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Tell All: Making A Case For More Dialogue In The Insurance Application Process

January 24, 2018 | | Insurance,Policyholder Protection

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Do nothing secretly; for Time sees and hears all things, and discloses all. – Sophocles Keeping secrets during the insurance application process is a bad idea. A policyholder who responds to application questions with incomplete or evasive answers to try to save a few dollars in premiums risks losing coverage altogether when those secrets are revealed. Conversely, by providing the underwriter with the information she needs to properly assess the risk, a policyholder is more likely to receive an insurance policy that meets its coverage needs. It behooves the parties to try to make the application process a cooperative exchange of information. But even among well-intentioned parties, a potential for disconnect exists. Each side looks at the information exchange from a different perspective. The policyholder knows the people, property or business to be insured, but may not know what type of information the underwriter needs to assess the risk. The underwriter knows the type of information she needs to assess the risk, but may know little about the people, property or business to be insured. Striking the correct balance of responsibilities in the information exchange can be difficult. **How did we get here? How disclosure obligations evolved** Nearly 100 years ago, the United States Supreme Court characterized insurance policies as traditionally being contracts "uberrimae fidei" (utmost good faith) in *Stipcich v. Metro. Life Ins. Co.,* 277 U.S. 311, 316 (1928). Under that view, the burden of disclosure fell primarily on the applicant, who was required to voluntarily disclose all known facts that materially affected the risk being insured regardless of whether the underwriter made a specific inquiry into such facts. Uberrimae fidei made sense when the insurance industry was in its infancy. When asked to insure a ship that might be half a world away, underwriters sitting in a London coffeehouse in the 1700s were completely dependent on the candor of the applicants' disclosures. They had no other way to obtain information about the thing they were being asked to insure. Indeed, in many United States jurisdictions, uberrimae fidei is still the law with respect to marine insurance, as Thomas J. Schoenbaum demonstrates in "Admiralty and Maritime Law." But in other lines of coverage, as insurers' sophistication and technology have evolved, legislators and courts have put more responsibility on the underwriter. Subject to a variety of limitations, most states still permit an insurer to avoid coverage upon showing that a misrepresentation in, or an omission from, an insurance application was "material" to the risk. Material in this context has been defined as information that would increase the insurer's exposure to the risk insured against or affect an underwriter's decision to issue coverage, the premiums, or the terms of coverage. If the information is material, only a minority of states require the insurer to also show that the policyholder acted with intent to deceive the

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insurer, in order to deny coverage based on a misrepresentation in the application. In a departure from uberrimae fidei, however, most states limit a policyholder's obligation to voluntarily disclose information. The prevailing rule in the United States is that, absent fraud, a policyholder has no duty to disclose information not specifically asked for in the application. But that rule is not universal and is subject to exceptions and qualifications. California, for example, historically required a policyholder to disclose private information it considers material to the risk, even if the underwriter did not specifically ask for the information in the application, creating an affirmative duty of disclosure to the carrier. See Cal. Ins. Code § 332, cf. *Gen. Acc. Fire & Life Assur. Corp., Ltd., of Perth, Scotland, v. Indus. Acc. Comm'n* (Cal. 1925) 237 P. 33, 37 ("an applicant is bound to disclose a fact material to the risk, even though no specific inquiry is made on that subject"). This duty has been relaxed in more recent case law. *Maryland Cas. Co. v. Nat'l Am. Ins. Co.* (Cal.App. 1996) 56 Cal. Rptr. 2d 498, 504 ("[W]here ... the insurer fails to question the insured, the latter cannot be said to have concealed facts so as to void the policy unless they are facts which he [or she] knows, or which a reasonable [person] should have known, to be material to the risk and unless he [or she] does so for the purpose of obtaining insurance which could not have been obtained after a disclosure of such facts.") (Internal quotations omitted.) In practice, it can be difficult to distinguish between a failure to volunteer information and a misrepresentation by concealment. The distinction can be particularly blurry where the insured knows, or should know, that the omitted information would affect the underwriter's decisions, where the policy contains provisions concerning the effect of a non-disclosure of information, or where the application makes a catchall request for all information the policyholder knows is material to the risk. In short, despite evolving legal standards, the scope of a policyholder's disclosure obligations is still often unclear. **Just the right amount of disclosure** An eight-year study of insurance disclosure obligations in the United Kingdom (the birthplace of uberrimae fidei), identified a number of problems stemming from the lack of clarity as to a policyholder's disclosure obligations, including:

- A disproportionate burden on medium and large commercial policyholders – which tend to have more information and greater decentralization – to identify information that might be material to the underwriter
- "Data-dumping" – i.e., the submission of large volumes of information to the underwriter no matter how trivial it might be
- The creation of a "market for lemons" by encouraging unscrupulous insurers to take shortcuts in the underwriting process so they can charge low-rate premiums and undercut their competition; and
- Post-claim underwriting by the insurer to try to avoid its coverage obligations

England's solution to these issues was to enact the Insurance Act of 2015, a sweeping statutory reform that replaced the strict uberrimae fidei disclosure rules with a duty of "fair presentation." Under that new standard, the policyholder fulfills its obligations by either disclosing all material circumstances known to it or by at least disclosing "sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances." As explained by the

English and Scottish Law Commissions “Insurance Contract Law” (July 2014), the intent behind this change was to encourage a dialogue between the parties: We think this should be central to the duty of disclosure. Good disclosure requires cooperation from both sides. The policyholder knows the facts; the insurer knows which facts are relevant. To provide an effective and efficient process, we think that insurers should see their role as assessing what they are told and asking further questions as appropriate. Because insurance law in the United States is exclusively a creature of state law, interstate insurance regulation and a uniform disclosure standard is unlikely in the United States any time soon. But in keeping with the spirit of the English reforms, there are things the parties can do to improve the information exchange. Perhaps the most important initial step an underwriter can take is to issue a detailed application. By asking questions on an application, the underwriter helps identify the information she needs to assess the risk. Once the application is returned, the underwriter should assess the information and ask further questions when necessary. A policyholder, typically through or with the assistance of a broker, can also facilitate a dialogue. For starters, policyholders should be aware of the significance of the application process. Incomplete or erroneous answers in an application may invite a coverage dispute, regardless of the applicant’s intent. When it’s not clear what information the underwriter is looking for, the broker should seek clarification from the underwriter. And even when the policyholder and broker think all requested information has been provided, it is usually a good idea to ask the underwriter whether she needs any additional information. Even if they don’t elicit a response, such inquiries can make it more difficult for the insurer to later try to avoid its coverage obligations based on information that was not provided during the application process. There is no magic panacea to prevent deceitful policyholders or unscrupulous underwriters from trying to take advantage of an information disconnect. But where the parties are well-intentioned, engaging in a dialogue can help ensure that the insurance application process is a cooperative information exchange that results in the policyholder getting the coverage it needs.