



COMBINED INSURANCE COMPANY OF AMERICA

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**THE IMPORTANCE OF UNDERSTANDING
CONTRACT LAW WHEN SELLING LIFE AND
ACCIDENT AND SICKNESS INSURANCE IN
THE COMMON LAW PROVINCES**

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CONTINUING EDUCATION ON THE WEB
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INTRODUCTION

The Law(s) of Contracts

A contract is an agreement between two or more parties and is based upon an exchange of promises to perform certain activities in the future.

Most often, contracts involve an agreement for the exchange of goods and/or services, or the provision of goods or services in exchange for payment. The obligations taken on by either, or both, parties under the contract are legally enforceable by the courts.

Example: Jim contracts with John, for John to build a wooden deck on the back of Jim's house. John promises to provide all materials and labour and to build the deck to Jim's specifications, within an agreed-upon time. Jim promises to pay John the sum of \$2,500 upon the satisfactory completion of the deck.

LEARNING OBJECTIVE

For the a student to have a working knowledge of the legal issues relating to the formation and execution of a contract of insurance and the responsibilities of an agent to effectively discharge his or her responsibilities to both the insurance company and the prospective policyowner.

Contracts may be governed by common law, civil law, statute law and/or the law of contracts.

Common law governs contracts in the provinces and territories outside of the province of Quebec. Common law is derived from the English form of law and is based upon a series of precedent cases decided in the courts of law.

Common law is progressive in nature, in that, over time, existing cases are guided by rulings made in earlier, precedent cases, but the courts, in light of current thinking and differentiated circumstances, may modify those rulings.

Civil law is the system of law used in the province of Quebec and is based upon the *Civil Code* of France, a codified (statutory) set of laws (rather than a series of precedent court decisions).

Statute law is a law or an act that expresses the will of a legislature or parliament. Criminal law (The Criminal Code of Canada) is an example of statute law.

The law of contracts is the branch of private law dealing with the drafting, interpretation and enforcement of contracts between individuals. This is in contrast to the **law of torts**, which deals with a wrong or injury (other than a breach of contract) for which a recovery of damages is permitted by law.

Example: If one day John strikes Mike and breaks Mike's arm, causing him to lose time off work, Mike could sue John for his *tort* (harmful act). It is not likely that Mike could sue John under *contract law*, because it is highly unlikely that there would be a contract (formal agreement) between the two to the effect that that one would not strike the other.

In general, contracts may be either oral or written and both forms may be legally binding.

The Uniform Life Insurance Act

The concept of a *Uniform Life Insurance Act* (“*the Act*”) does not actually exist as a single statute, either federally or provincially. Rather, the title refers to a series of provincial statutes dealing with contracts of life insurance issued within the jurisdiction of each province and territory, with the exception of the province of Quebec.

The statutes are generally uniform (hence the name) and can, for the most part, be considered as if they were one, homogeneous law.

Although Quebec has not adopted the *Uniform Life Insurance Act*, its statutes dealing with life insurance are similar to the Act in most respects.

Documents Forming a Life Insurance Contract

As noted earlier, the documents comprising a life insurance contract (the “entire contract”) are stipulated under the *Uniform Life Insurance Act* and consist of:

- a) the application;
- b) the policy;
- c) any document attached to the policy when issued; and
- d) any amendment to the contract agreed upon in writing after the policy is issued.

The latter would include riders, exclusions, amendments, and any additional benefits added to or deletions from the standard policy coverage.

Parties to a Life Insurance Contract

Before proceeding to a discussion of the contractual rights and obligations of the various parties to a contract of life insurance, a brief review of the definition of the various parties involved is in order.

<p>NOTE: <i>The definitions found in this module are those found in the Uniform Life Insurance Act, the Ontario Act in particular.</i></p>

The following definitions will be analyzed with reference to the following situation:

Tony purchased a five-year renewable term policy from the Acme Life Insurance Company, on the life of his wife, Maria. The policy has a face amount of death benefit coverage of \$100,000 and requires an annual premium payment of \$800.

Insurance “means the undertaking by one person to indemnify another person against loss or liability for loss in respect of a certain peril to which the object of the insurance may be exposed...” For purposes of the Act, the term “insurance” is expressly defined to include life insurance. Of course, for purposes of this course, the “person” who provides the insurance is not a person at all but, rather, a life insurance company.

Example: The five-year renewable policy that Tony purchased is an insurance contract.

Life insurance means an undertaking by an insurance company to pay insurance money,

- a) on death, or
- b) on the happening of an event or contingency dependent on human life; or
- c) at a fixed determinable future time; or
- d) for a term dependent on human life, and, without restricting the generality of the foregoing, includes,
- e) accidental death insurance, but not accident insurance;
- f) disability insurance; and
- g) an undertaking entered into by an insurer to provide an annuity”.

Example: Tony’s policy pays out a death benefit in the event of Maria’s death, so it is a *life insurance* contract.

The insurer “means the person who undertakes or agrees or offers to undertake a contract” of insurance. For the purpose of this course, the “person” in this case is the life insurance company.

Example: The Acme Life Insurance Company is the *insurer* of Tony’s policy.

The **insured** “means the person who makes a contract with the insurer.” Because life insurance policies are transferable, the insured under a given policy at any given point in time might not be the person who originally contracted with the insurer.

Example: Tony, as owner of the life insurance policy, is the *insured*.

The **life insured** is the person upon whose life the contract of insurance is based.

Example: Maria is the *life insured* under the policy.

A **premium** “means the single or periodic payment under a contract for insurance...” The premium is generally paid by the insured to the insurer and is compensation to the insurer for the risk assumed and administrative costs of undertaking to provide the insurance.

Example: The annual premium payable under Tony’s life insurance policy is \$800.

Insurance money “means the amount payable by an insurer under a contract....”

Example: The death benefit of \$100,000 is the *insurance money* payable under Tony’s policy.

The **beneficiary** of a life insurance contract “means a person, other than the insured or his personal representative, to whom or for whose benefit insurance money is made payable in a contract or by a declaration.” Technically, the insured and the estate (legal representative) of the insured cannot actually be beneficiaries under a life insurance contract, although the insurance proceeds may be payable to the insured or to the insured’s estate.

Example: Technically, as the insured under the policy, Tony cannot also be the beneficiary (from a legal perspective), but he is the person to whom the \$100,000 death benefit is payable in the event of Maria’s death.

The beneficiary is not a legal party to the contract.

Types of Life Insurance Contracts

Life insurance contracts can be categorized into three basic types:

- **Two-party contracts**, where an individual insures his or her own life.

Example: John takes out a life insurance contract, on his own life, with the Acme Life Insurance Company.

The two parties to the contract are the insurer and the insured (who is also the life insured).

- **Third-party contracts**, where an individual insures the life of another.

Example: John also took out a life insurance contract on the life of his son, Daniel, with the Acme Life Insurance Company.

The three parties to the contract are the insurer, the insured and the life insured.

- **Group insurance contracts**, where an organization (usually an employer) contracts with an insurance company to insure the lives of the members of the group (its employees).

Example: John is also a member of the group life insurance plan where he works. His employer, the Ralston Realty Company, has contracted with the Acme Life Insurance Company to provide life insurance coverage on the lives of its employees (of whom John is one), under the terms of a group policy.

Group insurance contracts are always third-party contracts, because the insured is always going to be different than the persons whose lives are insured. The three parties to the contract are the insurer, the insured organization and the lives insured/group members.

LEARNING OBJECTIVES

Upon completion of the material on insurance contracts, the student will understand:

- The essential elements of forming a contract;
- The requirements for a valid insurance contract;
- The steps involved in the issuance of a life insurance contract;
- The characteristics of a life insurance contract; and
- Contract remedies.

REQUIREMENTS OF A VALID LIFE INSURANCE CONTRACT

Essential Elements of a Valid Contract

To be legally valid (enforceable by the courts) a contract must, minimally, meet all of the following requirements:

OFFER AND ACCEPTANCE

A contract involves an agreement, a “meeting of the minds.” The parties to the contract must agree on the specific rights and obligations of each party under the contract. First, a process of offer and acceptance must be entered into: one party must offer to enter into a contract with the other and the other party must unconditionally accept that offer.

The acceptance must be communicated to the offeror and the offeree (to whom the offer was made) must accept the offer in full, without condition.

Example: In the course of the sale of a house, the advertisement for sale does not constitute an offer, it is merely an invitation to enter into negotiations. If an interested party tenders an offer to purchase to the vendor, this becomes the first offer. If the vendor signs back the offer without change, this becomes acceptance of the offer and the parties are deemed to have contracted. However, if the vendor signs back the offer with conditions (a higher price, a different date of possession, etc.), this becomes not an acceptance of the original offer, but a counter offer. It is only when the parties agree to terms without conditions that the process of offer and acceptance has been completed and a contract has been struck.

In the case of a life insurance contract, the presentation of a sales presentation or a product illustration to a prospective buyer does not constitute an offer, but rather an invitation (also called an “invitation to treat”) for the prospective applicant to tender an offer to the insurer.

When a prospective purchaser completes and submits an application form for insurance, that is the first offer entered into by the parties. The completion of a temporary insurance agreement does not constitute acceptance of that offer, because the validity of the temporary insurance agreement is dependent upon among other things) the insurer being willing to issue the policy as applied for, after completion of the underwriting process.

The applicant's offer can be considered to have been accepted once the approved policy has been issued and delivered to the applicant. If the policy is delivered subject to conditions (e.g., completion of an Aviation Questionnaire), the process is not complete until the questionnaire has been completed and accepted by the insurer.

Only when there are no longer any outstanding requirements can the contract of insurance be said to have been completed.

COMPETENT PARTIES

For a contract to be valid, the parties to the contract must have been legally competent at the time of execution of the contract.

Both parties must have been of the legal age of majority. For most contracts (except contracts for the necessities of life, e.g., food, shelter, medical care, etc.), the legal age of majority in Canada is either 18 or 19, depending on the jurisdiction.

In the case of a contract of insurance, the legal age of majority is 16 (although a person under the age of majority (18/19) cannot give a discharge for his or her interest in the proceeds, e.g., death benefits, for example, under an insurance policy).

Policies entered into by a minor are void, but may be ratified by the minor, in writing, once he or she reaches the age of majority. In the meantime, a contract entered into by a minor can be enforced *by* the minor, but cannot be enforced *against* the minor by the other party.

In addition to being of legal age at the time of execution of the contract, the parties must be otherwise legally competent and entering into the contract of their own volition. In other words, the parties must be of "sound mind" and not under the influence of drugs or alcohol at the time of contracting.

LEGAL PURPOSE

To be valid, contracts must be for a legal purpose. Contracts binding the parties to commit illegal acts, such as a bet or a crime, are not legally enforceable.

In the case of a life insurance contract, the general purpose of the contract is, of course, legal.

The exception to this would be a contract taken out on the life of a person in whom the insured has no insurable interest. Although the purpose of the contract may be, technically, legal, the *Uniform Life Insurance Act* specifically prohibits the issuance of a life insurance contract in circumstances where there is no insurable interest (see Insurable Interest later in this module).

AN ABSENCE OF FRAUD OR MISREPRESENTATION

The parties to a legal contract must have a “meeting of the minds” with regard to the terms and conditions imposed on each under the contract. If one party or the other has a misunderstanding or misconception regarding the terms of the contract that, in itself, will usually not be enough to void the contract, unless the misunderstanding was created by some misrepresentation or fraudulent representation by the other party to the contract.

In the case of insurance contracts, as we have seen, if there has been a misrepresentation of a material fact in the underwriting process, the insurer has the option to avoid the contract, provided the misrepresentation is discovered within two years of policy issue.

If the misrepresentation was fraudulent (intended purposely to mislead the insurer) the insurer has the right to avoid the contract at any time.

CONSIDERATION

A contract is not legal unless it involves an exchange of consideration (something of value).

The consideration under a contract might be an exchange of services, an exchange of goods, or an exchange of goods and services. Most frequently, the exchange of consideration is an exchange of goods or services for money.

<p>Example: Ted agreed to sell his house to Mary for \$225,000. Ted’s consideration under the contract was the delivery of title to the house. Mary’s consideration is a cheque for \$225,000.</p>

In the case of an insurance contract, the consideration provided by the insurer is the promise to pay the policy benefits at a future date upon the happening of a future event (death, disability, policy surrender, etc.). The insured’s consideration is the periodic premiums paid to the insurer, over the life of the contract.

The exception to the consideration requirement occurs when contracts are executed under seal. Affixing a seal to the contract solemnizes the promise (or promises) made under the contract and validates it, even in the absence of consideration from both parties.

Generally, contracts are not valid until consideration has been paid or promised. Some insurance contracts (such as automobile or homeowner’s insurance) are valid from the moment of agreement (under a *binder*), even though the consideration (the policy premium) has not yet been paid.

In the case of life or disability insurance, COD contracts are not binding upon the insurer until at least the first month’s premium under the policy has been paid.

Example: Hanif applied for a \$100,000 term insurance policy on his own life, with the proceeds payable to his wife. At the time of application, Hanif was a bit “cash short” because he had just booked a business flight to India. He told his agent that he would pay the first premium on a COD basis, when an issued policy was delivered to him, upon his return from India. Unfortunately, Hanif died of a heart attack while in India. Even though Hanif’s \$100,000 insurance policy had been approved in the interim, there were no benefits payable to his wife, because the “policy” was void for lack of consideration.

The Steps involved in the Execution of a life Insurance Contract

Most contracts involve a simple process of offer and acceptance. The completion of a life insurance contract involves a fairly complex series of steps along the way, because a life insurance policy is not merely *bought* (as a GIC might be) but is *sold* and is subject to an approval process by the insurer:

- First, the insurance company, through an agent, solicits an offer from a prospective client, by way of a sales presentation.
- Next, an interested prospective policyowner completes an application form (an *offer*), requesting the issuance of a policy.
- The application must be approved for issue by the insurer. Alternatively, the insured could reject the offer (decline the application) or make a counter offer subject to specified conditions (issue a policy subject to additional requirements, exclusions or modifications).
- Once issued, the policy must be delivered to the applicant (usually personally, by the agent) for acceptance. The policy delivery constitutes the insurer’s acceptance of the applicant’s offer.
- Even after delivery, the policyowner usually has a 10-day period in which to decide to accept or reject the issued policy, called the *right of rescission*. If the policyowner decides to reject the policy, he or she can avoid the contract, return it to the insurer for cancellation, and request the return of any premiums paid to date under the policy.

Characteristics of a Life Insurance Contract

Certain characteristics found in all life insurance contracts are peculiar to insurance contracts:

Most contracts are bilateral: they bind both parties to the contract to a promise or series of promises. Life insurance contracts are *unilateral*: they bind only the insurer. Generally, the insured (the policyowner) has only one obligation under a contract of insurance: to pay the premiums when due. If the insured chooses not to meet this obligation, the insurance company has no right to compensation or to compel the insured to pay the premium. The insurance company’s only recourse is to cancel the policy.

The earlier definition of a contract spoke of a mutual agreement between the parties to the contract. Most contracts involve an element of bargaining, a give and take between the parties before the terms and conditions of the contract can be agreed upon. Life insurance contracts are contracts of *adhesion*, meaning that one party (the life insurance company) sets the terms and conditions of the contract and the other party (the applicant), if it wishes to contract, must accept those terms and conditions in their entirety.

Insurance companies must take care in drafting the wording of their insurance contracts, so that the language used does not create ambiguity. In any lawsuit that revolves around a question of the meaning of a term or condition contained in a contract, the principle on *contra proferentem* applies. In cases where one party is an acknowledged expert in a given subject and had drafted the documentation (contracts, warranties, etc.) in relation to that subject, the assumption is that the expert has a decided advantage over an inexperienced third party, and so the expert is held to a higher standard of proof and care under the contract.

In short, the insurer, being the expert in the field of life insurance and having drafted the contract, will be held responsible for any ambiguity and the courts favour, when in doubt, will fall upon the insured.

Insurable Interest

A person cannot purchase life insurance on the life of another on a whim or as a mere *bet*. The purpose of life insurance is to compensate the beneficiary for losses that would be incurred in the event of the death of the life insured. These losses might take the form of actual expenses triggered by the death of the life insured (a parent having to pay funeral expenses for a deceased child), or obligations triggered as the result of the death (a requirement to buy out a deceased partner's business interest, under a buy/sell agreement) or lost support to someone who was financially dependent upon the deceased (proceeds to provide income replacement payments to a wife and mother who relied upon the income of her deceased husband).

This relationship between the life insured and the beneficiary of a life insurance policy is known as *insurable interest*.

In fact, under the *Uniform Life Insurance Act*, there is a provision that, "...where at the time a contract would otherwise take effect the insured has no insurable interest, the contract is void." Although the Act does not specifically define the concept of "insurable interest," it does recognize circumstances in which an insurable interest exists:

“Without restricting the meaning of the expression ‘insurable interest,’ a person has an insurable interest in his own life and in the life of,

- a) the person’s child or grandchild;
- b) the person’s spouse;
- c) any person upon whom the person is wholly or in part dependent for, or from whom the person is receiving, support or education;
- d) an employee of the person; and
- e) any person in the duration of whose life the person has a pecuniary interest.”

There is, however, an exception to the insurable interest rules under the Act, in that a contract is not void for lack of insurable interest if, at the time of contracting, the life to be insured consented in writing to insurance being placed on his or her life. Consent, on the part of the life to be insured, is normally obtained by having the life to be insured sign the application for insurance. In circumstances where the life to be insured is a minor, the signature of a parent or guardian would constitute consent.

In practice, a life insurance company will not issue a contract unless the applicant can establish an insurable interest in the life to be insured.

The issue of insurable interest only arises at the time of issue of the contract. If the relationship between the insured and the life insured subsequently changes, such that a relationship of insurable interest no longer exists, the contract remains valid. In fact, if after issue the policy is transferred from the original insured to a new owner who has (or never had) no insurable interest in the life insured, the policy remains valid.

The Concept of a Legal Signature on a Life Insurance Application

Applicants for life insurance (and the prospective life insured, if different) will be required to sign the application form, often in several places. If a life insurance policy is ultimately issued, the application form will become part of the resulting contract of insurance.

As such, these signatures will have significant legal weight and consequence and should not be undertaken lightly.

DEFINITION

A person’s legal signature is a handwritten (not hand printed, typewritten or otherwise mechanically printed, or reproduced by mechanical means, e.g., a stamp) version of the person’s legal name, e.g., John Quincy Adams, written by himself or herself.

If a person is illiterate and unable to write his or her own signature, the affixation of the person’s mark (X), underscored with a printing of his or her legal name (by a third party), will usually suffice as a legal signature.

IMPORTANCE OF A LEGAL SIGNATURE ON A LIFE INSURANCE APPLICATION

In signing the application form, the applicant is certifying that the information included therein (including answers to the non-medical portion of the application) are true and complete.

This could become critical if there is a question of material misrepresentation or fraud in the completion of the application. As noted earlier, insurer's can avoid a contract if they act within two years after policy issue, in the case of a material misrepresentation, or at any time, in the case of fraud.

Determination of misrepresentation or fraud will be based upon the information provided (or left out) by the applicant/life insured on the application form. In signing the application form the applicant is certifying the information included on it (even if the applicant does not read the answers written in by the agent prior to signing the form) and can be held legally responsible for its contents.

SIGNATURE OF THE APPLICANT

In addition to attesting to the truthfulness of the information contained within the application, the applicant will also generally be signing a permission form, allowing the insurance company to solicit medical, financial and other information about him or her from the Medical Information Bureau, from the applicant's physician(s), from investigators, and from various other sources.

SIGNATURE OF THE LIFE INSURED

If the life insured is a third party (not the applicant), he or she will also be required to sign the application. In signing the application the life insured is attesting to the truthfulness and completeness of his or her statements on the application as well as signing a permission form, allowing the insurance company to solicit medical and other information about him or her from the Medical Information Bureau, from the life insured's physician(s), from investigators, and from various other sources.

If the life insured is a minor, the signature of the minor's parent or guardian will be required, instead of the signature of the minor.

WITNESS TO THE SIGNATURE(S)

Signatures on the application form must be witnessed and the witness must also sign.

Unlike the signature of the applicant, the witness's signature is not attesting to the validity of the contents of the application. The witness is merely verifying the signature of the applicant (and/or the life to be insured).

Legally, the witness must be of legal age (age 18 or 19, as the case may be, in the provinces and territories of Canada) and must be mentally competent. In theory, anyone meeting these criteria could act as a witness (except, of course, the applicant or life to be insured signing the application form). Most typically, the witness to these signatures will be the agent taking the application.

Required Contents of a Life Insurance Policy

The *Uniform Life Insurance Act* also specifies the type and extent of the information (minimally) that must be included in the life insurance policy itself:

“An insurer shall set forth the following particulars in the *policy*:

1. The name or a sufficient description of the insured and of the person whose life is insured.
2. The amount, or the method of determining the amount, of the insurance money payable, and the conditions under which it becomes payable.
3. The amount, or the method of determining the amount, of the premium and the period of grace, if any, within which it may be paid.
4. Whether the contract provides for participation in a distribution of surplus or profits that may be declared by the insurer.
5. The conditions upon which the contract may be reinstated if it lapses.
6. The options, if any,
 - a) of surrendering the contract for cash;
 - b) of obtaining a loan or an advance payment of the contract money; and
 - c) of obtaining paid-up or extended insurance.”

The policy may (and typically will) include much more information than this (future premium schedules, guaranteed cash surrender value schedules, extended term option schedules, etc.) but the list represents the minimum information that must be included in the policy, where appropriate.

Rights of Parties to the Life Insurance Contract

The various parties to any life insurance contract (insurer, insured, etc.), have certain legal rights under the contract, as prescribed under the *Uniform Life Insurance Act*:

RIGHTS OF THE INSURER

As noted previously, a life insurance contract is unilateral. Once the contract has been issued, and provided that the insured keeps the contract in force, the insurer is more in a position of being required to perform obligations, rather than of enforcing rights.

The few rights that the insurer does have are limited to the following:

- The right to charge interest in various situations (policy loans, for example).
- The right to apply dividends or bonuses declared for the purpose of keeping the contract in force, unless the insured has stipulated otherwise.
- The right to deduct any premiums due out of the death benefit or cash surrender value benefits payable.
- The right to be furnished with the required proof of claim before payout of the sum insured.

These rights are granted under the *Uniform Life Insurance Act* and may, in some cases, be augmented with additional rights stipulated in the contract.

The purpose of all of these insurer rights is to enable the insurer to conduct its business efficiently, without needless involvement in litigation.

RIGHTS OF THE INSURED

Earlier we discussed the fact that an insurance contract is a unilateral contract: all the responsibilities and obligations rest with the insurer and all the rights rest with the insured.

The insured (policyowner) has the right to cancel the contract at any time and to receive the net cash surrender value (if any). The insurer, on the other hand, must keep the policy in force for as long as the contract provides and the insured wishes – so long as the policy premiums continue to be paid.

In addition to the right of surrender, the insured has a wide variety of other rights:

- The right to name a beneficiary under the policy.
- The right to change the named beneficiary under the policy.
- The right to borrow against the cash surrender value of the policy from the insurer.
- The right to collaterally assign his or her interest in the policy to a third party.
- The right to absolutely assign (transfer) the policy to a third party.
- The right to receive dividends, if declared, on the policy (provided the policy is a participating policy).

NOTE: All of these rights are absolute rights of the insured if a revocable beneficiary has been designated under the policy. If a beneficiary has been designated as irrevocable, the insured needs the written permission of the beneficiary to exercise these rights.

Additionally, the insured may have other rights granted by the specific insurance policy, such as the right to renew a term policy, the right to exercise a guaranteed insurance option or the right of conversion, to name but a few examples.

RIGHTS OF THE LIFE INSURED

Legislation gives no rights whatsoever to the life insured. In fact, legally, the life insured is not even a party to the contract; he or she is merely the yardstick against whose life the payment of benefits is measured.

RIGHTS OF BENEFICIARIES

The rights of beneficiaries are generally dependent upon whether the beneficiary was named as a *revocable* or an *irrevocable* beneficiary.

Revocable Beneficiaries

During the lifetime of the life insured, a *revocable* beneficiary under a life insurance contract has no enforceable rights, even if he or she pays the policy premiums.

If the revocable beneficiary predeceases the life insured, the designation terminates. It does not vest in the beneficiary's estate.

Of course, during the life of the life insured, the insured may change the revocable beneficiary designation at any time.

Irrevocable Beneficiaries

If a beneficiary has been named *irrevocably*, he or she at least knows that the insured cannot change the beneficiary designation without the irrevocable beneficiary's written consent. Otherwise, the irrevocable beneficiary has no more rights under the contract than does the revocable beneficiary (although, as we have seen, the policyowner is restricted in his or her dealings with the contract where an irrevocable beneficiary has been named).

CLAIMS

At the death of the life insured under the life insurance contract, the beneficiary (whether named revocably or irrevocably) has the right to receive the net proceeds of the life insurance contract.

The proceeds do not form part of the estate of either the insured or the deceased life insured, such that the creditors of the insured cannot usurp the rights of the beneficiary. Additionally, the Act provides that, "a beneficiary may enforce for the beneficiary's own benefit...the payment of insurance money made payable to him, her or it in the contract..." Thus, even though the beneficiary is not a legal party to the contract, he or she has the right to sue the insurer for the insurance money.

Contract Remedies

INTRODUCTION

In the event that a contractual relationship does not meet all of the requirements of a valid legal contract, or one or the other of the parties to the contract does not perform his or her required obligations under the contract, there are a number of remedies in law that can either:

- terminate the contract;
- correct the problem; or
- compensate the injured party.

VOID OR VOIDABLE?

If a contract fails to meet the requirements of a legal contract it may either be *void* or *voidable*.

A *void* contract is one that does not meet the conditions of a valid contract in such a way that the fault cannot be corrected. The contract is void ab initio (void from the outset), such that no legal obligation ever existed.

Example: Lloyd, age 24, had a used car for sale. Lloyd was approached by Doug, who offered him \$1,000 for the car. They struck a deal and prepared the proper paperwork, planning to complete the sale in two days time. When the day came, Doug reneged on the purchase. It turns out that Doug is only 15 years old. He does not have the legal capacity to contract. Lloyd has no enforceable rights under their “contract” and, even if the two wanted to, they could not agree to the sale. There is simply no way for Lloyd to enter into a legal contract for the sale of his car with a 15-year-old. The contract is void.

A *voidable* contract is one which does not meet the requirements for a legal contract, but under which the parties to the contract can pursue one of three options:

- the contract can be *avoided* (deemed to be void);
- the parties can amend the contract, to “fix” the offending problem; or
- the parties can agree to accept the contract, as is, as a valid contract.

Consider the following situation where an applicant for life insurance failed to disclose a material fact on the application form.

In completing an application for insurance, when asked about “dangerous hobbies,” Maureen failed to disclose that she goes skydiving a couple of times a month during the summer. Unaware of this risk, Maureen’s insurance company, Harmony Life, issued her a \$250,000 term insurance policy, with “smoker” rates.

A year after policy issue, Maureen, who had decided to stop smoking when she discovered how much lower non-smoker premiums are, applied to have her policy changed to non-smoker status. In reviewing Maureen's application, Harmony's head office underwriter noticed a medical report about a broken ankle that Maureen had suffered two years ago that had been ignored in the initial underwriting process. Further investigation revealed Maureen's skydiving activities.

Failure to disclose the skydiving constituted a misrepresentation of a material fact on Maureen's part. Discovery of the misrepresentation occurred before the expiry of the two-year "contestability" period. The Harmony Life Insurance Company could pursue any one of the following options:

- a) avoid the contract, canceling it for misrepresentation, and return Maureen's premiums paid to date under the contract;
- b) amend the contract by adding a skydiving exclusion and otherwise keep the policy in force as issued; or
- c) decide that Maureen's skydiving is not sufficient cause for concern and re-affirm the contract as originally issued.

BREACH OF CONTRACT

If one of the parties to a contract is in breach of the terms of the contract because of wrongful non-performance (failing to do what was promised), the other party can seek a remedy through the courts. The most typical types of contract remedy are:

- restitution;
- specific performance; and
- injunction.

Restitution

If one of the parties to a contract fails to fulfill its obligations under the contract and the other party suffers a loss as a consequence, the injured party can seek restitution (damages).

Example: Generally speaking, the insurer under an insurance contract will have no right to seek restitution. The only "obligation" on the insured is to pay the policy premiums when due. And this is not a true legal obligation because, if the insured fails to pay the premiums, the insurer cannot sue to recover the unpaid premiums. Rather the insurer can simply cancel the policy for nonpayment.

The insured, on the other hand, could sue the insurer if it failed to provide benefits as promised, such as:

- additional coverage under a guaranteed insurability option;
- the payment of dividends declared on a participating policy; or
- waiver of premium benefits while the insured was disabled.

Under any of these instances of non-performance, the insured could seek damages (a cash award equal to the value of the lost benefit) or specific performance of the insurer's obligation under the contract (see below).

In addition to the insured being able to sue the insurer for damages for nonperformance, the policy beneficiary has the right to sue as well. For example, if an insurer failed to pay out a valid death claim under a policy, the beneficiary could sue for the death benefit proceeds.

Specific Performance

In circumstances where the payment of damages cannot satisfy the claims of an injured party in a breach of contract case, the courts might order specific performance of the obligation under the contract. In other words, the party who is in breach of the contract will be compelled to fulfill the obligation, the non-performance of which led to the breach of the contract. Specific performance is most frequently ordered by the courts in circumstances where mere cash is insufficient to compensate the injured party for his or her loss.

Example: Don was entitled to increase his face amount of coverage under his term life insurance policy by \$100,000 in 2001, under a guaranteed insurability option. Don's insurance company claimed that Don had filed his application to exercise the option after the expiry of the option period and refused to issue the additional coverage. Don, who has diabetes, knows the potential value of that extra coverage to his family and is certain that he filed the papers with the insurance company on time. He sues the insurance company. The courts find in Don's favour and compel the insurance company to issue the additional \$100,000 of coverage.

Injunction

In some cases, the remedy for breach of contract might be a court injunction against a party who was in non-compliance with the contract because he or she had committed an act that was prohibited under the contract. This situation is most likely to arise in situations where the contract deals with restraint of commercial activity, usually to do with a former employee.

Example: Mel was a salaried sales representative with the Ace Motorcycle Company, which services motorcycle distributors in Newfoundland. Ace found that its sales were declining throughout the province (not just Mel's sales) and it needed to reduce its sales force to cut overhead. Mel was offered a fairly generous separation package by Ace, provided that he sign a contract guaranteeing not to contact his former customers with regard to motorcycle sales for a competitor for a period of one year. Eight months after leaving Ace, Mel joined a competing motorcycle manufacturer and started prospecting his old client list. Ace took Mel to court and got an injunction preventing him from soliciting his old clients for the duration of the contract.

THE AGENT'S LEGAL ROLE IN THE UNDERWRITING AND CONTRACTING PROCESS

It should be understood, that government and industry regulatory bodies place constraints on the actions of insurance agents in such areas as the illustration of potential policy values (cost illustrations) to a prospective client, publishing misleading advertising, misrepresentation to the client or the insurance company, and the twisting of existing insurance policies to the detriment of the policyowner (to name but a few examples). Agents should also be keenly aware, however, that these actions may easily cross the line between prohibited activity and criminal conduct.

LERNING OBJECTIVES

For the a student to appreciate the criminal law provision relating to various activities that an agent may be tempted to undertake in the application and contracting processes, and the potential implications of such activities.

It may sometimes be that the agent considers the life insurance application and attendant forms and procedures to be merely “forms” or “rules” provided by the life insurance company and does not treat them, and the application or claims process, with due legal respect. In fact, the agent is vested with a serious responsibility with respect to the completion and handling of all documentation associated with an application for life insurance or the claims process and in the handling of clients’ funds, and failure to follow the “rules” could have serious practical and legal ramifications for the agent. For example, improper actions on the part of the agent could be construed by the courts to constitute acts of fraud, theft or forgery.

Fraud

Knowingly assisting or permitting an applicant to render false information with respect to material facts concerning a life insurance application, with the intent of deceiving the insurance company to issue a contract it would not otherwise issue (or would issue with amended terms, if the insurance company were aware of the true relevant facts) constitutes perpetrating a fraud against the life insurance company.

Example: Joe Agent is sitting with Claire Client, who lives alone. There are full ashtrays scattered around Claire’s apartment and Joe saw Claire smoking a cigarette when the two had lunch the previous week. When he came to the “smoker” question on the non-medical portion of the application form, Joe said to Claire, “There are two classifications of applicant for life insurance purposes: smokers and non-smokers. Smokers are those who have smoked cigarettes in the past 12 months and smokers pay premiums at rates about twice that of non-smokers. Which are you, a smoker or a non-smoker?”

Claire responded that she was, of course, a non-smoker, and Joe duly recorded her answer to the question and made no reference to the issue when filing his agent’s report to the life insurance company.

Joe is guilty of conspiring with Claire to commit a fraud against the life insurance company by providing information intended to deceive the insurer into thinking that Claire was a non-smoker, so that the insurer would charge Claire a lower premium than was appropriate for her circumstances.

The Criminal Code of Canada (“the Code”), in section 380, defines fraud to be:

“380. (1) Everyone who, by deceit, falsehood or other fraudulent means...defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,

- a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding ten years, where the value of the subject matter of the offence exceeds five thousand dollars, or
- b) b) is guilty (i) of an indictable offence and liable to imprisonment for a term not exceeding two years, or (ii) of an offence punishable on summary conviction, where the value of the subject matter does not exceed five thousand dollars.”

Example: In Joe’s case above, he and Claire are guilty of attempting to defraud the life insurance company of the premium dollars to which it would have been entitled (the difference between the smoker and the non-smoker premium rates) had the two provided full and truthful disclosure on the application form.

Forgery

Another area where life insurance agents may tend to get lax (albeit often with good intentions) is the forging of documentation, particularly the forging of the applicant’s signature on life insurance company documents.

Example: Joe Agent took an application for life insurance on the life of his friend, Murray, who was leaving on a month-long vacation the next morning. At noon that day (after Murray had left Canada), Joe realized that he and Murray had completed all of the necessary documentation and that Murray had signed the application, but that he had forgotten to sign the separate Nonsmoker’s Declaration Form used by Joe’s insurance company for applicant’s who qualify for (reduced) non-smoker rates. Knowing that Murray had wanted to apply for the non-smoker rates (he had, after all, completed the form; he just forgot to sign it), and knowing that Murray would be out of town for a whole week, Joe decided to go ahead and “complete” the paperwork by himself. Joe traced Murray’s signature from the application form onto the Nonsmoker Declaration and submitted the forms to the insurance company.

Regardless of his good intentions, Joe was guilty of forgery.

Forgery is a serious offence, even if done with the best of intentions.
The Criminal Code of Canada defines forgery as:

- “366. (1) everyone commits forgery who makes a false document, knowing it to be false, with intent
- a) that it should in any way be used or acted upon as genuine, to the prejudice of any one, whether within Canada or not; or
 - b) that a person should be induced, by the belief that it is genuine, to do, or to refrain from doing anything, whether within Canada or not.
- (2) Making a false document includes:
- a) altering a genuine document in any material part;
 - b) making a material addition to a genuine document or adding to it a false date, attestation, seal or other thing that is material; or
 - c) making a material alteration to a genuine document by erasure, obliteration, removal or in any other way.”

Although such actions as “duplicating” a client’s missing signature are merely a rectification of an oversight on the part of the client, these (and similar) actions on the part of an agent constitute a forgery against the interests of the life insurance company (and perhaps the client) and are subject to severe penalties under the Criminal Code. Similarly, it is an offence to forge a client’s signature on such documents as cheques, change of beneficiary forms or cost illustrations.

And then there are those situations where an agent might be tempted to commit forgery for much less “innocent” reasons. A client’s signature on a claim cheque could be forged, with a false endorsement over to the agent, to permit the agent to access the funds. An agent could process a forged letter of instruction to the insurance company (without the knowledge or permission of the client) diverting dividends from an existing policy to pay the premiums on a newly issued policy that is otherwise in danger of lapsing, to protect the agent from suffering a charge-back of commissions. The list of possible offences is almost endless.

Theft

There may be occasions when clients wish to tender cash to the agent by way of payment of a policy premium (particularly the initial payment made with the application). Accepting cash payments should be avoided at all costs, even at the risk of losing a sale. Receipt of cash by the agent places him or her in a very precarious position: the cash could be lost or stolen and it could not be replaced (the way a lost cheque could). Holding the cash in the hands of the agent, even for a short period of time, could be construed as theft of the insurance company’s money (see below).

Even if the agent commits no illegal act, possession of the client's cash places him or her in a highly vulnerable position, open to implications or appearances of wrongdoing. Alternatively, clients might make a premium payment by cheque payable directly to the agent, rather than making it payable to the life insurance company. As with cash payments, this situation should always be avoided. If this were to happen, the agent should always be mindful that he or she is receiving funds on behalf of the insurance company and that said moneys belong to the insurance company.

Diverting premium funds to the use of the agent personally, even on a temporary basis, would constitute an act of theft (under s. 322 of the Criminal Code of Canada) and theft is an indictable offense that could result in a prison term of not more than two years (in the case of a theft of less than \$5,000), or of not more than 10 years (in the case of a theft of more than \$5,000).

And, of course, there may be those instances when agents intentionally divert client funds for their own benefit. For example, agents have been known to take one deposit cheque for credit to a new RRSP application and a new life insurance application, and then modify the application forms and divert the funds so as to generate the maximum amount of commission for the agent - rather than being a reflection of the client's wishes. Such manipulations constitute a fraud against the insurance company and a theft of the client's funds.

Summary

Insurance agents, particularly those who are new to the business, may find themselves in a variety of situations where there is a temptation to "take the easy way out," either in the handling of documentation or in the use and/or manipulation of the client's funds. Whether undertaken for "good" or "bad" intentions, such temptations must be avoided at all costs.

Aside from the risk of discovery, termination of employment and irrevocable damage to one's reputation, these criminal sanctions should make agents think very carefully before mishandling the client's, or insurance company's, funds or documentation.