DUTIES OF INSURANCE INTERMEDIARIES: CONFRONTING THE LEGAL ISSUES

Introduction

This article will present briefly the legal relationship of an insurance intermediary with his/her principal. An understanding of this legal relationship will put into perspective many issues that are faced by both parties. The duties that are owed by one party to the other depend on this very basis. Thus, the remedies available when there is a breach of such duties are also similarly affected.

An 'agent' is defined as a person employed to do any act for another or represent another in dealings with third persons.[1] This other person is the 'principal' to the agent. In the context of insurance contracts, there are two types of intermediaries – an insurance agent and a broker.

An insurance agent is the agent for the insurer.[2] The role of insurance agents is mainly to procure business for the insurer. This they do by soliciting or obtaining new proposals for insurance and the renewal or continuance of existing policies. The principal for the insurance agent is the insurer i.e. the insurance company. This is despite the fact that many insurance agents may behave as if they represent their 'clients' who are in actual fact the proposers to the insurance contracts. The agent is not a party to the insurance contract.

The insurance broker[3] on the other hand, is the agent for the proposer/insured. The main function of the broker is to obtain the 'best deal' for the proposer by getting quotations from several insurers pertaining to the plan required by the proposer. Hence the principal to the broker is the 'client' i.e. the proposer. The broker acts on behalf of the

[1] Section 135 of the Contracts Act 1950.

[2] Section 2, Insurance Act 1996.

[3] Section 2, Insurance Act 1996.

proposer. The peculiarity lies in the fact that the insurance broker gets his commission from the insurer and not the proposer.[4] This does not change the fact that the proposer is the principal. In a reinsurance contract, the insurer then becomes the proposer and the reinsurer is the insurer.

Applicable Laws

The governing law on insurance intermediaries in Malaysia is a combination of local statutes, common law and English statutes. The main statutes are the Contracts Act 1950 and the Insurance Act 1996. Common law and relevant English statutes are 'imported' via the Civil Law Act 1956.

The duties of an agent towards the principal can be categorized into three classes. These fall under the fiduciary duties, duties under tort and contractual duties. Specific duties include the following:

(a) To act in good faith and in the interest of the principal.
(b) To act as per instructions.[5]
(c) To act with reasonable skill and care.[6]
(d) To receive or forward payment.[7]
(e) To communicate with principal.[8]
(f) To disclose material facts.
(g) To exercise utmost good faith.

The duty to disclose and the duty to exercise utmost good faith are actually that of the principal. Due to the fact that an agent acts on behalf of his principal, these duties are then to be exercised by agent as if he was the principal. This is especially pertinent because an insurance contract has an inherent requirement of utmost good faith or what is often cited as '*ubberimae fidei*'.[9]

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[4] Section 138, Contracts Act 1950 – No consideration is necessary to create an agency.

[5] Section 164, Contracts Act 1950.

[6] Section 165, Contracts Act 1950.

[7] Section 166, Contracts Act 1950.

[8] Section 167, Contracts Act 1950.

[9] Section 17, Marine Insurance Act 1906.

Fiduciary Duty

An agency is a special relationship. It creates an undertaking by the agent to act in good faith and in the interest of the principal. An agent owes a fiduciary duty to the principal by the very nature of this relationship. This duty is implied and need not be expressly stated. It is over and above contractual duties.[10] Where there is a conflict between the interest of the agent and that of his principal, the interest of the principal overrides his personal interest. A simple illustration is with regard to the type of coverage to recommend to the client versus the commission receivable by the intermediary.

Duty to Act as Per Instruction

Where the instructions are clear and precise, the agent has a duty to act as per instructions. This is because an agent is to act on behalf of the principal. Where the principal had instructed the agent, the agent is duty-bound to carry out the instructions. In the event of the absence of such instructions, the agent is bound to conduct the business of his principal according to the prevailing custom in the business of the same kind.[11] The agent is liable to the principal for any loss sustained as a result of the agent's failure to follow the principal's instructions.

In the case of *Fraser v. BN Furman (Production) Ltd,*[12] the principal had instructed the broker to obtain an employers' liability coverage from Eagle Star Insurance. The broker did not get the coverage. The principal's employee was injured and he was ordered to pay compensation. He could not claim as there was no policy in existence. He took legal action against the broker and succeeded. The Court of Appeal held the broker liable on the basis that there was a breach of duty.

An agent having authority to act on behalf of his principal has the authority to do every lawful thing necessary to carry out the instructions. Similarly, an agent having the authority to carry on a business has the authority to do every lawful thing necessary for the purpose or the

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[10] *Re Goldcorp Exchange Ltd* [1995] 1 AC 74.

[11] Section 164, Contracts Act 1950.

[12] (1967) 3 All ER 1.

usual course of conducting such a business.[13] In an emergency, an agent has the authority to take all necessary actions for the purpose of protecting his principal from loss. The agent must act in accordance with the standard of a person of ordinary prudence.[14]

Duty of Care

The intermediary owes a duty of care towards his principal. He is expected to act with reasonable skill and diligence. If the intermediary fails to so act, he may be liable for negligence. For an action in negligence to succeed, in addition to the duty of care, it must be proved that there was a breach of that duty and that the breach had resulted in damage or injury. The court will then determine whether or not there has been negligence. It is a question of fact for the court to determine.

In the case of *United Marketing Co. v. Hasham Kara,*[15] where the agent did not renew the fire policy despite instructions to do so, the court held the agent liable for the loss of goods damaged as a result of the fire. It was held that the agent had failed in his duty to act with reasonable skill and care.

In so far as 'advise' is rendered, the agent owes a duty of care towards the principal as well. He must exercise due care in giving such advise. It is better not to render such advice if the agent is not knowledgeable on the matter. However, as soon as he renders advice on a specific matter, he has a duty to ensure that he has exercised reasonable skill and care.[16]

In the case of *Superhulls Cover,*[17] the court stated that one of the general duties of an insurance broker is to use reasonable skill and care to procure the cover asked for expressly or by implication by the client. Should this be not possible, the broker must then revert to his client on the matter and seek alternative instructions.[18] In a situation where the

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[13] Section 141, Contracts Act 1950.

[14] Section 142, Contracts Act 1950.

[15] [1963] 1 Lloyd's Rep. 331.

[16] *Caparo Industries plc v. Dickman* [1990] 1 All ER 568.

[17] [1990] 2 Lloyd's Rep 431.

[18] Section 167, Contracts Act 1950.

client is not reachable at that moment, the broker must then proceed with the 'next-best' cover for the time being and the client is bound by that contract.[19]

In the case of *Harvest Trucking Co Ltd v. PB Davis Insurance Services,*[20] it was stated by the court that the extent of the duties depended on the circumstances of the case, including the particular instructions he had received from his client. The broker is to advise his client as to the type of insurance best suited to his requirement and must exercise reasonable care in obtaining such a coverage for his client. The client in this case had requested for cover against loss of goods and liability, which the client as bailees, might incur towards owners of fashion garments while the same were in the client's possession. The insurer had imposed a limiting provision. There was to be no cover for theft of property from the larger vehicles unless they are individually attended. This was not brought to the attention of the client. The risk occurred on the larger vehicle and the client could not claim from the insurer. An action was brought against the broker for professional negligence. The broker was held liable.

Similarly, in the case of *Mint Security v. Blair,*[21] the broker was instructed to obtain a cash in transit cover. This was accordingly obtained. The business expanded in the meantime. Upon renewal, the insurer was prepared to undertake only part of the enlarged risks. The broker failed to inform his client of the limitation. A loss occurred and the claim was unsuccessful. The broker was sued and was held liable by the court.

Another case which illustrates the lack of professional competence on the part of the broker is the case of *Cherry v. Allied Insurance Brokers.*[22] The brokers in this case had been handling the plaintiff's business for the past 50 years. The plaintiff was unhappy over the total premium due to the low claims record. Plaintiff instructed the brokers to terminate all policies as they intend to get new brokers. The new brokers arranged for the new policies. The brokers then informed the

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[19] Section 142, Contracts Act 1950.

[20] [1991] 2 Lloyd's Rep 638.

[21] [1982] 1 Lloyd's Rep 188.

[22] [1978] 1 Lloyd's Rep 274.

plaintiff that the insurer had refused to cancel the policies mid-term. Plaintiff then cancelled the new policies but did not inform the broker of that fact. Subsequently, the insurer agreed to cancel. The policies were then cancelled but plaintiff was not informed of it. The plaintiff was without any cover when loss occurred. The broker was sued for negligence and was held liable.

Duty of Disclosure

This duty arises from the element of utmost good faith or *ubberimae fidei* in a contract of insurance. This duty is imposed on both parties to the contract – the proposer and the insurer. As the intermediary, whether insurance agent or insurance broker, acts on behalf of his principal, the duty of disclosure is accordingly to be exercised by him as if he is the party concerned.

Lord Mansfield explained in the case of *Carter v. Boehm*[23] in 1766 the reason why utmost good faith is essential to a contract of insurance:

> Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie more 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 risqué as if it did not exist. The keeping back of such a circumstance is a fraud, and, therefore the policy is void... Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary...

If utmost good faith is not observed by either party, the contract may be avoided by the other party.[24] In other words, the contract becomes voidable, at the option of the other party. Therefore, if the broker in filling up the proposal form for his client, failed to disclose certain material facts like past claims and other risk factors, the insurer

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[23] (1766) 3 Burr 1905.

[24] Section 17, Marine Insurance Act 1906.

may avoid the policy. In such a case, a claim under the policy will fail should the insurer choose to avoid the policy. The broker, however, may be liable in negligence or for breach of contract as discussed above.

The effect of non-disclosure by the proposer is mentioned in section 149(4) of the Insurance Act 1996. The insurer is required to prominently display a warning that if the proposer does not fully and faithfully give the facts as he knows them, the policy may be invalidated.

The duty of disclosure on the proposer is stated in Section 150 of the Insurance Act 1996. A proposer shall disclose to the insurer a matter that the proposer knows to be relevant to the insurer. This relevant matter is linked to the decision of the insurer whether to accept the risk and the terms and rates to be applied. A more objective test of the reasonable man is also stated in the section.

There are several exceptions to the duty. A proposer need not disclose a matter that diminishes the risk to the insurer. If the proposer had installed an effective alarm system for his premises and this fact was not disclosed in his proposal for a burglary policy, the insurer cannot avoid the policy on the ground of non-disclosure. In reality the proposer/insured would have paid extra premium for the coverage.

A matter that is of common knowledge need not be disclosed. This is because if it is common knowledge, the insurer is deemed to know that fact. For example, the house is situated in a notorious area where break-ins are regularly reported. The fact that the proposer for a house owner/householder policy did not disclose that fact is inconsequential as it is common knowledge.

The third type of facts that need not be disclosed are those facts which the insurer knows or in the ordinary course of his business ought to know. A simple example would be the history of past claims. If the policyholder had made previous claims with the same insurer, the insurer knows or ought to know of that fact.

Finally, an insurer may sometimes waive the requirement of disclosure. In such a situation, the insurer cannot at a later stage allege that there was non-disclosure on the part of the proposer. For example, if the proposer was told that he only needs to give details of his previous hospitalization for the past one-year only. This means the insurer is

waiving the duty to disclose prior to that one-year period. Another waiver is statutorily imposed under section 150(3) of the Insurance Act 1996. This pertains to a situation where the proposer fails to answer or has given incomplete answers. If the matter was not pursued further by the insurer, such duty of disclosure is deemed to have been waived by the insurer.

The duty of disclosure on the insurer and insurance agent is stated in section 150(4)(b) and (c) of the Insurance Act 1996. The insurer shall not fraudulently conceal a material fact. In the case of an insurance agent, the agent shall not use any sales brochure or illustration not authorized by the insurer. Breach of this duty can result in a penalty of RM1 million. The contract of insurance becomes voidable at the option of the policy owner. This option however, is not an attractive option to the policy owner as he will then be left without any cover whatsoever.

Whose Agent?

Another issue that arises often is the fact that an insurance agent more often than not appears to act on behalf of the proposer. There have been cases involving the non-disclosure of the agent to the insurer even though the proposer may have informed the agent of the relevant facts. If the agent is the agent of the proposer, the act of non-disclosure is deemed to be that of the proposer. Thus, the insurer can avoid the contract. However, if the insurance agent remains the agent of the insurer, whatever facts the proposer had disclosed to the agent is deemed to have been disclosed to the insurer. The knowledge of the agent is deemed to be the knowledge of the insurer.[25]

Section 151, Insurance Act 1996 settled this issue. It is stated that an insurance agent is deemed for the purpose of the formation of the contract of insurance, to be the agent of the insurer. Therefore the knowledge of the agent is deemed to be the knowledge of the insurer. The statement made or act done by the insurance agent is also deemed to be that of the insurer's. This is notwithstanding the fact that the agent may have contravened section 150(4), i.e., used unauthorized brochures or illustrations, or other provisions.

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[25] *United Oriental Insurance v. Mazzarol* [1984] 1 MLJ 260; *Syarikat Uniweld Trading v. The Asia Insurance Co. Ltd.* [1996] 2 MLJ 160.

The first exemption from the above provision is when there is collusion or connivance between the insurance agent and the proposer. However, the burden lies on the insurer to prove this. The second exemption is where the insurance agent has ceased to be the insurer's agent and the insurer has taken all reasonable steps to inform or bring to the knowledge of potential policy owners and the public in general of the fact of such cessation. An advertisement in the major newspapers on the matter would suffice.

The consequence of a notice given to an agent is also stated in section 182 of the Contracts Act 1950. Such notices given to or information obtained by the agent in the course of the principal's business, have the same legal consequence as if he were the principal.

Where the broker fails to disclose material facts on behalf of his client, the insurer is entitled to avoid liability based on the said non-disclosure or misrepresentation. In the case of *Dunbar v. A & B Painter Ltd & Ors,*[26] the broker in filling up the proposal form had made several serious misrepresentations regarding the increased premiums and two previous claims under an earlier policy. The misrepresentations were made in the attempt to get the 'best' rate for their client. The claim against the insurer naturally failed on the ground of misrepresentation.

Duty to Receive Payment[27]

The concept of 'cash before cover' generally applies to general insurance. Premium received on behalf of the insurer is deemed to have been received by the insurer. The burden lies on the insurer to prove that the person is not authorized to receive such payment on its behalf. This is stated in section 141 of the Insurance Act 1996.

It is the duty of the agent who had received payment on behalf of the insurer to remit it to the said insurer within the prescribed period. This is stated under section 141(3). Failure to do so attracts a penalty of RM500,000.

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[26] [1986] 2 Lloyd's Rep 38.

[27] Sections 166 & 174, Contracts Act 1950.

Principal's Duty to Agent

As stated under section 141 of the Contracts Act 1950, an agent authorized to do an act or carry on a business by the principal, has the authority to do or take all necessary actions to carry out his duty. In such an event, the principal is bound to indemnify his agent against the consequences of all lawful acts done by the agent.[28] The principal is equally liable against consequences of acts done in good faith by his agent.[29]

Conclusion

It is doubtless that the duties of an intermediary, whether an agent or a broker, are onerous indeed. It carries with it the possibility of being liable for the loss suffered by the principal. Professional indemnity coverage for intermediaries is increasingly crucial to ensure the survival of intermediaries. This is especially so in the light of cases where the intermediary were held liable for the loss suffered by their principal. At present, there is no requirement for insurance agents to have professional indemnity coverage. Brokers are, however, required to have professional indemnity coverage. Perhaps it is high time for such a requirement to be introduced by the Central Bank.[30]

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[28] Section 175, Contracts Act 1950.

[29] Section 176, Contracts Act 1950.

[30] Section 3, Insurance Act 1996 – the Central Bank oversees the implementation of the Insurance Act 1996. The Governor of the Central Bank is also the Director General of Insurance in Malaysia.

STATELESS AND ABANDONED: THE FOUNDLING IN MALAYSIA

Citizenship denotes allegiance as well as a sense of belonging to a country. In return for such allegiance, certain benefits are conferred exclusively on citizens of the country. A person who is not a citizen of any country is a stateless person. Having no citizenship in a country, she is a perpetual alien, even in her country of origin and domicile. A stateless person has been likened to a vessel on the open sea not sailing under the flag of a state, or a bird that flies alone.

A foundling, namely an abandoned child of unknown parentage, suffers a plight similar to that of a stateless person. Helpless and unable to fend for herself, she is cast out into the unknown, without the protection of a family. The child's problem is compounded when she is also stateless. A child experiences tremendous rejection when abandoned by her family. Having been rejected by those who should have nurtured and protected her, the stateless foundling then faces a second hurdle – the rejection by her country as an alien. The denial of equality with others around her who enjoy the status of citizenship is akin to rubbing salt in the wound of a foundling. To a child, such rejection may be difficult to comprehend. Such rejection of a foundling also runs contrary to the conscience of a caring society.

The stateless foundling in Malaysia is no exception. She encounters substantial hardship in various aspects of ordinary life. The problem of statelessness is, however, one which may be alleviated. Citizenship is granted to foundlings in a variety of situations and jurisdictions to prevent the hardship caused by statelessness. In Malaysia, the issue of a foundling's statelessness has been addressed to some extent. An examination of the law relating to citizenship in Malaysia enables the position of the foundling to be better understood.