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Case note / Vonnisbespreking

Moral hazard as a material fact in the assessment of the risk

In the context of the law of insurance, moral hazard, also referred to as moral risk (see for example Peter Havenga 'The Financial Position of an Insured and Serious Threats of Physical Attack on Insured Property as Material Facts' (1995) 7 *SA Merc LJ* 110) generally refers to the financial position of the insured. In practice, however, hazard/risk refers to the 'serious financial difficulties' or 'poor financial history' of the insured, manifested in most cases by the insured's actual but in other cases factual insolvency. Questions which arise are whether this hazard/risk is a material fact which should be disclosed on conclusion of a contract of insurance (or on renewal, if the contract is renewable), and whether if this is not done the insurer can avoid liability on that basis.

In *Munns and another v Santam Ltd* 2000 (4) SA 359 (D) Tshabalala AJP held that moral hazard is a material fact which should be disclosed by the insured. Failure to do so provides a ground on which to avoid liability. His lordship said (at 367E):

> The defendant [insurer] clearly established that first plaintiff [insured] was technically insolvent. His financial position was material and should have been disclosed to the defendant. Information concerrning the financial position of an insured touches on the moral risk and the basis thereof is that the insured's financial position is regarded as touching on his whole personality.

As authority for this proposition the court referred to *Grusd v Norwich Union Fire Insurance Society Ltd* 1922 WLD 146 and *Van Zyl and Maritz NNO v SA Special Risks Insurance Association* 1995 (2) SA 331 (SE) (other cases holding that the financial position of the insured is material to the assessment of the risk are referred to by Havenga at 111). *Grusd v Norwich Union Fire Insurance Society Ltd* is, however, distinguishable from *Munns'* case because there the insurer had in a proposal form specifically asked if the insured had previously been declared insolvent or had made a compromise with his creditors. While the 'no' answer was initially correct it subsequently turned incorrect when the policy was renewed (it being renewable annually) as the insured's estate had since been provisionally sequestrated after which he entered into a compromise with the creditors. None of these facts had been disclosed when the policy was renewed. The court held that it was the duty of the insured on the date of renewal to disclose these facts because (at 152):

> The duty of disclosure attaches to the renewal of a policy to the same extent as to the making of the original policy; and the renewed insurance is equally liable to be avoided by reason of a breach of this duty.

David M Matlala, Senior Lecturer in Law, University of Venda for Science and Technology, Northern Province.

The approach of the court in the other case, namely *Van Zyl and Maritz NNO v SA Special Risks Insurance Association,* is not entirely satisfactory as it equates the insured's poor financial position with a potential to defraud the insurer without evidence that such is the case. Moreover, if there were to be some fraudulent activity on the part of the insured that would be sufficient ground on which to avoid liability. The most objectionable part of the judgment of Kroon J in the *Van Zyl and Maritz* case reads (at 361G-H):

> Where the insured is in the desperate financial condition as that in which the [insured] was, dangers such as that the insured might institute an inflated claim under the policy or might not take proper and reasonable steps to protect the property insured from any loss insured against, or might even himself deliberately cause damage to the property are, as in the case of the declared insolvent, just as real.

The English decisions on which the court in *Munns'* case relied deal mostly with the criminal record of the 'whole personality' of the insured or a spouse of the insured rather than his poor financial position (see *Woolcatt v Sun Alliance and London Insurance Ltd* (1978) 1 All ER 1253; *Lambert v Cooperative Insurance Society Ltd* (1975) 2 Lloyd's Rep 485 (CA)).

Regarding the duty of the insured to disclose material facts when taking insurance cover, the court in *Munns'* case quite correctly reiterated the general principle that it is the duty of a proposer for insurance to disclose any fact, exclusively within his knowledge, which is material for the insurer to know (at 366B). The court also said, once again correctly, that information material for the insurer to know is information that may influence his opinion as to the risk that he is undertaking and consequently as to whether he will take it or what premium he will charge if he does take it. Applying the reasonable man test the court said (at 366C):

> The test of materiality is that of a reasonable man, whatever the insured's own assessment of the fact in question is, that is if a reasonable man would recognise that it is material to disclose the fact in question, disclosure is required.

While following the correct approach and applying the correct reasonable man test, the decision nevertheless fails to address one critical point, namely, the manner in which the poor financial history of the insured would influence the opinion of the insurer to accept the risk, and, if so, the premium at which to provide cover. Does it mean for example that in property insurance the risk of damage, loss or destruction of property is high if the insured is a man of straw and low if the insured is well endowed with earthly possessions and that the premium must be determined accordingly if the risk is accepted at all? It is submitted that the financial position of the insured is not material to the assessment of the risk in property insurance much the same as it is not material to life insurance, where, generally speaking, the amount of cover involved is normally substantially higher. It is further submitted that the financial positition of the insured is a material fact where the subject matter of the insurance is the credit and more particularly the creditworthiness of the insured rather than his property.

The court's decision, which is submitted with much respect to be incorrect, seems to have been influenced by the personal circumstances of the insured and his demeanour as a witness rather than the more objective principles of the law. In this respect the court indicated a number of points which were a matter of much concern, including that the insured (at 367 A-D):

- had not been in gainful employment for about seven years preceding the insurance being taken out and had numerous judgments against him;
- on the date of the conclusion of the contract was unable to pay his debts and was technically insolvent with is liabilities exceeding his assets;
- was in dire financial straits and had to be helped by his 22 year old son;
- was less than candid in his testimony. He was evasive and had contradicted himself about his earnings;
- had lied before the magistrate about his assets. He had also lied to the Legal Aid Board about his earnings;
- had in another unrelated matter while giving evidence said that the important thing was to 'nail the insurance company' (at 364 D).

On these facts, said the court, the insured 'would not qualify for insurance as he had no other assets and he was in financial difficulties' (at 367C-D). More surprising though is the statement that (at 368A-B):

> [...] the moral hazard is of particular importance in the case of jewellery insurance because of the smallness and little weight of the jewellery and because in jewellery insurance there is often a lack of documentation and jewellery is very easily disposed of.

That being the case it is submitted that it is these and any other considerations, where applicable, which are material to the assessment of the risk and the determination of the premium rather than the moral hazard of the insured.