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The United Kingdom Insurance Act 2015

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The case for reform

- The Marine Insurance Act 1906 ("MIA") codified principles developed by the English Courts in the 18th and 19th centuries
- Introduced to protect a fledgling insurance industry - criticised as insurer friendly and outdated
- Does not reflect:
  - diversity of the modern insurance market
  - changes in practice
  - the information revolution
  - the current commercial environment
- Insurance Act based largely on recommendations of the Law Commission (a project which started in 2006)

Marine Insurance Act 1906

1906 CHAPTER 41 6 Edw 7

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Overview – Insurance Act

- Sets out a new "default" regime in three main areas:
  - Disclosure and misrepresentation
  - Insurance warranties and terms (including basis of the contract clauses)
  - Insurers' remedies for fraudulent claims
- Applies to insurance and reinsurance
- Aimed at ensuring a better balance of interests between insureds and insurers
- Broadly supported by insurance industry
- Biggest change to English insurance contract law in 110 years and arguably, ever!
- Consumer Insurance (Disclosure & Representation) Act 2012 – concerns an individual who buys insurance "*wholly or mainly for purposes unrelated to the individual's trade, business or profession*"

Overview

Insurance Act

- Introduced into Parliament on 17 July 2014
- Received Royal Assent on 12 February 2015
- Comes into force on 12 August 2016
- Additional amendments to the Act to follow
- Today:
  - Pre-contractual obligations
  - Warranties and other terms
  - Fraud
  - Ongoing issues
  - Implications

Pre-contractual obligations

Duty of disclosure – old / current law

- Utmost good faith
- Requires:
  - disclosure of all "material" circumstances known or deemed to be known by the insured
  - no material misrepresentations
- Materiality - judged by reference to the views of a hypothetical "prudent insurer" – no need for circumstance to be decisive
- Inducement - any non-disclosure or misrepresentation must have induced the actual underwriter to write the risk on the terms he/she did
- Separate duty of disclosure applies to insured's agent (e.g. broker)
- Only remedy for breach – avoidance of the insurance contract

Criticisms of the duty of disclosure

Duty of disclosure is poorly understood and one-sided

Duty on insured is unduly wide

Data dumping

Underwriting at the claims stage

Single remedy of avoidance

Lead to disputes

Duty of disclosure - Reform

Law Commission has set out 3 aims:

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Fair presentation of the risk – Reform

New statutory obligation on the insured will be to make a fair presentation of the risk

A fair presentation of the risk is one that meets the following 3 criteria:

First element

Substance:

1. First limb: duty to disclose every material circumstance which the insured knows or ought to know; or
2. Second limb: failing that, sufficient information to put a prudent insurer on notice that it needs to make further enquiries in order to reveal those material circumstances

Additional guidance re. “material circumstance” (non-exhaustive):

- Special or unusual facts which increase the risk
- Particular concerns leading to the purchase of insurance
- Anything which those concerned with the class of insurance and field of activity in question would generally understand as something that should be disclosed (i.e. what the market would expect)

Fair presentation of the risk – First Element

Knowledge of the Insured – *"knows or ought to know"*

- Corporate insured "knows" only what is known to:
  - Senior management team (i.e. board members or those who pay a significant role in the decision making process of the business)
  - Those responsible for placing the insurance (i.e. risk manager and/or broker)

- An insured "ought" to know:
  - There is a positive duty on the insured to conduct a "reasonable" search for information available within the organization and held by others (i.e. agents)

- "Knowledge" does not include:
  - Confidential information held by the insured's agent (i.e. broker) acquired through a relationship with someone other than the insured.

Fair presentation of the risk – First Element

BUT – the Insured does not have to disclose a circumstance if:

- **The Insurer knows it, ought to know it, is presumed to know it, or waives information concerning it, or it diminishes the risk.**

- Known:
  - information known to the underwriter personally or any employee or agent involved in the underwriting decision
- Ought to have known:
  - employees or agents of the underwriter who have knowledge and ought to have passed it on (i.e. claims department, reports by surveyors or medical experts)
  - Information held by the insurer which is readily available to the underwriter e.g. electronic records
- Presumed to have known:
  - Things which are common knowledge
  - Things which an insurer offering insurance of the class in question would reasonably be expected to know in the ordinary course of business

Fair presentation of the risk - Reform

Second element

Form

•Additional requirement for insured to disclose information in a manner which is reasonably clear and accessible to a prudent insurer

•Targets “data dumps”

•Equally targets overly brief and cryptic presentations

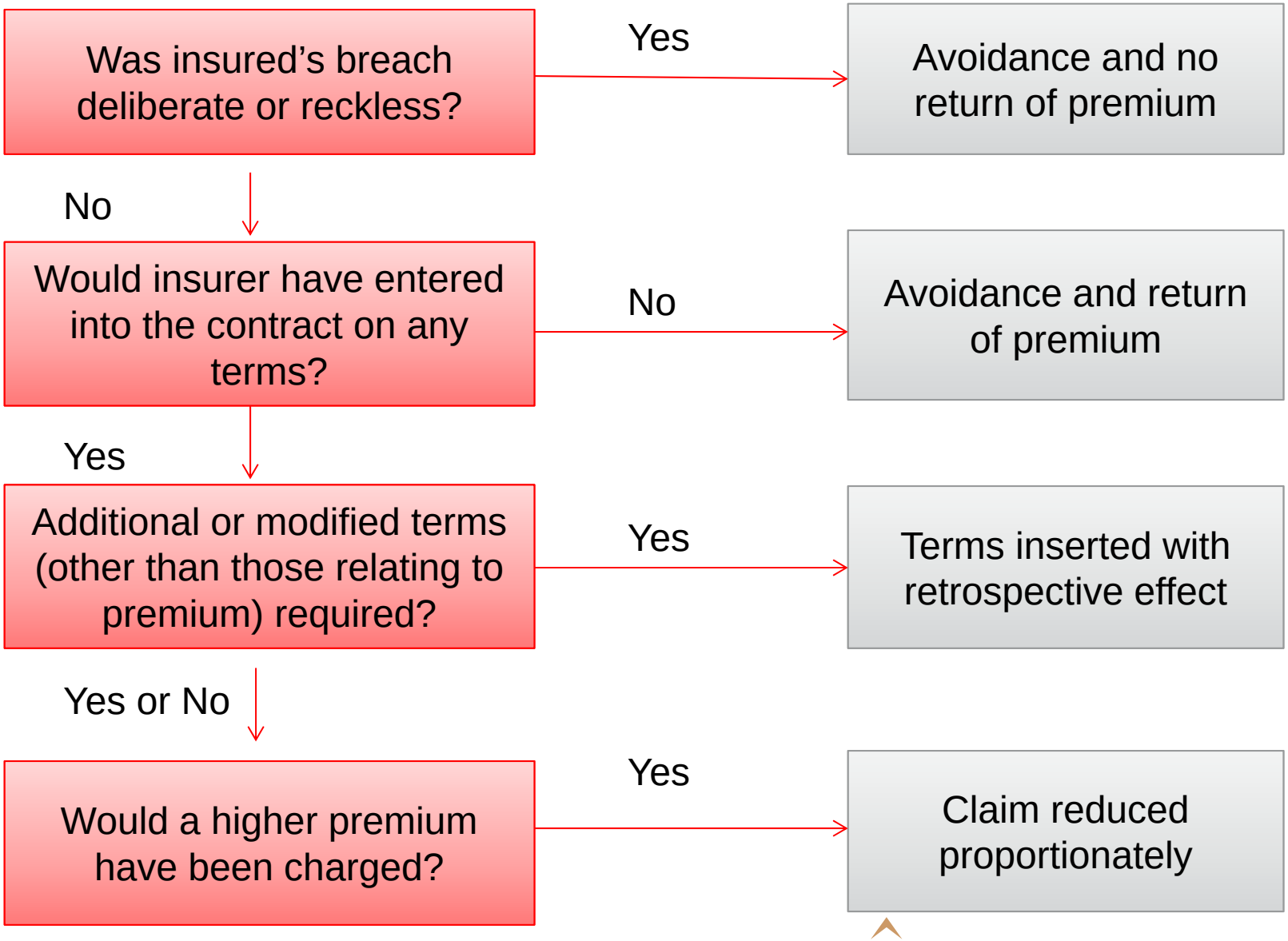
Third element

Material representations

•Duty not to make misrepresentations (No Change)

- •Every material representation as a matter of fact is substantially correct
- •Every material representation as a matter of expectation or belief is made in good faith

Default remedies for non-disclosure or misrepresentation



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Warranties

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Warranties – Old / Current law

Summary of key characteristics

1. Must be a term of the contract

2. Exact compliance required

3. Matter warranted need not be material to the risk

4. Breach leads to insurers being automatically discharged from liability **even if**:

- Loss has no connection with the breach;
- Breach is remedied before the loss; or
- Breach is minor

Warranties – Draconian impact of the law

De Hahn v Hartley (1786)

- Policy of insurance was taken out on a vessel sailing from Liverpool to the British West Indies
- Warranty that the vessel would leave Liverpool with “50 hands or upwards”
- Vessel set sail with only 46 hands
- 6 hours later, the vessel picked up a further 6 crew members in Anglesey
- Weeks later off the coast of Africa the vessel (still with 52 hands) was captured and lost
- Held: Breach of warranty - claim not covered. It was irrelevant that the breach had been remedied within 6 hours and before the vessel had left the relatively safe waters around Britain

“Basis of the contract” clauses

- Converts pre-contractual information supplied by the insured in a proposal form into contractual warranties

- Insurer discharged from liability if any inaccuracy in answers given, even if they are immaterial

- Already abolished in respect of consumer insurance

Warranties - Reform

Abolish ‘basis of the contract’ clauses

Abolish existing statutory remedy for breach i.e. automatic discharge of liability

New default remedy: breach suspends rather than discharges insurers from liability

Remedy of breach by insured prior to loss puts insurers back on risk

Suspension of Liability / Remedy of the Breach

- What to do about time limits?
  - i.e. condition survey within 30 days
  - remedied if *"the risk to which the warranty relates later becomes essentially the same as that originally contemplated by the parties"*

- What to do if a time limit is critical for an insurer?
  - Don't leave it to the background law, set out the remedy (i.e. state in the policy if do not comply then cover will terminate on 30th day).

- Causation?
  - caused a debate about remoteness

Warranties/other terms - Reform

Requirement for breach to relate to loss

- New regime for terms (warranties and other terms (eg conditions, termination provisions and exclusions)
- Section 11

(1) This section applies to a term (express or implied) of a contract of insurance, other than a term defining the risk as a whole, if compliance with it would tend to reduce the risk of one or more of the following—

(a) loss of a particular kind,

(b) loss at a particular location,

(c) loss at a particular time.

(2) If a loss occurs, and the term has not been complied with, the insurer may not rely on the non-compliance to exclude, limit or discharge its liability under the contract for the loss if the insured satisfies subsection (3).

(3) The insured satisfies this subsection if it shows that the non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

Warranties/other terms - Reform

- So:
  - may not apply, for example, to terms requiring a vessel to be classed or property to be certified – as these appear to "*define the risk*"
  - but would apply to clauses covering requirements for locks, alarms, sprinkler systems etc
- Where there has been a breach:
  - Insurers will have no defence to a claim
  - if the insured can show that non-compliance with the term could not have:
    - increased the risk of loss which actually occurred
    - in the circumstances in which it occurred

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Fraud – Current law

Types of fraud

- Pure fraud
- Exaggerated claims
- Fraudulent devices

Effect of fraud

- G*alloway v Guardian Royal Exchange (UK) Ltd* [1997] All ER (D)14

Legal uncertainty

- Common law rule of forfeiture; or
- Remedy of avoidance for breach of the duty of utmost good faith
- (i.e. forfeit the fraudulent claim vs. avoid the whole contract for breach of good faith (incl. genuine claims))

Fraud – Current law

- The Law Commission identified 3 unresolved issues:
  - Does a fraudulent claim affect a previous claim made under the same policy?
  - Does a fraudulent claim affect subsequent claims?
  - May the insurer sue the insured for damages to recover the cost of investigating a fraudulent claim?

Fraud - Reform

Common law rule of forfeiture put on a statutory footing

- Insurer not liable to pay insurance claim to which the fraud relates
- Can recover monies already paid out on a claim which is later discovered to be fraudulent

Forfeiture of subsequent claims

- Insurers have the option to treat the contract as if it had been terminated at the time of the fraudulent act
- Must give notice of their election to do so to the insured
- Insurers may then refuse to pay claims arising from ‘relevant events’ occurring after the time of the fraudulent act and need not return any premium paid.

Fraud - Proposals

No avoidance of previous valid claims

- Insurer remains liable in respect of claims in relation to relevant events that took place before the date of the fraudulent act.

- A ‘relevant event’ may include, for example:
  - Occurrence of a loss
  - Making a claim
  - Notification of a potential claim

Fraud – Reform

No forfeiture of previous valid claims

- Insurer remains liable in respect of claims arising from “relevant events” that took place before the date of the fraudulent act.

Not covered by the Act

- Damages to recover the reasonable costs of investigating the claim

ADDITIONAL POINTS TO NOTE

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Points to note

Contracting out

- Provisions of the Bill are intended to provide **default rules**
- Non-consumer insurance: parties are free to agree alternative regimes provided that the insurer satisfies 2 transparency requirements

1. Must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into
2. Disadvantageous term must be clear and unambiguous as to its effect

Exception

- Basis of the contract clauses

Good Faith

- Avoidance as a result of the breach of duty of good faith – removed!
- Will remain an interpretive principle

Damages for late payment of claims

- One contentious issue removed from the draft Bill at the end of 2014
  - Implied obligation to pay claims within a reasonable time; and
  - damages for late payment of a claim by the insurer

Current law:

- Property insurance: insurer is in breach of contract from the date of the loss and the cause of action against the insurer arises on that date – cannot claim "*damages on damages*"
- No remedy for late payment of claim e.g. *Sprung v Royal Insurance* [1999]

BUT Back on the agenda:

- Widely thought to be on the “back burner”, until the Enterprise Bill proposed an amendment to Insurance Act to introduce an implied term that claims will be paid within a reasonable time!

Today

- New insurance law which comes into force in <u>May 2017</u> introduced by the Enterprise Act 2016
  - Part 5 - amendment to the Insurance Act to include an implied obligation that insurers pay claims within a reasonable time
  - Enterprise Bill had nothing else to do with insurance
  - implies a term into (re)insurance contracts written after 4 May 2017 that claims will be paid within a reasonable time
  - if not, insurers are exposed to claims by the assured for consequential damages, potentially in excess of policy limits
- Entirely new concept under English insurance law and has far reaching implications

Enterprise Act 2016

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Insurance Act 2015/Enterprise Bill (cont'd)

- Market lobbied against part 5 of the Enterprise Bill whilst it was being debated in the House of Lords
  - no evidence of systematic problem
  - paying valid claims lies at the heart of what commercial insurers do
  - vexatious/speculative litigation => significant legal uncertainty
  - May:
    - result in the market cutting short proper investigations
    - deter investigation of fraudulent claims
  - criticised the government's inadequate impact assessment:
    - transitional litigation costs of £100k per annum for 5 years
    - on going costs of £375k per annum
    - proposed that large risks be excluded from the new legislation

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Insurance Act 2015/Enterprise Bill (cont'd)

- But without success
  - difficult to argue against the principle of paying claims within a reasonable time

EveningStandard.

The insurance industry needs to heed this sound advice

We no longer live in a world where customers are expected to take what they are given and be suitably grateful. The chief executives of the London market are on the wrong side of history and it really is not clever lobbying to put pressure on the Treasury to side with the dinosaurs.

The new law

- Implied term of every insurance contract that, if the policyholder makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a **reasonable time**
- What is a reasonable time?
- Includes a reasonable time to investigate and assess the claim
- Will depend on all the relevant circumstances, but includes:
  - the type of insurance
  - the size and complexity of the claim
  - compliance with any relevant statutory or regulatory rules or guidance
  - factors outside the insurer's control

What if a claim is disputed?

- Where the claim is disputed
  - (whether as to the amount of any sum payable or the validity of the claim)
  - an insurer will not be in breach of the implied term merely for failing to pay the claim (or the affected part of it)
  - while the dispute is continuing if it can show that there were **reasonable grounds** for disputing the claim
- but
  - the **conduct of the insurer in handling the claim** may be a relevant factor in deciding that it is in breach of the implied term despite the fact that the claim is disputed
- The fact that the claim is upheld may not be determinative – legislation is aimed at catching bad claims handling practices, not for delays caused by genuine disputes

What "*conduct*" may be relevant?

- Conducting investigations too slowly or not changing position quickly enough as new facts emerge
- Treatment of the insured in pre-action correspondence
- Refusal to agree to alternative dispute resolution
- Refusal to make/accept reasonable settlement offers
- Failure to make interim payments
- Unsuccessfully contesting or making interlocutory and summary judgment applications
- Failure to meet deadlines resulting in the trial timetable being lengthened
- Deciding to appeal unfavourable judgments

What are the consequences of a breach?

- Insured may have a claim for damages
- Insured will need to show that:
  - It has suffered actual loss in addition to the loss claimed under the policy
  - The loss was caused by the unreasonable delay
  - The loss was foreseeable, in that it was within the "*reasonable contemplation*" of both parties at the time the contract was made
  - The policyholder took all reasonable steps to mitigate its loss

Limitation and Contracting out

Limitation:

- Amendment to the Limitation Act 1980, inserting a limitation period on claims for damages for late payment of one year from the date the insurer made the full payment of the claim or otherwise settled the claim

Contracting out:

- Provisions of the Act are intended to provide default rules
- Consumer insurance: regime will be mandatory
- Non-consumer insurance: parties are free to contract out or agree own regime provided that the insurer satisfies 2 transparency requirements:
  - Must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into
  - Disadvantageous term must be clear and unambiguous as to its effect
- Will have no effect in respect of a deliberate or reckless breach of the implied term

Implications

- Inevitable concern for insurers is that insureds will bring additional claims whether merited or not
- Law Commission's response to this:
  - "*we do not think it will take long for the courts to curb abuses*"
  - the aim of the new legislation is "*to catch bad claims handling practices, not prevent legitimate investigations by insurers*"
  - "*there may be an apparently legitimate reason for an insurer to question the validity or value of a clam which ultimately turns out to be payable and we do not consider that late payment of claims should be a regular occurrence in such cases*"
- So - claims declined in a *"reasonable way"*, but ultimately paid should not give rise to a breach of the implied term

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Implications (cont'd)

- But the law will change dramatically
- The test of "reasonableness" is objective, but inevitably:
  - where claims are not settled promptly, inevitable dispute about whether the delay or grounds to dispute the claim are reasonable
  - if a claim is declined, the insured's reaction may be one of indignation – views become polarised
  - considerable skirmishing expected as the new law comes in where insureds seek to test the boundaries
  - wait for judicial guidance in an area where so far, there is none
- Some guidance on when interest starts to run
  - e.g. a yacht case - *Julia*
  - Tomlinson J "*in my experience, it is conventional to allow a period for investigation by underwriters of an actual or constructive total loss of a vessel. … I consider that a period of one month within which underwriters are entitled to investigate the loss and decide whether to accept or decline the claim is a modest allowance*"

Implications (cont'd)

- Implications on contentious claims:
  - exposure is not capped at the policy limit
  - potential for insurers to have to fight 2 battles
- Will the assured add an additional claim for damages – whether merited or not?
  - significantly increases the issues in dispute, the extent of disclosure, the need for expert evidence and trial length
  - or will the assured wait until the outcome at trial before launching a second claim in the event they prevail on coverage?
  - what happens at mediation?
  - the test of whether Underwriters have *"reasonable grounds"* to dispute is likely an objective one
- Underwriters cannot release the advice received to show that their decisions were reasonable without:
  - running the risk of revealing that advice to opponents
  - thereby waiving legal privilege in the process

General implications

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Underwriting insurance

Insurers

- Change in emphasis in relation to duty of disclosure – underwriters required to play a more active role in the pre-contractual negotiations
- Consider setting out material circumstances to the brokers for a particular risk in advance
- Need to make further enquiries based on the information provided if a prudent underwriter would make such enquiries
- Consider working with insureds to develop general guidance and protocols regarding what a standard presentation of the risk for that class of business should include
- Effective information sharing between the underwriting and claims teams will be required
- Insurers need to evidence that they have:
  - carried out a reasonable search of information available within their organisation
  - a reasonable level of knowledge relating to the class of business in question

Underwriting insurance

Insurers - continued

- Consider defining in the policy documentation whose knowledge in an organisation is relevant for disclosure purposes
- Awareness that avoidance is no longer the sole statutory remedy
- Arguably – more effective proportionate remedies? However, to take advantage of these:-
  - Insurer may need to produce (in addition to witness evidence from the underwriter in question) that had a fair presentation been made, they would not have written a risk, would have amended the terms or charged more premium
  - This may involve producing other comparable policies to support the underwriting position and/or underwriting guidelines
  - Going forward, there will need to be a greater focus on standard underwriting guidelines and contemporaneous notes/records
  - Applies whether you lead or follow
  - Maintain a record of risks declined and why?

Placing insurance

Insureds

- Change in emphasis from disclosure to making a fair presentation
- More active and considered approach is required when deciding what information should be given to the insurer
- Need to structure and signpost their presentation in a clear and accessible way i.e. no “data dumping”
- Required to seek out information about their business and the risk to be insured by undertaking a reasonable search and by making enquiries of their staff and agents (including brokers)
- “Draconian” remedy of avoidance restricted – proportionate remedies introduced

Placing insurance

Brokers

- No longer a separate statutory duty on agents to disclose information to the insurer when effecting insurance on the insured's behalf
- However, the broker's knowledge is likely to be within the definition of the insured's knowledge, the broker being responsible for the insured's insurance
- Greater onus on brokers to keep records and to verify information contained in underwriting submissions
- No need to disclose confidential information held on behalf of other clients, but there is a duty to disclose non-confidential information

Warranties/other terms

- Wordings
  - To contract out or not to contract out?
  - Under the Act, breach of warranty is only suspensory
  - Under the Act, breach of other risk mitigation terms must “relate” to the loss
  - Do insurers wish to impose contractual remedies similar to the existing law on warranties/condition precedents?
  - Do insurers wish to adopt the default position in the Act?
  - Either way, wordings should be reviewed to ensure that they are either compliant with the Act or the transparency requirements are satisfied

At the claims stage:

- Claims professionals will need to be fully aware of the new law and its implications, where risks governed by English law
- Important to establish whether insurers and the assured have contracted out of some or all of the provisions of the new law
- Is this a claim under the old or the new law or a bit of both?
  - Placing issues
    - to discuss very carefully with underwriters any potential issues around failure by the assured to make a fair presentation
    - focussing in particular on what the underwriter's response would have been had a fair presentation been made
    - relevance to remedies

At the claims stage:

- Warranties
  - Has there been a breach and was it remedied prior to loss?
  - If compliance required by a particular time, was compliance late, but still prior to loss? If so, is the risk *"essentially the same"* as that originally contemplated
  - If breach not remedied prior to loss, is it a term which *"defines the risk"*
  - If not, is the provision irrelevant to the type of loss which actually occurred? If so, can insurers rely on it?

- Fraud
  - Do insurers wish to terminate the risk from the point of the fraudulent act or are insurers content to remain on risk?

Any questions?

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