UTMOST GOOD FAITH – A BROKER'S VIEW
by Peter Madge

I speak as a UK broker handling retail business not reinsurance and mainly from a commercial business insurance point of view and as an insurance arbitrator and expert witness appearing in over 100 cases.

The present law on good faith was established a long time ago under different social, business and trading conditions. The prudent insurer test was formulated on the basis that underwriters did try professionally to underwite by reflecting the risks involved in the premium they charged. Underwriting standards were high and "lead" underwriters were respected by other underwriters. Competition was less intense and there was much more loyalty of an insured to his insurer than exists today. Shopping around for the cheapest price was not normally the name of the game. Nor was the underwriter hemmed in by such matters as investment income, cash flow, market share and market penetration.

I submit that in those days there *were* such things as prudent underwriters but I pose the question, how many such people exist today? If our market employs prudent underwriters assessing risks and premiums on a professional basis and qualified by training, experience, statistics and all the modern aids to underwriting how can it be that the insurers are making such heavy underwriting losses? Because as we all know they are not underwriting prudently. I submit that today the prudent underwriter is in danger of becoming a hypothetical person – like the reasonable man in the negligence cases he exists only in the text books and in principle – not in practice. But he appears from time to time in hard market conditions only to disappear in soft ones. Yet insurers still judge the insured by a prudent underwriter test when *they* are not applying it.

Consider the problems of the modern day underwriter:

1. He may be under pressure from his management to write for premium income or for cash flow or for market share;

2. or under pressure from his marketing department to enter into a new class of business where the underwriter has no expertise;

3. or to accept risks for commercial reasons which often override the prudent insurer test.

One of the unsatisfactory features of the insurance market in the last decade is that price has become the dominant theme, lip service is paid to policy cover, service, etc., but price is the determining factor, a price which is often inadequate. Losses arise, premiums are forced up and the market becomes hard for a while and then competition forces premiums down. We have the classical cyclical hard and soft market position with insurers coming in and out at what they believe to be the right moment. Those of us who went through the market crisis in the mid 1980s remember it well.

In this price war standards slip for both insurers and brokers as they fight to hold on to what they've got and acquire new business to repalce income lost by reduced premiums and commissions.

Underwriting Cycles

The cyclical nature of the insurance market with the cycles getting shorter each time they occur finds no support from any of the participants in the market place. Yet exist it does and against this unprofessional modern background the good faith principles are still applied. In my view that is unfair to the majority of insured's. Insurers and brokers drop their standards and often mislead the insured. They change the rules of the game except that rule relating to good faith.

I further submit that many insurance practitioners are unaware as to how unfair the present rules of non-disclosed have become. Applying the *C.T.I. v. Oceanus (Court of Appeal)* case a fact is material if it might have influenced the mind of a prudent insurer. thus althought a non-disclosed fact may *not* have influenced the mind of a particular insurer, he may nevertheless declare the policy void if he can produce evidence that it would have influenced the mind of a prudent insurer. Moreover it is not necessary to show that a prudent insurer would have declined the risk or increased his premium or taken some other special underwriting considerations like imposing a large excess. It is sufficient that it can be shown that the non-disclosed fact would have influenced him in forming an opinion. It seems to me that that test is far too harsh.

It is not difficult for an insurer to run a case on non-disclosure if he can find an underwriter to say that he, i.e. the prudent underwriter, would have considered the non-disclosed fact material. A judge unfamiliar with the workings of the insurance market might well be influenced by that expert opinion.

To prove my point, standard proposal form questions enquire about previous attitudes of other insuerers, have they increased the premium, did they decline the risk or

impose an excess or have other insurers refused to quote? In the text book sense these are all material facts.

I was recently involved as an insurance expert in a case where the underwriter underwrote a personal accident and sickness scheme in which he had no expertise but was attracted by a large premium and as the claims poured in and the losses mounted he looked for a way of declaring the policy void and cutting his losses. The broker had obtained quotations from other insurers who had all quoted more than the insurer who underwrote the risk. Moreover one insurer had refused to quote because he had no reinsurance facilities for accident and sickness shemes. The particular insurer said that these aspects should have been disclosed to him since they would have influenced his opinion and that of a prudent insurer. They illustrate where theory differs from practice.

In all the cases I have been involved with I must say that none of what I call the first division insurers have been involved. In my experience they usually play fairly by the rules and do not seek to apply the non-disclosure rules to the extent that the law at present would allow them to do. But it is not satisfactory that whether or not an insured's policy is valid should depend on the good will of the insurers.

It is often those insurers in the third division who take the non-disclosure points – and against whom the insured requires some protection. But times change. I have noticed recently that in the present climate of large underwriting losses even the first division insurers are raising points that they would never have taken years ago.

The Broker

How does all this affect the broker?

It is the broker's job to advise his client about the duty of disclosure and to make a fair presentation of the risk to the underwriter. A great many brokers overlook this simple point. Whilst the good broker will collect as much underwriting information as he feels the underwriter requires, not many in my experience put the stark question to the insured, and is there anything else material to the risk that you want to tell me? And in my experience nor do insurers' representatives themselves when they are dealing direct with an insured (all of which itself opens up the real problem of what is a material fact – what will a prudent insurer consider material – a theme I do not have time to develop).

As an industry we do not go out of our way to explain the principles of good faith to the insured or the consequences of not disclosing all material facts.

The broker is extremely vulnerable in periods of soft markets when standards slip, underwriters don't always ask the right questions – and in an era when soft markets have produced inexperienced underwriters – those who often don't know the correct question to ask as was the case in the Group Personal Accident Sickness Scheme. Faced with large underwriting losses insurers have to react. Claims are declined, litigation often ensues and the insured is often advised by his lawyers to sue his broker. This has been the situation in many of the disputes in which I have been involved – I must say in many cases with a high chance of success – because the broker has forgotten his duty to his client. He has not explained the principles of good faith.

But sometimes unfairly. Consider a recent case where I was involved where an insured was renovating new business premises and had employed contractors one of whom caused a fire. Insurers declined to pay declaring the policy void since there was non-disclosure by the proposer of a criminal conviction *thirteen* years previously for robbery which was not spent under the Rehabilitation of Offenders Act.

Although a proposal form was used:

1. Insurers did not ask a question about previous convictions; (why not if it was material?)

2. The insured did not consider it material;

3. It never occurred to the broker to enquire.

No wonder the insured felt that the insurance world had let him down.

Time for Change?

We must reconsider whether the present law is doing a disservice to the insurance industry. Should the prudent insurer test be replaced so that the particular insurer is judged by the standards of other underwriters experienced in the particular class of business who are:

1. Operating in the market at the time the risk was underwritten or renewed; or

2. The court be allowed to consider the underwriting philosophy purused by the particular underwriter at the time he underwrote the risk or at renewal (premium income – loss leader – market share)

3. The court to hear evidence as to what the market position was at the time – hard or soft;

4. The court to consider the particular insurer's expertise in the area of insurance involved;

5. And if a fact is to be material then the onus is on the insurer to show that a question was asked, e.g. the previous convictions matter.

When I entered insurance many years ago proposal forms were nearly always required. Then they fell into disuse. It may not be popular to say this but I believe brokers for the own protection – and also to enable them to do a more professional job – should consider again the use of proposal forms (of their own forms containing underwriting questions and answers) with a clear warning about the dangers of non-disclosure. And the broker ought to show to his client his submission to underwriters before he makes that submission – to make sure it is accurate. Many insured's have no idea what representations are made by their brokers to the market place.

Good Faith Applies Both Ways

Finally, a reminder that the good faith principle applies both ways. In *La Banque Financiere de la Cite v. Westgate Insurance Company (1990)* the House of Lords confirmed that the insured is entitled to expect that his insurers will act in good faith towards him. However, the insured's remedies should the insurer not do so *at the moment* are limited simply to having the policy declared void and to obtaining a refund of his premium, but not to sue for damages caused by the insurers' breach of good faith causing a loss to the client. In *La Banque Financiere* Lord Bridge of Harwich accepted the statement of the Court of Appeal that: "... the duty falling on the insurer must at least extend to disclosing all facts known to him which are material either to the nature of the risk sought to be covered or the recoverability of a claim under the policy which a *prudent insured* would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer." This is a development of enormous importance to insurers and one I hope we have the chance to discuss later.