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CPD Supplement

Insurance Act 2015

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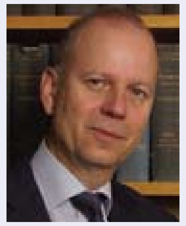
WELCOME

David Hertzell



I am delighted to be asked to introduce this guide. The foundation of the Law Commissions' work is consultation and both the Chartered Insurance Institute and BLM were diligent and active contributors.

As a result of their efforts and the efforts of all of those who responded, the Law Commissions have been able to propose a new law that reflects agreed best practice across the market. The Law Commissions anticipate that this will provide as firm a foundation for insurance contracts in the 21st century as the Marine Insurance Act did in the 20th century. Although the new law has an implementation period before it comes into force, it is important that market practitioners begin to prepare for the changes sooner rather than later. Your customers will expect no less.

David Hertzell, consultant, BLM and former Law Commissioner | david.hertzell@blmlaw.com

Terry Renouf

We are very pleased that David launches this supplement, being the Law Commissioner who steered the reforms, and we are also delighted that he is working with BLM as a consultant to assist our clients and others with implementation of the reforms.

This supplement is a first introductory step to those new to the *Insurance Act 2015* and focuses on the changes to commercial insurance law. Space does not allow us to deal in this supplement with two areas of the Act: firstly, provisions that enable the Third Parties (Rights Against Insurers) Act 2010 to come into force just two months from now; and secondly, provisions relating to fraudulent claims in respect of group policies. However, additional materials, videos and the opportunity to take the test online are available at **blmlaw.com/timeforchange**.

As we have said, the supplement is only an introduction to the Insurance Act. Further work will be required before new policies subject to the Act are incepted. However, much of the terminology will be familiar and the legislation reflects common market practice in many instances. The reform is evolutionary and consequent on broad consultation, but change is always challenging and there is risk associated with new legislation and reform. We do hope and consider that there should be protocols and discussions among all stakeholders to ensure there is an understanding of the reforms and thereby diminish any uncertainty and risk.

We consider that, with the Insurance Act 2015 applying to new and renewed policies, from 12 August 2016 there is an opportunity for the UK insurance market to offer an enhanced product that reflects the needs of the market and of purchasers of commercial insurance. We at BLM hope this supplement assists with that outcome.

Terry Renouf, partner, BLM | terry.renouf@blmlaw.com

LEARNING OUTCOMES

After studying this module and completing the self-assessment questionnaire you will understand:

- The new duty of "fair presentation of risk" required by the Insurance Act 2015
- The definition of knowledge relevant to the duty of "fair presentation"
- Insurer's remedies for breach of duty of "fair presentation"
- The new provisions relating to warranties
- How the Act affects fraudulent claims
- When parties may "opt out" of the provisions of the Act

INSURANCE ACT 2015

The end of the 2014/2015 parliamentary term saw the completion of a review of the legislation underpinning insurance law in the UK, with the passage of the Insurance Act 2015. This concluded a reform process initiated jointly by the Law Commission of England & Wales and the Law Commission of Scotland in 2006. The Act which received Royal Assent on 12 February 2015 will change the UK's commercial insurance law and ensure that it is fit for the 21st century market. The current regime, underpinned by the Marine Insurance Act 1906 (the MIA 1906) will continue to apply to policies incepted or renewed for a period of 18 months but thereafter the 2015 Act will apply, by default, to commercial (or in the terminology of the legislation, 'non-consumer') insurance policies.

The law has already been changed to bring the personal lines insurance market up to date. The Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) consolidates in law the broad impact that the role of the Financial Ombudsman Service (FOS) and market-wide statements and practices have, during the past two decades at least, had on how policies are written and how they should respond at the claims stage. This 2012 Act also arose from extensive consultations and joint recommendations by both Law Commissions.

The rationale for the changes to commercial insurance was explained by the government when introducing the reforms:

"The aim is to update the default regime for commercial insurance, by removing rules which no longer reflect good commercial practice and replacing them with ones which are broadly neutral between insurer and insured… The new rules reflect what is considered to be broadly right for the generality of the market. They may not meet the needs of all parties, especially in sophisticated and specialist markets. In these cases, commercial parties will remain free to contract on different terms, provided that they do so on a transparent basis."

How are these aims and benefits to be realised in practice? The Insurance Act 2015 seeks to achieve these aims and benefits by clarifying commercial insurance law in three key areas:

a) The pre-contractual duty of disclosure and the effect of (mis)representations at that stage;

b) The effect of warranties contained in the policy; and

c) The insurer's remedies for fraudulent claims.

A) PRE-CONTRACTUAL DUTY OF DISCLOSURE

The common law has always acknowledged that there is an explicit duty of disclosure on policyholders to inform an insurer of any fact that would be relevant to their assessment of a risk. The MIA 1906 codified marine insurance law and, by extension, non-marine insurance law. One of the most famous Latin doctrines in insurance was founded here: uberrima fides, or utmost good faith. This principle imposed a clear duty on the insured to answer questions honestly. Failure to meet the duty of uberrima fides brought about harsh penalties.

As mentioned above, there has been a recent balancing of the rights and obligations of the parties in the area of consumer contracts. In 2012, CIDRA set aside the strictness of the duties under the MIA and instead required consumers to take reasonable care not to make pre-contractual misrepresentations.

The Insurance Act 2015 also adjusts the disclosure obligations of the MIA, by requiring the commercial policyholder to make 'a fair presentation of the risk' to the insurer. This will include the manner of presentation, which should be "reasonably clear and accessible to a prudent insurer". Although the substance of what constitutes 'fair presentation' will be determined by case law in the fullness of time, the legislation states clearly that a 'fair presentation of the risk' requires "disclosure of every material circumstance which the insured knows or ought to know, or… gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries".

It is the latter requirement, imposing an obligation on insurers to make their own enquiries, which is the most significant change to existing duties.

Knowledge

In the 100 years since codification of insurance law in the MIA, the volumes of data and information available to both insurer and insured and the complexity of commercial business has increased by factors that could not have been imagined by the Edwardians. The 2015 Act therefore revisits the issue of the knowledge of both parties to the insurance contract.

Thus, for an insured who is not an individual, its knowledge includes knowledge of its senior management and of the persons responsible within the organisation for arranging the insurance for the business. Knowledge includes what ought to be known in the ordinary course of the insured's business. Knowledge will also be imputed where there was a suspicion about something but a deliberate decision was taken to refrain from enquiring further about that suspicion.

The knowledge imputed to an insured also extends to include information that "should reasonably have been revealed by a reasonable search", which covers the insured's own organisation and may include information held by others. While this may include information held by an agent, such as a broker, the insured will not be imputed to know confidential information acquired through a business relationship unconnected to the contract of insurance in question.

Similar tests are applied with regard to an insurer's knowledge, but the complexity and extent of large insurance businesses, together with the duties of client confidentiality, are reflected in the Act. The extent of knowledge that will be attributed to the insurer is limited to "the individuals who participate on behalf of the insurer in whether to take the risk" (a term which includes agents of the insurer).

Insurers' remedies for breach of duty of fair presentation

The last section of that part of the Act which covers the duty of fair presentation deals with remedies for breaches. The legislation allows insurers to review the insured's entitlement to indemnity where it (the insured) has breached this duty, but only if the insurer can prove it would not have entered the contract at all, or would have done so only on different terms.

If this can be shown, the insurer's remedies will be determined by the action the underwriters would have taken had 'a fair presentation' been made in the first place.

The current law (under the MIA) allows an insurer, in the event of material non-disclosure or misrepresentation by an insured, to avoid the policy from its inception. To put it another way, they can act as if the policy never existed. The premium will be returned to the insured, who will have to account to the insurer for any claims previously paid.

It goes without saying that this is an 'all or nothing' position, which means a policyholder may find themselves without any cover at all, even for the most trivial or accidental act of non-disclosure. All that an underwriter must be able to do is satisfy a court that their assessment of the risk, and therefore the premium, was influenced by the non-disclosure. The perception – and, some might say, the reality – is that this leaves the present law heavily weighted in favour of insurers.

The Insurance Act 2015 redresses this imbalance between insurers and commercial policyholders in cases of material non-disclosure or misrepresentation by introducing the concept of so-called 'proportionate remedies', which have already been introduced in consumer insurance by CIDRA (note that the phrase 'proportionate remedies' does not actually appear in the 2015 Act).

As noted above, under the 2015 Act an insurer will only have a remedy against an insured for breach of the insured's duty of fair presentation where it can show, but for the breach, that it would:

a) Not have entered into the contract of insurance at all; or

b) Have done so only on different terms.

However, before an insurer can even consider its remedy, it has to establish that there has been a 'qualifying breach', which is defined as either:

a) Deliberate or reckless; or

b) Neither deliberate nor reckless.

A qualifying breach is 'deliberate or reckless' if the insured either knew or did not care that they were in breach of their duty of fair presentation. Importantly, the burden is on the insurer to show that a qualifying breach was deliberate or reckless. Breaches of the duty of fair presentation that are "neither deliberate nor reckless" will include innocent or merely careless breaches. That said, it is important to note that the drafters of the Act meticulously avoid both adjectives – innocent and careless – in this context.

The importance of the distinction between these two categories of breach is made to preserve rights for insurers where there has been a deliberate or reckless breach and to provide certain rights for policyholders where the breach is neither of those.

Remedies for deliberate or reckless breaches

If a qualifying breach has been deliberate or reckless, the insurer:

a) May avoid the contract of insurance and refuse to pay all claims; and

b) Need not return any of the premiums paid.

In this way, the new remedy for a deliberate or reckless breach of the duty of fair presentation goes further than the existing law, because the insurer currently has to return the premium unless fraud has taken place.

Remedies for other qualifying breaches

Where the qualifying breach has been neither deliberate nor reckless then new proportionate remedies will be applied:

a) If the insurer would not have entered into the policy on any terms, the insurer may avoid the policy and refuse to pay all claims, but must return the premiums paid.

b) If the insurer would have entered into the policy but on different terms, other than terms relating to the premium, the policy is to be treated as if it had been entered into on those different terms. For example, if the underwriter would have imposed a theft exclusion, had there been fair presentation, the claim would have to be dealt with under the policy, but subject to application of the theft exclusion. Therefore, if the claim submitted was for theft of equipment, for example, the insurer can reject it. It could not, however, seek to avoid the policy.

c) If the insurer would have entered into the policy but would have charged a higher premium, the insurer is entitled to reduce, proportionately, the amount to be paid on a claim, e.g. if the premium would have doubled if fair presentation had taken place, then the amount of the claim payable is reduced by 50%.

B) WARRANTIES

The Insurance Act 2015 makes three changes of note to the law relating to insurance warranties. First, a blanket ban on 'basis of the contract' clauses (which seek to turn all the insured's representations into warranties. Second, that the insured's breach of a warranty merely suspends, and no longer necessarily discharges, the insurer's liability under the policy. Third, and finally, that an insurer may not rely on a breach of a warranty where that warranty relates to a risk that is irrelevant to the type of loss that actually occurred.

Warranties are important terms of an insurance contract, being a device used by insurers to control risk, ensuring that they remain liable for risks only for as long as policyholders keep to their promises. The changes introduced by the 2015 Act arise because warranties within an insurance contract are not well understood beyond the insurance industry and therefore are often controversial in English law. Even a minor breach of a warranty, regardless of whether or not it is the direct or even indirect cause of a loss, will generally provide technical grounds for discharging the insurer from liability.

Given the controversies around warranties, the 2015 Act adopts various legal doctrines and precedents that have arisen since the MIA 1906, and changes the law on warranties to make it more equitable between the insurer and insured (there is surely an echo here of the rebalancing of the remedies, above, for the breach of the duty of fair presentation). The new Act provides that:

a) Warranties should become 'suspensive' conditions, meaning that the insurer will not be liable for losses occurring while the insured is in breach of the warranty, but that its liability will be restored once the breach is remedied (although it should be noted that the legislation anticipates that there will be situations in which a breach of warranty cannot be remedied).

b) A breach of warranty will be taken as remedied where the risk to which the warranty relates becomes essentially the same as that contemplated by the parties (an example would be an insured doing something later than required by a time limit in a warranty).

c) Where a warranty relates to loss of a particular kind, location or time, the insurer cannot rely on breach by the insured to discharge its liability if the insured can show that its breach (of that warranty) could not have increased the risk of the loss that actually occurred.

d) 'Basis of the contract' clauses are prohibited, hence any warranty in the policy will have to be expressly agreed between the parties.

C) FRAUDULENT CLAIMS

While the present law on fraudulent insurance claims is fairly clear, the further clarification provided by the Insurance Act 2015 is to be welcomed.

The Act has no definition of fraud – leaving this decision to the judge hearing the case – but it confirms that the insurer has no liability for a fraudulent claim (as at present) and, further, that the insurer is entitled to refuse all claims occurring after the fraudulent act. It also states that the insurer should meet legitimate claims occurring before then.

The most important points to note from the new Act are that:

a) The remedies proposed for fraudulent claims are universal, in that they apply to both consumer and non-consumer insurance contracts alike (as opposed to those other parts of the Act that apply only to non-consumer contracts).

b) Where an insured commits any fraud in relation to a claim the insurer will have no liability to pay that claim (a codification of the long-established legal principle that any fraud taints the entire claim).

c) As a consequence, any payments already made in relation to the fraudulent claim are recoverable by the insurer.

d) The insurer, on giving notice to the insured, may treat the contract as having been terminated with effect from the time of the fraudulent act.

e) Upon termination, an insurer's liability under the contract for claims occurring before the time of the fraudulent act is unaffected, but they may refuse any liability in respect of a claim that occurs after the time of the fraudulent act.

f) Additionally, if the contract is terminated, premiums are non-refundable at the discretion of the insurer.

Any argument over whether the contract could be avoided by the insurer because the presentation of a fraudulent claim might, of itself, amount to a breach of good faith is settled by the Act. It states unequivocally that any 'rule of law permitting a party to a contract of insurance to avoid the contract on the ground that the utmost good faith has not been observed by the other party is abolished'.

D) DEFAULT REGIME

The government passage quoted in the introduction above emphasises that the Act is intended as a 'default regime' for commercial insurance, such that parties may contract out of its provisions (save for the prohibition on 'basis of the contract' clauses). Contracting out is, however, subject to 'the transparency requirements', which provide that the insurer must take sufficient steps to draw the insured's attention to the less favourable terms in a clear and unambiguous manner before the contract is entered into (or before any variation is agreed).

Note too that the new regime is very much 'one size fits all' and thus makes no distinction based on the size or sophistication of either the insured or its business (save perhaps in relation to the transparency requirements, where the Act states that the characteristics of the insured and the circumstances of the transaction are to be taken in to account.)

Finally, it should be noted that the Act does not oust or alter the jurisdiction of the FOS in relation to micro-enterprises. These are defined in FOS regulations as businesses with a turnover of less than £2m and fewer than 10 employees.

It follows that where the FOS is adjudicating in disputes involving this type of commercial policyholder, it should be anticipated that consumer-style remedies are likely to be applied.

MULTIPLE CHOICE QUESTIONS

Question 1: The Insurance Act 2015 is the first legislation that modifies the law relating to the obligations of insurer and insured in relation to commercial insurance since:

A. Marine Insurance Act 1906
B. Third Parties (Rights Against Insurers) Act 1930
C. Pan Atlantic Insurance Co v Pine Top Insurance Co [in 1995]
D. Consumer Insurance (Disclosure and Representations) Act 2012

Question 2: The Insurance Act 2015 defines commercial insurance as:

A. Employers' liability policies
B. Contractors all-risks policies
C. All of the above
D. A contract of insurance that is not a consumer insurance contract

Question 3: The Insurance Act 2015 received Royal Assent on 12 February 2015 and is now a Statute. It will apply to policies incepted or renewed:

A. 6 months after receiving Royal Assent
B. One year after receiving Royal Assent
C. 18 months after receiving Royal Assent
D. Immediately

Question 4: The obligation on the part of the policyholder to disclose information before the contract of insurance commences is:

A. To make a fair presentation of the risk
B. To disclose information in a reasonably clear and accessible manner
C. To disclose every material circumstance known or which ought to be known
D. To disclose sufficient information to put the insurer on notice to make enquiries

Question 5: The corporate insured will be held to know material facts:

A. Known to its senior managers
B. Known to those responsible for its insurance (including its agents)
C. That would be reasonably revealed by a reasonable search of information available to it
D. All of the above

Question 6: On receipt of the information from the policyholder, the insurer:

A. May rely on the policyholder's representations
B. Should consider whether it has received sufficient information
C. Should consider making further enquiries
D. All of the above

Question 7: In the event that the policyholder fails to comply with its disclosure obligations, and does not do so deliberately or recklessly, the new remedies available are:

A. Avoidance
B. Application of the terms that would have been applied by the insurer had proper disclosure been given
C. Adjustment of the claim
D. Both (b) and (c)

Question 8: The Insurance Act 2015 alters the law relating to warranties in commercial insurance contracts by providing that:

A. A breach of warranty may be remedied
B. An insurer may not rely on breach of a warranty where that warranty is irrelevant to the loss that has occurred
C. Both (a) and (b)
D. Warranties in insurance contracts are not allowed and may not be relied upon

Question 9: The Insurance Act 2015 provides that where a fraudulent claim is made the insurer has no liability to pay the claim, it may recover any sums paid to the insured in respect of that claim, and it:

A. May terminate the policy from the date of the fraudulent act
B. May avoid the policy from inception
C. May sue the insured for breach of the duty of good faith
D. May recover claims paid before the fraudulent claim occurred

Question 10: The Insurance Act 2015 is a 'default' set of rules that apply to commercial insurance policies. Parties may opt out of:

A. All of its terms and agree their own
B. All of its terms, save for 'basis of the contract' clauses
C. None of its terms
D. Any of its terms

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Answers

1. A) 2. D) 3. C) 4. A) 5. D) 6. D) 7. D) 8. C) 9. A) 10. B)