosure duty unless the insured’s breach was fraudulent. An insurer bears the onus of demonstrating steps taken to comply with the informational requirement.

The *ICA* gives insurers the option of voiding a contract only where non-disclosure or misrepresentation was fraudulent. Where the insurer chooses not to exercise its right to void a contract for fraudulent non-disclosure or misrepresentation, or where the breach was not fraudulent, the remedial options open to the insurer depends on the impact of the breach on the insurer’s underwriting decision. Where an insurer would have provided some coverage but perhaps on different terms, the insurer can revise the contract accordingly to reflect the terms and extent of liability it would have assumed under the contract had there been full disclosure or accurate representations; this is known as the proportionality

¹²¹ *Ibid.*

¹²² *Ibid* at para 33.

¹²³ *ICA*, *supra* note 35, s 21A. For a critique of this provision as unduly restricting the disclosure duty and potentially to the detriment of insurers, see Tay, *supra* note 19 at 198-99.

¹²⁴ *ICA*, *ibid*, s 22.

rule.¹²⁵ In the context of life insurance, where the insurer would not have entered into the contract had there been proper disclosure or accurate representations, the insurer is entitled to void the contract within three years of its commencement,¹²⁶ or vary the insurance amount to what it would have been had there been no breach upon giving written notice to the insured. The rectification remedy within three years of the coming into force of the contract is also available for non-fraudulent breach of the disclosure duty.¹²⁷ An insurer's assertion that it would not have provided coverage with full disclosure or accurate representation may be challenged based on the insurer's underwriting practices. An insurer could be compelled to give the insured or beneficiary access to its underwriting records through discovery.¹²⁸ The Australian Insurance Ombudsman Service specifically requires insurers alleging non-disclosure and misrepresentation to provide copies of their underwriting guidelines at the time of the contract in issue and examples of proposals for insurance in similar circumstances declined for similar reasons. A greater onus is placed on insurers where the non-disclosure relates to an unusual matter that is rarely the subject matter of specific questions in insurance application forms or guidelines.¹²⁹

The *ICA* gives courts the discretion to refuse avoidance of the contract in relation to a particular loss even in cases of fraudulent non-disclosure or misrepresentation if nullification would be harsh and unfair in the circumstances and the insurer has suffered no prejudice, minimal or insignificant prejudice from the breach.¹³⁰ As well, exercise of the

¹²⁵ See *ICA, ibid*, s 28. The Australian Insurance Ombudsman Service also applies the proportionality rule. The Insurance Ombudsman Service was established by the Insurance Council of Australia to provide dispute resolution services for amounts not exceeding \$280,000. Membership in the Ombudsman Service is optional for insurance companies. A significant number of insurers doing business in Australia are members of the IOS; see <<http://www.insuranceombudsman.com.au/pages/default.aspx?id=1&PageID=18>>.

¹²⁶ This may be contrasted with the situation in Canada where an insurer is entitled to nullify a contract within the first 2 years regardless of whether it would have been prepared to enter into a life or accident and sickness insurance contract with the insured but on different terms absent breach of the disclosure duty.

¹²⁷ See *ICA, supra* note 35, s 29; *Phillips, supra* note 29.

¹²⁸ See Hawke, *supra* note 81.

¹²⁹ Insurance Ombudsman Service (IOS), "Non-Disclosure and Misrepresentation", online: <<http://www.insuranceombudsman.com.au/pages/article.aspx?id=1&PageID=24&ArticleID=ArticleID2006215155232>>.

¹³⁰ See *Von Braun v Australian Associated Motor Insurers Limited*, [1998] ACTSC 122 (AustLII). The insured fraudulently misrepresented the value of the insured vehicle, resulting in over-insurance of the vehicle. The Court exercised its discretion under s 31 of the *ICA* to refuse nullification, noting that the misrepresentation in question

discretion depends on the extent of the insured's culpability and the loss he or she would suffer if the insurer is permitted to void the contract, bearing in mind the need to deter fraudulent conduct in the insured's relationship with the insurer.¹³¹ The *ICA* attempts to balance the competing interests of insureds and insurers while recognizing the vulnerability of insureds. At the same time, the *ICA* tries to avoid prejudice to insurers by essentially restoring insurers to the position they would have been in had there been no misrepresentation or non-disclosure. Insurers are not able to avoid liability after a loss has occurred when they would have provided coverage even with full disclosure and accurate representations. In commenting on the *ICA*, Hawke notes that it is "generally speaking a reasonably fair and sensible code...and is certainly more favourable to the interests of insured than is, for example, the English common law."¹³²

7. Conclusion

Private insurance is increasingly becoming an important aspect of financial planning in the neo-liberal state. Given the ubiquitous nature of private insurance, there is a tendency to conceive of insurance funds as quasi-public. It is therefore important for the law to facilitate access to insurance funds by those who have taken steps to seek financial security through the private market, specifically, insurance. Private insurance is not, however, a social security benefit available on the basis of criteria like citizenship or need. It is ultimately a voluntary agreement between insurers and persons who face common risks. Fairness to insurers and others in the insurance pool is critical to maintaining the financial sustainability of the insurance system and meeting legitimate expectations of stakeholders.

One mechanism for ensuring fairness within the insurance system is the obligation for applicants or prospective insureds to disclose and not to misrepresent material information. The purpose of the disclosure duty is to remedy the unequal access to information relevant for the proposed risk between the insurer and applicant or prospective insured. It allows insurers to fairly assess the proposed risk and make informed decisions about insurability and terms of the contract. As well, the disclosure duty promotes fairness to other policy holders and the viability of the insurance industry. The current position in Canadian common law jurisdictions on the scope of the disclosure duty, determinations of materiality and

only affected the extent of liability not acceptance of the risk. The actual difference in the purchase value was less than \$10,000. This would not have significantly affected the insurer's liability. As well, the misrepresentation did not create a moral hazard. Hence, any prejudice to the insurer was minimal and did not warrant nullification.

¹³¹ *ICA*, *supra* note 35, s 31.

¹³² Hawke, *supra* note 81 at 177.

remedies for breach, however, appears to favour insurers to the detriment of insureds. Such a position also disregards the power imbalance between insurers and insureds and the ways in which insurance products are marketed in contemporary society, which may exacerbate the vulnerability of insureds. There should be more emphasis on the mutuality of the duty of utmost good faith in insurance contracts. Insurers should be mandated to inform prospective insureds of the disclosure duty, although this will not necessarily give applicants an idea of the scope of the duty or factors the insurer considers relevant in the circumstances. The scope of the disclosure duty should be circumscribed, focusing on information specifically requested by the insurer, as well as on what a reasonable insured would know is material to the proposed risk, rather than the current reasonable insurer test. Nullification of the insurance contract for breach of the disclosure duty is a harsh remedy in many cases, especially since breach is often innocent. As well, allowing an insurer to void a contract regardless of whether it would have insured the risk on different terms with proper disclosure is unfair and inconsistent with the parties' reasonable expectations in the circumstances. It is particularly unfair to treat innocent and fraudulent breaches of the disclosure duty in the same way, subject to incontestability, as well as penalizing the insured for non-disclosure of information not specifically requested. This is especially true in light of pressures placed on individuals in the neo-liberal state to manage their own risk by relying less upon government schemes and more upon private ordering for financial security.

Variation of the insurance contract based on the proportionality rule is a reasonable response to innocent non-disclosure. Variation in these circumstances does not prejudice the insurer because revision allows it to achieve the same result as would have existed had there been no breach of the disclosure duty. Protecting innocent breaches will also have the additional benefit of avoiding the unfairness of nullification where the loss is totally unrelated to the breach of the disclosure duty. Insurers will not be compelled to provide coverage where they would not have done so had the risk in question been disclosed even if non-disclosure was in good faith. There is no advantage for applicants or insureds to risk breach of the disclosure duty because only innocent breaches will be protected. As well, good faith will be objectively determined. Deliberate or fraudulent breaches of the disclosure duty will still be punished with nullification and forfeiture of premiums paid even if there is no causal link between the risk that materialized and the misrepresented or concealed information. This should allay concerns about moral hazards or potential abuse by insureds, for example, by taking chances and hoping loss will be unrelated to the breach. Variation is also consistent with freedom of contract and the reality that disclosure of material facts, including unfavourable health conditions will not always result in denial of coverage. Rather, the insurer may still

provide some coverage but exclude some conditions, demand higher premiums and/or provide reduced benefits. Thus, the revised contract can still be considered a voluntary obligation assumed by the insurer. Further, variation of the contract as opposed to nullification in the event of a breach will encourage insurers to be more diligent in investigating responses in the application process prior to materialization of the insured risk. This will allow insureds to make alternative arrangements for financial security if it turns out that they are not insurable or cannot obtain the desired insurance amount because of their substandard risk status. It is also important for courts to have discretion to refuse nullification where the insured risks significant hardship and there will be little or no prejudice to the insurer. Although this could create uncertainty, encourage litigation and the risk of further financial losses by the insured or beneficiary should they lose the action, it will allow courts to at least consider the reasons for non-disclosure and whether dispensation is warranted in the circumstances.

Revision of the contract based on the proportionality rule to reflect what would have been the case had the non-disclosure not occurred is an insured-favourable position and consistent with the consumer protection rationale of insurance regulation. However, critics have rejected this approach as being complex: *ex post facto* determination of terms, premiums, and contract amount can result in increased litigation and administrative costs to insurers, and ultimately to other policyholders.¹³³ As well, critics have noted that the revised contract will be fictional and cannot be said to reflect the intentions of the parties as there is no guarantee that such a contract would have in fact been concluded with full disclosure.¹³⁴ Perhaps the insured would have chosen to order his or her affairs differently rather than accepting the contract on the revised terms. Notwithstanding these concerns, the proportionality rule is favoured in some jurisdictions and can be applied in Canada. It is fair from an insured's perspective as it avoids the all or nothing approach in the event of innocent breaches of the disclosure duty. A system that penalizes insureds for innocent breaches, even in respect of information not specifically requested and whose materiality the insured had no means of knowing, even based on an objective determination, can hardly be considered just. Variation also recognizes the vulnerability of insureds while preserving their reasonable expectations, and may be mandated by the mutuality of the duty of utmost good faith and the need for fairness between insurers and insureds. As already noted, variation of the contract is possible in Canadian common law jurisdictions in relation to misstatement of age in

¹³³ See UK Law Commission, *Insurance Law, Non-Disclosure and Breach of Warranty* (London: Her Majesty's Stationery Office, 1980, Law Com No 104) at 30 – 37, 42.

¹³⁴ See Norwood and Weir, *supra* note 12 at 379.

life, accident and sickness insurance contracts. Similarly, in Quebec, in the context of damage insurance, the proportionality rule applies where breach of the disclosure duty was not in bad faith and the insurer would have covered the risk even with full disclosure.¹³⁵ Finally, any prejudice to the insurer is minimal as it will not be compelled to offer coverage if the prudent insurer or in appropriate cases, the particular insurer would not have done so with full disclosure. Since other insureds could be similarly penalized by the current position of nullification in future claims, they should support the proportionality rule in relation to innocent breaches in situations where insurers would have still insured the risk in question. The changes suggested in this paper will help bring insurance law in Canadian common law jurisdictions into the twenty-first century and also ensure consistency with developments in other jurisdictions.

¹³⁵ See *Civil Code of Quebec*, LRQ c C-1991, Article 2411.