Insurance/
Reinsurance

July
2014

THE INSURANCE BILL

On 17 July 2014, the Insurance Bill (the Bill) was introduced into the UK Parliament. The Bill proposes to reform areas such as disclosure in business insurance, warranties and an insurer's remedies for fraudulent claims. The Bill will introduce new law (replacing the existing common law) and will also amend parts of the Marine Insurance Act 1906 (the MIA 1906).

The Bill was prepared as part of the joint review of insurance contract law by the Law Commission and the Scottish Law Commission (the Commissions), the first stage of which resulted in the Consumer Insurance (Disclosure and Representations) Act 2012 (the CIDRA 2012).

Background

In June and July 2014, the Commissions and HM Treasury (the sponsor of the Bill) consulted on a draft version of the Bill (the Draft Bill). With the exception of three major changes, the Bill that was introduced to Parliament is basically identical to the Draft Bill. The three major changes are that:

1. The clauses on terms relevant to particular types of loss (clause 11 of the Draft Bill) and damages for late payment (clause 14 of the Draft Bill) have been deleted. The Government's report on the responses to the Draft Bill explains that the responses showed that there was no consensus on these clauses. In a joint response, the LMA and IUA were of the view that clause 11 was unworkable and that clause 14 should operate only where the insurer refused to pay a claim in the knowledge that it was valid, or was reckless as to whether it was valid. We understand that the clause regarding damages for late payment might be reinstated (possibly in an amended form) when the Bill is reviewed by the Special Public Bill Committee as part of the Parliamentary process.


2. The clause regarding the deemed knowledge of an individual acting as agent of the insurer (clause 6(3)(b) of the Draft Bill) has also been removed. This stated that confidential information held by such an individual would not be attributed to the insurer where the information was acquired through a business relationship with someone other than the insurer. The omission of this clause means that the common law position will continue to stand. A practical example is where a coverholder acts for two insurers and issues a policy on behalf of each insurer for similar risks. Information (confidential or otherwise) that is received by the coverholder for the purposes of the first insurer may (but will not necessarily) be attributed to the second insurer.
3. The Bill contains new provisions amending the Third Parties (Rights Against Insurers) Act 2010 so that it can be brought into force. An omission in the Act regarding the definition of insolvency events had previously prevented this.

A simplified Parliamentary procedure for non-controversial Bills is being used, which is available only for Bills that attract a broad consensus of support. The shortened procedure has been adopted in light of the limited time that is available for the Bill to complete its passage through Parliament due to the general election in May 2015, as any bill that has not completed its passage through Parliament by then cannot be carried over to the next session.

For this reason, certain proposals that proved controversial amongst stakeholders, such as damages for late payment (as explained above), a reform of section 53 of the MIA 1906 (a broker's liability for marine insurance premium) and a statutory definition of "insurable interest", were not included in the Bill.

Content of the Bill

Disclosure in business insurance

Clause 3(1) of the Bill introduces a new requirement for the insured to make a "fair presentation of the risk" before the insurance contract is entered into. This replaces the duties regarding disclosure and representations that are contained in the MIA 1906. Disclosure must be made in a manner that would be "reasonably clear and accessible to a prudent insurer", a requirement which is designed to prevent the insured bombarding the insurer with a vast amount of information.

The insured is required to disclose every material circumstance which it knows or ought to know, or alternatively is required to give the insurer "sufficient information to put a prudent insurer on notice that it needs to make further enquiries" to reveal such material circumstances. Clause 7(3) states that a circumstance is material if it would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms. Clause 7(4) contains examples of what may be considered a material circumstance (for example, unusual facts relating to the risk). Although the burden of disclosure remains with the insured, placing responsibility on the insurer to make enquiries reflects the approach already taken by the courts and should prevent insurers relying on a passive approach to disclosure when seeking to exercise its remedies for non-disclosure.

Clause 3(3)(c) places an obligation on the insured not to make misrepresentations. Material representations as to matters of fact are required to be "substantially correct" and material representations as to matters of expectation or belief must be "made in good faith".

The Bill provides certain exceptions to the duty of disclosure, such as where the insurer knows, ought to know or is presumed to know something. The insured is also not required to disclose matters which diminish the risk or are something as to which the insurer waives disclosure. The latter two exceptions are almost exact replicas of exceptions contained in the MIA 1906.

To have a remedy for a breach of the duty of fair presentation, clause 8(1) requires the insurer to demonstrate that it would have acted differently if the insured had made a fair presentation of the risk i.e. that it would not have accepted the risk at all or would have done so only on different terms. The remedies, set out in the Schedule to the Bill, depend on whether the insured's breach was deliberate or reckless or otherwise:

- If the breach was deliberate or reckless, the insurer can avoid the contract and keep the premiums paid by the insured.
- If the breach was neither deliberate nor reckless, the insurer's remedy depends on the action it would have taken had the insured made a fair presentation of the risk.
- If the insurer would not have entered into the contract at all, it can avoid the contract and refuse all claims, but must return the premium. This reflects the common law position.



- If the insurer would have entered into the contract but on different terms, it can elect to treat the contract as having been entered into on those different terms and, if it would have charged a higher premium, reduce the claim paid in proportion to the under-payment of premium. This is described as the "proportionate remedy".

It is worth noting that there has been an increasing move in the market towards the introduction of bespoke clauses into the insurance programmes of major corporate insureds to bring in proportional remedies, dealing with disclosure, late notice, conditions precedent and warranties in particular, but also including defining or ring fencing who the knowledge holders are for the purposes of information obligations under a policy. Under the Bill, these remedies will become enshrined in statute.

Knowledge

This is the most complex part of the Bill, involving several new legal and factual tests that are likely to require clarification by the courts. We consider that it will take some time, and some decided cases, to clarify whether the Bill's prescriptive approach to determining attribution of knowledge has been successful in eliminating any perceived unfairness or uncertainty in the existing case law.

Under clause 4, an individual is treated as knowing both what he knows and what is known to the individuals responsible for his insurance. An insured who is not an individual is treated as knowing what is known to the individuals who are part of its senior management and, again, what is known to the individuals responsible for its insurance.

"The individuals responsible" for the insured's insurance include both employees of the insured (such as risk managers or the employees who are involved in negotiating the insurance) and the insured's agents (such as brokers). The insured is also required to carry out a reasonable search for relevant information and to make enquiries of its employees and agents, as it "ought to know" anything that would be revealed by such a search or enquiries.

Clause 5 sets out what the insurer "knows", "ought to know" and "is presumed to know":

- The insurer "knows" what is known to the individuals who decide on behalf of the insurer whether to accept the risk in question. This includes the individuals involved in underwriting decisions and prevents the insurer automatically being treated as knowing what is known to its claims department.
- However, the knowledge of the insurer's claims department may be attributed to the underwriter under clause 5(2), as the insurer "ought to know" information which an employee or agent of the insurer knows and "ought reasonably to have passed on" to the above individuals. The insurer also "ought to know" information which it holds and is readily available to the above individuals. Again, this forces the insurer to take an active role in the disclosure process.
- The insurer is "presumed to know" both things which are common knowledge and things which "an insurer offering insurance of the class in question to insureds in the field of activity in question would reasonably be expected to know". Although the insurer will be expected to have knowledge of an industry to the extent that it relates to the relevant classes (e.g. knowledge of the construction industry in the context of employers' liability insurance), the insurer will not be expected to have detailed knowledge of an entire industry (the construction industry in this example).

One of the major changes to the MIA 1906 is that the insured's agent has no separate duty under the Bill to disclose information to the insurer; the obligation to make disclosure is solely on the insured. Information held by an agent of the insured will not be attributed to his principal where that information is confidential and was acquired through a business relationship with someone other than the insured respectively. In the context of the duty of fair presentation, this clause would prevent an insured having to disclose to the insurer confidential information which his broker learnt from another client.

Clause 6 contains general provisions regarding knowledge:

- "Knowledge" includes not only actual knowledge, but also what has been termed "blind eye" knowledge: things which the individual suspected but deliberately chose to ignore.
- The knowledge of an individual (whether a broker or an employee of the principal) will not be attributed to the principal where the individual is defrauding his principal.
- This final provision may lead to disputes in practice, such as where the insurer subsequently discovers that the broker held

relevant information which was not disclosed to the insured on the grounds that it was confidential. A dispute of this nature would be particularly undesirable where the confidentiality of the information is debated in open court. Similarly, it would be harsh on the insured if the insurer could claim that it did not know information, simply because the insurer obtained the information from another insured.

Warranties

The principal purpose of clause 9 is to prohibit "basis of the contract" clauses in the context of non-consumer insurance. The equivalent provision in the context of consumer insurance is contained in section 6 of the CIDRA 2012. Clause 9 prohibits provisions which purport to convert all representations in either the proposal or the policy into warranties. This does not affect the insurer's right to include specific warranties in the policy.

Clause 10 contains a significant change to the insurer's remedy for a breach of warranty. It repeals the provisions of the MIA 1906, and any common law equivalent, which completely discharge the insurer's liability from the time of breach of the warranty. Instead, breach of warranty by the insured suspends the insurer's liability from the time of the breach until the breach is remedied. The insurer will not be liable for any loss which occurs during this period, or which can be attributed to something which occurs during this period. However, the insurer's liability will be reinstated once the breach is remedied (if it can be remedied).

Insurer's remedies for fraudulent claims

Where the insured makes a fraudulent claim, clause 11 states that the insurer is not liable to pay that claim and may recover any sums paid to the insured in respect of that claim. The insurer may also treat the contract as having been terminated with effect from the time of the fraudulent act. Where the insurer chooses to do this, it can retain all premiums paid by the insured and will not be liable for any events occurring after the time of the fraudulent act. However, the insurer will still be liable for events occurring before the time of the fraudulent act.

It should be noted that the Bill distinguishes between a "fraudulent act" and a "fraudulent claim", although the difference is not clear. The Explanatory Notes to the Draft Bill go some way to clarifying this by stating that a fraudulent element could be added to a genuine claim after the genuine claim has been submitted and the "fraudulent act" would be the addition of the fraudulent element, rather than the submission of the original claim. The time of the fraudulent act would be the date that the fraudulent element was added. In practice, a claim may be fraudulent from the start, in which case the date of the fraudulent act will be the date that the insured submitted the claim.

The Bill does not contain a definition of "fraud" or "fraudulent"; common law principles will be used to determine what constitutes fraud. Concerns have been raised that the lack of guidance in the Bill could lead to valid claims being denied due to the insured committing an act that, while technically fraudulent, does not have a material effect on the insurer's decision to pay the claim. It has been suggested that such actions should not result in the whole claim being denied, but public policy reasons may require the position to be strict in order to deter all types of fraud, material or otherwise.

Clause 12 sets out the effect of a fraudulent claim in the context of a group insurance policy and adopts the approach taken in the CIDRA 2012. The insurer has the same remedies as are available under clause 11. However, the remedies apply only in relation to that third party and the cover provided for the insured or any other beneficiary remains unaffected.

Contracting out

Clause 14 states that any provision of a consumer insurance contract that puts the insured in a worse position than that set out in Part 3 or 4 of the Bill is invalid.

Clause 15 permits the insured to contract out of the provisions of the Bill in a non-consumer insurance contract. It is not possible for parties to contract out of clause 9 (the prohibition on basis clauses). In order to vary the provisions of the Bill, the insurer must comply with the transparency requirements in clause 16 to make the insured aware that it is agreeing to a reduced level of protection. The terms that vary the provisions of the Bill must be clear and unambiguous and the insurer must take "sufficient steps" to draw them to the insured's attention, unless the insured had actual knowledge of the terms when it entered into the contract. "Sufficient steps" depend on the characteristics of the insured and the circumstances of the transaction, as steps that are sufficient for one insured may not necessarily be sufficient for another.



An Australian perspective

Although new concepts under English law, many of the concepts proposed in the Bill are well grounded in overseas jurisdictions, the closest ones probably being the Scandinavian jurisdictions (Sweden, Denmark, Finland and Norway) and Australia, all of which have insurance contracts legislation which to some extent either waters down traditional insurance contract avoidance defences or nullifies them completely. The underlying principle is to make the remedy proportionate to the breach. Experience of how these jurisdictions deal with these issues is a useful guide as to how the English courts may approach them.

In Australia, the only remedies for non-disclosure and misrepresentation by the insured are set out in section 28 of the Insurance Contracts Act 1984 (the Act). The main effect of the section is to restrict the common law right of avoidance to cases of fraudulent non-disclosure or misrepresentation, that is, a representation made with the intention of its being relied upon and with the knowledge that it is not true.

In the case of an innocent or negligent non-disclosure or misrepresentation, the insurer cannot avoid the contract from its inception but is entitled to cancel the contract under section 60 of the Act. Where the insurer would not have entered into the contract on the same terms if the non-disclosure or misrepresentation had not occurred, but would still have been prepared to accept the risk for a different premium, a higher excess or additional terms and conditions, the insurer is permitted to reduce its liability to the extent necessary to put it in the position that it would have been in. This remedy is similar to those contained in the Schedule to the Bill. The insurer must demonstrate this position through discovery of its underwriting guidelines, examination of its own expert witnesses or other similar evidence about its risk selection practices.

Where the insurer would not have issued the policy at all had the non-disclosure or misrepresentation not occurred, it may reduce its liability on the claim to nil.

The Act has been the subject of extensive review in recent years and, given that the remedies in section 28 were not amended in the 2013 reforms and have a fairly settled interpretation, they would seem generally to operate satisfactorily to the benefit of both parties to the contract of insurance.

Next steps

If the Bill receives Royal Assent before the current Parliamentary session ends on or around 30 March 2015, we expect the new Act to enter into force in early to mid-2016.


For more information, please contact the authors of this Briefing:

Richard Spiller
Partner, London
T: +44 (0)20 7264 8770
E: richard.spiller@hfw.com

Will Reddie
Associate, London
T: +44 (0)20 7264 8758
E: william.reddie@hfw.com

Mikaela Stafrace
Special Counsel, Melbourne
T: +61 (0)3 8601 4513
E: mikaela.stafrace@hfw.com

Richard is Chairman of the Insurance Law Committee of the City of London Law Society and Will is its secretary.

HFW's London office is part of an international network of 13 offices in 11 countries. For further information about insurance/reinsurance issues in London or any other jurisdiction, please contact:

Paul Wordley
Partner, London
T: +44 (0)20 7264 8438
E: paul.wordley@hfw.com

Andrew Bandurka
Partner, London
T: +44 (0)20 7264 8404
E: andrew.bandurka@hfw.com

Olivier Purcell
Partner, Paris
T: +33 1 44 94 40 50
E: olivier.purcell@hfw.com

Pierre Frühling
Partner, Brussels
T: +32 (0) 2643 3406
E: pierre.fruhling@hfw.com

Jeremy Davies
Partner, Geneva
T: +41 (0) 22 322 4810
E: jeremy.davies@hfw.com

Dimitri Vassos
Partner, Piraeus
T: +30 210 429 3978
E: dimitri.vassos@hfw.com

Sam Wakerley
Partner, Dubai
T: +971 4 423 0530
E: sam.wakerley@hfw.com

Mert Hifzi
Partner, Singapore
T: +65 6411 5303
E: mert.hifzi@hfw.com

Henry Fung
Partner, Hong Kong/Shanghai
T: +852 3983 7788/
+86 21 2080 1000
E: henry.fung@hfw.com

Paul Hatzer
Partner, Hong Kong
T: +852 3983 7666
E: paul.hatzer@hfw.com

Richard Jowett
Partner, Melbourne
T: +61 (0) 3 8601 4521
E: richard.jowett@hfw.com

Andrew Dunn
Partner, Sydney
T: +61 (0)2 9320 4603
E: andrew.dunn@hfw.com

Hazel Brewer
Partner, Perth
T: +61 (0)8 9422 4702
E: hazel.brewer@hfw.com

Geoffrey Conlin
Senior Associate, São Paulo
T: +55 (11) 3179 2902
E: geoffrey.conlin@hfw.com

Lawyers for international commerce hfw.com

São Paulo London Paris Brussels Geneva Piraeus Dubai Shanghai Hong Kong Singapore Melbourne Sydney Perth