



When Fraud Isn't Really Fraud

Robert Barney

There is an ugly gaping loophole which allows life insurance companies to avoid paying claims, and the loophole is getting bigger all the time. The loophole is found in the two-year contestability clause that is in virtually every life insurance policy owned or sold to Canadians.

The limit of two-year contestability is designed to protect the consumer but it would appear to be no longer providing that protection because of the ugly loophole that I will explain here.

As background, when a life insurance company sells you a new life insurance policy they want to make certain that you are insurable. What does that mean?

Consider that most property and casualty companies will not put new fire insurance policies on burning buildings. The reason should require no explanation but suffice it to say that it would drive up the cost of insurance premiums for all the people who actually bought their fire insurance before their building was burning. If there were companies issuing policies on burning buildings they would not be able to compete with a company who didn't and so not insuring burning buildings is a win-win situation for policyholders and companies.

Life insurance is similar. Life insurance companies do not issue policies for people as they are being wheeled into hospital emergency rooms, suffering from life-threatening injuries, illnesses or diseases. Furthermore, life insurance companies do not accept new business on people who have been told that they have 6 months to live. If you are in that group, you are like a burning building and considered "uninsurable".

That is why, when you complete an application for a new life insurance policy, there are all kinds of pesky questions, particularly about your health. Companies ask the questions trying to turn up anything that might indicate that you won't live long enough to pay lots of premiums.

Once again, this is not a bad thing for the majority of consumers wanting life insurance. When someone dies and a claim is paid, that claim comes out of the premiums that the rest of us are paying. The more claims paid, the higher the

premiums needed. So, if you want low premiums for your own policy, you can appreciate why life insurance companies are trying to ensure that new customers are insurable.

But not all illnesses are that apparent at first. Hints and clues that something is wrong can be missed, particularly if the new insurance buyer fails to mention them. Never had a heart attack – great! Have you had chest pains but failed to mention them to your doctor? That may be a clue that there is a bigger problem that you just haven't pursued yet.

And so there is a contestability clause in the policy that addresses the problem. The clause basically says that if the company discovers that you did not accurately disclose your insurability, and the company finds out about it after issuing the policy, then they can give your premiums back and cancel the policy. If you die and they find out that you were uninsurable after the fact, then they can decline the death benefit and return the premiums to your beneficiary.

An Example

Suppose you bought a non-smoking policy, failing to disclose that you had a single cigarette at a party 3 months before. The company issues the policy and you die 6 months later from an unrelated problem, such as a car accident. The company investigates and turns up someone who will testify that they saw you smoking at the party. The company has the right to deny the payment of the claim.

In this example, it wasn't even a case of you being uninsurable. Had you declared that you smoked the cigarette, the company would have likely issued a policy at a higher smoking premium and paid the benefit on death. But because there was misrepresentation on the policy, the company has the right to contest payment of the claim.

In order to limit just how long a life insurance company can cheerfully take your money before discovering that, had they known better, they would not have given you the policy in the first place, each province has virtually identical laws requiring a contestability period of no more than 2 years. After two years, policies are not supposed to be contestable, except for the ugly loophole.

Now keep in mind that if there was no two-year rule, there is no reason for a company not to take your money and do their investigating after you die. Even twenty years later, giving back the premiums is a lot cheaper than paying a death claim. Think about the windfall profits for companies. Uninsurable people might pay premiums for years, thinking that they have insurance but don't really have it because of mistakes (misrepresentation) in their applications. If a claim happens, the company investigates and denies payment of the claim. What's the downside for the company?

And windfalls would be even greater because many uninsured people might pay premiums for years, and later quit the insurance before they died. The company would have collected all those premiums, which they get to keep, never having been at any risk of having to pay a claim.

The Ugly Loophole

So the two-year rule was intended to require a company to do their homework up front, just as they should. It protects you the consumer so that you know, beyond two years, your policy is in the clear.

Except for the ugly loophole called "fraud". If it is determined by the company that the misrepresentation about your insurability was "fraud", then the two-year limit is gone. The company can come back anytime after issuing you the policy, and for the reason of fraud, deny the claim.

When I tell this story to most people they initially respond, "Yes, but we shouldn't reward people who commit fraud. People should not be allowed to get away with fraud."

While I take the point, this is not your local prosecutor's definition of fraud. In fact the fraud may not be anything remotely close to criminal fraud. The insurance company simply declares that the misrepresentation they uncovered is fraud and decline the claim.

But what if the misrepresentation was an innocent omission or an honest mistake? You simply failed to tell something you didn't think was important and which, in the mind of the average person, wasn't important. What if you told your agent but they said it wasn't important and the agent didn't mark it down? It could later be argued that this was a failure to disclose and misrepresentation. All the life insurance company has to do is declare it fraud and not pay the claim.

What Can You Do?

Well, you can sue the life insurance company – actually not you but your beneficiary would have to sue. Remember, you are the one who is now dead. And I trust you see how the case is handicapped by the fact that the key witness for the plaintiff is no longer available to testify. You

can no longer stand up for yourself and tell your side of the story. And do I need to mention that lawsuits can cost a lot of money, take a lot of time, and that the outcome can be far from certain?

And the problem flies in the face of our entire system of justice. North American laws consider a person "innocent until proven guilty" – except in this case. In this case you can be declared guilty by the life insurance company and your beneficiary would have to go to court to prove your innocence.

Are you upset yet? I am getting angrier as I hear more and more about lawsuits resulting from Canadian life insurance companies who appear to have found a new way to add to their profits.

The solution is simple. The fraud exclusion needs to be removed from policies. After two years, if the insured dies, the policy should pay the claim, period. I am quite satisfied, as more and more stories about denied claims and litigation surface, that the fraud exclusion is being overused by life insurance companies.

This problem needs to be fixed by the provincial governments of Canada. The reason that they can fix it is because the two-year contestability clause is mandated by the insurance laws of each province. The wording about fraud is prescribed in each province's law. But who is going to convince the provinces to fix this by getting rid of the fraud clause and closing the loophole?

You would think agents would want this fixed. I tried that.

I am a past president of one of the two life insurance agent associations in Canada. I took my concern, and this story, to the current leaders of my old group and encouraged them to lobby government regulators to fix the problem. Not only would they do nothing to help, they defended the fraud provision. The angrier I got arguing with them, the angrier they got in response.

I don't know what the agent association is thinking. Every time a lawsuit is created by a claim denial, the agent who sold the policy is named in the lawsuit. When that happens, the agent's Errors and Omissions (E&O) insurance comes into play by having to pay for the lawyers needed to defend the agent. This drives up the premium costs of E&O insurance for agents and the premiums are increasing because of these lawsuits. Even so, the agent association had no interest in the issue. As their past president, I'll let you speculate how I feel about that. I can assure you that agents, the supposed constituents of the group, should not be happy.

So, that leaves me to appeal to you, the consumer. What can you do about it? Let me underline that I know to whom I am speaking. Most Canadians are among the most laid back, apathetic political subjects on the planet. Trying to convince a Canadian to take political action is a challenge.

Let me see if I can motivate you.

In the United States, where I also do business, the two-year contestability clause has no fraud loophole. After two years, the company must pay the claim, period. This means that a U.S. consumer is buying a clearly superior insurance policy versus those sold to Canadians, in many cases by the very same life insurance companies who happen to sell on both sides of the border.

Can you tell me why Canadians are getting inferior insurance products by comparison to Americans? Are you paying less for those inferior products? Absolutely not! As I have referenced in previous articles, Canadians routinely pay more for life insurance than Americans do and it's not because Canadians don't live as long. So, Canadians pay more than Americans for life insurance and end up with defective insurance policies by contrast. Does that seem fair to you?

What can you do? I strongly recommend that you take a copy of this article and attach it to a letter to your provincial Premier and send a copy to your local member of the provincial legislature. You need to express your indignation and outrage that this loophole is giving life insurance companies the ability to deny the payment of life insurance claims to widows, widowers and orphans who have lost a family breadwinner. Is this what government is for, to enable corporations to profit from people at their time of greatest need?

Can you write those letters for me, for yourself, and for every other Canadian who buys life insurance? And if you do, take yourself out to lunch, you will have deserved it.

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