

## CHANGES TO INSURANCE LAW – TAKING STOCK

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### OVERVIEW

The review of insurance law, commenced in 2006 by the Law Commission, produced the Consumer Insurance (Disclosure and Representations) Act 2012 and is finally drawing to a close with the Government's recent introduction of the Insurance Bill. The Bill will be considered under the special Parliamentary procedure for uncontroversial Law Commission Bills, which should enable it to be passed before the end of the current parliamentary session in 2015. The use of this procedure has meant that one or two of the more contentious areas under consideration have been removed from the Bill, although the Law Commission has indicated that further work will continue to try to find a solution to these. The Bill is also being used to bring into force the long awaited Third Party (Rights Against Insurers) Act 2010, to which some minor revisions have been made.

If the Bill is passed it will not come into force for a further 18 months after it receives Royal Assent, (with the exception of the provisions relating to the Third Party (Rights Against Insurers) Act 2010, which are likely to come into force sooner), to allow time for policy wordings to be amended where necessary. In the interim there remains a period in which changes to consumer insurance law are already in force, but the regime for business insureds remains unchanged. This Bulletin is intended to summarise the current position, outlining the changes already in force for consumers and the further changes which the Insurance Act 2014 is expected to introduce.

### THE CONSUMER INSURANCE (DISCLOSURE & REPRESENTATIONS) ACT 2012

The Consumer Insurance (Disclosure and Representations) Act 2012 ("the Act") came into force on 6th April 2013.

#### Disclosure Obligations – Consumer Insureds

The Act radically changed both the disclosure obligations of consumers and the insurer's remedy in the event of breach.

Prior to the Act coming into force a consumer had a duty to disclose all 'material facts', that is facts that an insurer would consider material to its underwriting of a risk, before placement. The Act changed the duty to one that requires consumer insureds, defined as individuals buying insurance "*wholly or mainly for purposes unrelated to their trade, business or profession*", to answer all questions posed by the insurer honestly and to take reasonable care not to make a misrepresentation.

Before the Act came into force a failure to disclose material facts gave an insurer the draconian right to avoid the policy. The Act preserves that right, but only in cases where a deliberate or reckless misrepresentation has been proved to have been made by the consumer. More proportionate remedies have been introduced for cases where the misrepresentation made was careless, based on what the insurer can show it would have done had there been no misrepresentation. The insurer can still avoid the policy if it would not have entered into the contract on any terms. If the insurer would have imposed different

terms it may choose to treat the contract as if those terms applied. If the insurer would have charged a higher premium, any claim under the policy can be reduced proportionately.

### **‘Basis of Contract’ Clauses – Consumer Insureds**

‘Basis of Contract’ clauses are commonly used in proposal forms or elsewhere and seek to turn every representation made, however trivial, into a warranty. The Act abolished ‘Basis of Contract’ clauses for consumers.

Members are referred to Griffin’s two previous bulletins on the Act for further details: The Consumer Insurance (Disclosure and Representations) Act 2012 and The Consumer Insurance (Disclosure and Representations) Act 2012 - Frequently Asked Questions.

## **THE INSURANCE BILL**

The Insurance Bill now before Parliament deals with a number of issues as follows:

For Business insureds

- contracting out of the new law;
- bringing disclosure obligations more in line with those of consumer insureds, although the duty to volunteer information is retained; and
- prohibiting ‘Basis of Contract’ clauses - already prohibited for consumer insureds so, in effect, these are now abolished.

For all insureds – Business and Consumer

- warranties - changed into suspensive conditions;
- fraudulent claims – insurers can terminate cover with effect from the fraudulent act;
- good faith - avoidance as a remedy for breach is abolished; and
- Third Party (Rights Against Insurers) Act 2010 - minor provisions concerning this Act which awaits implementation.

### **Contracting out**

The provisions of the Insurance Bill are intended to establish the default position for business insureds, with parties being free to contract out of its provisions and agree their own terms if they choose. However, any terms of the Insurance Bill which relate to consumer insureds are mandatory and the prohibition on ‘Basis of Contract’ clauses cannot be contracted out of by consumer or business insureds.

### **Business Insureds**

#### **Disclosure Obligations**

The business insured will still have a duty to volunteer information to insurers, but the duty to disclose all material facts prior to a placement is replaced by a duty to make a fair presentation of the risk. The Bill provides that the insured is required to give:

- disclosure of every material circumstance which the insured knows or ought to know,  
or

- failing that, disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances.

Disclosure needs to be made in a manner which would be “*reasonably clear and accessible to a prudent insurer*” so that the duty will not be discharged by providing voluminous, unstructured documentation to the insurer concerning a risk. Where the insured is an individual his knowledge will be deemed to be what is known by him and what is known to those who are responsible for the insurance. Where the insured is an organisation, the knowledge of the senior management of the business, or those responsible for arranging its insurance, will be deemed the knowledge of the insured. Whether an individual or not, the insured will be expected to know what should “*reasonably have been revealed by a reasonable search of information available to the insured*” and that includes information held by the insured’s agents. However, it will not include confidential information acquired by the insured’s agent through a business relationship with someone other than the insured. The insurer will be expected to know things which are common knowledge or which would be known to an insurer operating in the field of insurance concerned. The insurer will also be expected to know something if it is known to an employee or agent who should have passed it on.

Proportionate remedies will be introduced where there is a non-disclosure or misrepresentation. Insurers will still be entitled to avoid the policy where the insured has been deliberate or reckless and there will be no requirement to return the premium. In all other cases the remedy will be intended to put the parties in the position they would have been in had full disclosure been made. As with Consumer insureds, where the insurer can show it would not have entered into the contract on any terms, the contract can be avoided but the premium must be returned. If the insurer would have agreed to enter into the contract but on different terms, the contract will be treated as if those different terms apply. Where a higher premium would have been charged for entering into the contract (with the existing or different terms applying) the insurer is entitled to proportionately reduce the amount paid on any claim.

### **‘Basis of Contract’ Clauses**

‘Basis of Contract’ clauses will be prohibited in business insurance, bringing the position in line with consumer insurance.

### **All Insureds – Business and Consumer**

#### **Warranties**

Breach of a warranty will no longer result in automatic termination of a policy from the moment of breach, but instead all cover will be suspended until the breach has been remedied. This means that insurers may still be discharged from liability for a loss which has no connection with a warranty that has been breached, if that breach has not been remedied at the time of the loss. However, the insurer will remain liable for valid losses occurring under the policy after a breach is remedied.

## Fraudulent Claims

Insurers will be entitled to terminate a policy with effect from the date of any fraudulent act, without having to return any premium. Insurers will have no obligation to pay any legitimate claims thereafter, although they would remain liable for genuine claims occurring before the date of the fraudulent act.

## Good Faith

The remedy of avoidance for breach of the duty of utmost good faith is abolished. The Law Commission has previously pointed out this remedy is unsatisfactory, since where an insurer breaches its own duty of good faith the insured will want to be able to claim under the policy.

## Contracting Out

The Insurance Bill provides the default position for business insurers and parties may choose to contract out of its provisions, other than the prohibition on 'Basis of Contract' clauses. Insurers will need to draw every departure from the default position to an insured's attention before the contract is entered into and cannot simply rely on a standard opting out clause. Where an alternative position to that detailed in the Bill is not specified, it is likely that the position outlined in the Bill would be implied by the courts.

## THIRD PARTY (RIGHTS AGAINST INSURERS) ACT 2010

This Act is intended to make it easier for direct claims to be brought against insurers by third parties when an insured becomes insolvent. It received Royal assent in 2010 but has been awaiting a further statutory instrument to bring it into force ever since. The Law Commission has now taken the opportunity to make some minor amendments to its provisions, principally to amend the definition of an 'insured' under the Act and the type of insolvency event which may trigger the Act's application.

## Late Omissions From The Insurance Bill

The draft Bill contained proposals for late payment damages, once insurers had had a reasonable period to consider a claim and did not have reasonable grounds to dispute it. These proposals were subject to criticism during the consultation process and have been dropped in their entirety from the final Bill.

The draft Bill had also contained proposals concerning 'description of loss' warranties and conditions precedent. The intention was that provisions designed to reduce the risk of a particular type of loss would entitle insurers to avoid paying claims for those types of loss when breached but not for unrelated losses. Breach of warranty to install and maintain a sprinkler system, for example, would preclude recovery for fire losses but not, say, for theft losses. Again, these proposals have been dropped from the final Bill.

The Law Commission has indicated it will continue in its efforts to find a "*workable solution*" to these two areas and so further reforms are likely in due course.

## SUMMARY OF CURRENT POSITION

### Changes In Force Since April 2013:

- New disclosure obligations for consumers; and
- 'Basis of Contract' clauses abolished for consumers.

### Changes Proposed in Insurance Bill:

- New disclosure obligations for business insureds;
- All 'Basis of Contract' Clauses abolished;
- Warranties become suspensive conditions;
- Fraudulent Acts entitle insurers to treat contract as terminated;
- Avoidance for breach of duty of good faith to be abolished; and
- Amendments to the Third Parties (Rights Against Insurers) Act 2010.

These forthcoming changes will have considerable practical implications for Members. Griffin will issue further bulletins in due course, confirming the details of the Insurance Act 2014 when passed by Parliament, the likely implementation date and providing practical guidance as to how best to prepare. In the meantime we are always happy to help with any individual queries or concerns which Members may have concerning these changes.

This bulletin is for general information purposes only and does not provide a comprehensive or complete statement of the law relating to the issues discussed nor does it constitute legal advice. In addition, by its nature, this bulletin may be superseded by subsequent regulatory or legal developments. Professional advice should be sought where appropriate in relation to any particular circumstances.

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