INSURANCE ACT 2015

OVERVIEW

The Insurance Act 2015 ('the Act') received Royal Assent on 12th February, marking the final chapter in the Law Commissions' review of insurance law. The Act's provisions relating to insurance contract law come into force on 12th August 2016, with the intervening 18 month period intended to give the market an opportunity to make the necessary preparations for change.

Some Members have already had to deal with the changes to Consumer insurance law in force since April 2013, which changed the disclosure obligations of Consumer insureds and abolished 'Basis of Contract' clauses in Consumer policies. Members are referred to the following Bulletins for further details of these changes already in force: Consumer Insurance (Disclosure & Representations) Act 2012 and Consumer Insurance (Disclosure & Representations) Act 2012 – Frequently Asked Questions.

All Members will now have to prepare for an additional raft of changes under this further legislation, which will affect both Consumer and Business insureds, and which also applies to reinsurance, as follows:

For Business Insureds

- disclosure obligations are brought more in line with those of Consumer insureds, although the duty to volunteer information is retained; and
- 'Basis of Contract' clauses, which convert all pre-contractual representations into warranties, are prohibited – these are already prohibited for Consumer insureds so, in effect, they are now abolished.

For All Insureds – Business and Consumer

- warranties are changed into suspensive conditions;
- provisions are included to deal with the situation where the insured does not comply with a term which would otherwise affect the insured's ability to recover but is not relevant to an actual loss;
- fraudulent claims – insurers can refuse to pay claims and terminate cover with effect from the fraudulent act; and
- good faith - avoidance as a remedy for breach is abolished.

CONTRACTING OUT

The provisions of the Act are intended to establish the default position for Business insureds, with parties being free to contract out of its provisions (i.e. agree between themselves that they will not apply to their contract) and agree their own terms if they choose. This does not apply to Consumer insureds - any terms of the Act which relate to Consumer insureds are mandatory. If insurers wish to contract out, they will need to draw every proposed departure from the default position (or "disadvantageous term") to a Business insured's attention before the contract is entered into and cannot simply rely on a standard opting out clause. If

an insured's broker is aware, as a matter of fact, that a term is 'disadvantageous' when a contract is being entered into, the insured will also be deemed to be aware of that. The onus will then be on the broker to ensure that the insured understands the position. In practice this means that brokers will need to be familiar with the default position under the Act so that such 'disadvantageous' terms are recognised and highlighted to clients.

If, having agreed to contract out of any part of the Act, no alternative position is specified, it is likely that the position detailed in the Act would then be implied by the courts. However, 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 prior to placement, renewal or a variation of the contract. The Act 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 businessman (which is distinct from a Consumer) his knowledge will be deemed to be what is known by him and what is known to those who are responsible for the insurance (which can include a broker). 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 that agent has with someone who is not connected with the contract of insurance. A broker, therefore, is not under a duty to disclose information which it has learned as a result of placing an unconnected risk. The insurer will be presumed to know things which are common knowledge and things which would be reasonably known to an insurer operating in the field of insurance concerned. The insurer also ought to know something if it is known to its own employee or agent who ought reasonably to have passed it on. Parties will not be able to avoid having knowledge simply by "turning a blind eye".

Proportionate remedies are introduced where there is a non-disclosure or misrepresentation. Insurers will still be entitled to avoid the policy where this has been deliberate or reckless on the part of the insured (or its agent) and there will be no requirement to return the premium. In all other cases the remedy is based on what the insurer would have done had the insured made a full and fair presentation of the risk. 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. For instance, the insurer may be able to show that a higher deductible or lower limits would have been applied. 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. These remedies will, of course, be wholly dependent upon insurers providing compelling evidence of what, if anything, they would have done differently.

'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 CONSUMERS

Warranties

Breach of a warranty will no longer result in automatic termination of a policy, but instead all cover will be suspended from the moment of breach and until the breach has been remedied (if capable of being remedied). Insurers will have no liability for anything which occurs during the period of suspension (subject to the paragraph below concerning terms not relevant to the actual loss), but liability will resume from the moment any breach is remedied.

Terms Not Relevant To An Actual Loss

The Act includes a provision which applies to any warranty or other term which would have the effect of reducing the risk of loss either of a particular type, or at a particular location, or at a particular time. An example would be a sprinkler warranty, which would have the objective of reducing the (particular) risk of fire damage. The insurer will be liable for a loss, even where such a provision has been breached, if the insured can show that breach of such a term could not in fact have increased the risk of the loss which actually occurred. So, if the loss in question was caused by theft, it is very unlikely that a sprinkler failure would have increased the risk of intrusion. The onus is on the insured to show that, in the circumstances in which it occurred, the breach could not have increased the risk of the loss that actually occurred.

There is a qualification to this: the provision will not apply where the warranty or other onerous term defines the risk as a whole. The Explanatory Notes to the Act give some examples of the sort of terms that are contemplated in this respect, and they include terms which set out:

1. the use to which an insured property can be put (e.g. commercial/personal);
2. the geographical limits of the policy;
3. the class of a ship being insured; or
4. the minimum age/qualifications/characteristics of a person insured.

Using the insurance of a ship as an example, terms relating to its class, the qualifications of the captain and the commercial use made of the ship would tend to affect either the whole risk, or a significant part of the risk. In contrast, terms relating to locks would only affect risks of intruders in the particular part of the ship kept locked. Similarly terms relating to sprinkler systems would only relate to the particular risk of fire-damage. If the class term was breached, the insurer would be likely to be entitled to rely on the breach to avoid liability for

any loss. If the sprinkler term was breached, the insured would be entitled to recover under the policy provided it could show that the breach had no effect on the actual loss suffered.

Fraudulent Claims

Insurers will be entitled to terminate a policy (by way of notice to the insured) 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 will remain liable for genuine claims occurring before the date of the fraudulent act. As "fraudulent claim" is not defined in the Act, it is not entirely clear whether the Act will apply where a fraudulent device has been used in support of an otherwise valid claim. However, it is highly probably given the recent decision in the *Versloot v HDI Gerling* case (see Bulletin Fraudulent Device: Entire Claim Forfeited) where the court held that the use of a fraudulent device is a type of fraudulent claim. This issue is likely to come before the courts for resolution at some future point.

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.

PRACTICAL IMPLICATIONS FOR MEMBERS

Duty of Disclosure - Business Insureds

- New disclosure warning will need to be developed for Business insureds.

- Members acting for both Consumer and Business insureds will need to ensure that the correct disclosure warning is given to clients.

- Clients may need guidance to ensure that placing presentations have sufficient signposts to put a prudent insurer on notice as to whether they should ask for anything further.

- Effective record-keeping by Members will be essential since the broker's knowledge will be attributed to the insured – a Member may be in a better position to verify information concerning a long-standing client than a client's newly appointed risk manager.

- Care will be needed to ensure that all relevant information concerning a placement is passed on by Members, whilst ensuring that the confidentiality of information gleaned in the course of acting for other clients, not connected to the placement, is preserved.

Contracting Out - Business Insureds

- The onus is on insurers to draw the insured's attention to any provision in a policy which places the insured in a worse position when compared to the default provisions of the Act. Members will need to be alert to the fact that insurers can discharge this duty by drawing the provision to the broker's attention (or if the broker has "actual knowledge" of the provision) and the responsibility will then be on the broker to relay this information to the client. Brokers will, therefore, be exposed to criticism and potentially E&O claims if they simply leave it to insurers to flag up provisions of which the brokers themselves are aware.

Handling Warranties and other Onerous Provisions – All Insureds

- New standard warnings will be required for warranties, conditions precedent and other onerous provisions. These will need to cater for the fact that warranties are suspensive provisions when breached but insurers will remain liable where an insured can show that breach of warranty, or other onerous provision, is not relevant to a loss suffered.

- Members will still have a duty to highlight all such provisions to clients from an early stage in the placement process, to give an appropriate warning of the consequences of breach and to seek confirmation that the insured can comply.

- Since insurers will no longer be able to rely on breaches of warranty or other onerous provisions to avoid liability, they may scrutinise presentations more closely as an alternative means of managing their underwriting objectives.

Handling Claims – All Insureds

- Clients will need to appreciate that any embellishment of information submitted in support of a genuine claim could amount to a fraudulent device and may have catastrophic consequences. Unless a broker has any particular suspicion of embellishment in the context of a particular claim, a standard warning in the broker's terms of trade/business should be sufficient.

PRACTICAL GUIDANCE FROM GRIFFIN

Griffin will assist Members in the period between now and when the Act comes into force in August 2016 by:

- Preparing a recommended standard duty of disclosure warning for use with Business insureds;

- Preparing a recommended standard wording explaining the nature of warranties, conditions precedent and other onerous provisions and the consequences of breach;

- Developing training proposals to assist Members in becoming familiar with the details of the forthcoming changes;

- Continuing to deal with ad hoc queries from Members on the changes and collating these into a Frequently Asked Questions Bulletin (as was done in respect of the previous consumer insurance changes) if appropriate.

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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