Insurance/ Reinsurance

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INSURANCE BULLETIN





Welcome to HFW's Insurance Bulletin, which is a summary of the key insurance and reinsurance regulatory announcements, market developments, court cases and legislative changes of the week.

In this week's bulletin:

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2nd Middle East Insurance Industry Awards 2015 LAW FIRM OF THE YEAR

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1. Regulation and legislation

France: Adoption of a historical reform of contract law

On 10 February 2016, the French government enacted an Ordinance reforming the provisions of the French Civil Code relating to contracts *(Ordinance n° 2016-131 published in the Official Journal n° 0035 of 11 February 2016)*. This part of the French Civil Code had remained unchanged since 1804 and it no longer reflected the actual contents of French contract law as it resulted from several decades of case law.

The aim of this reform is to make French contract law *"more accessible"* and *"more foreseeable"* in order to strengthen its attractiveness, said the Minister of Justice. To that purpose major rules established by case law are consecrated in the Civil Code.

Among others, the following new provisions are particularly important:

- The principle of good faith is reinforced: it is now a principle of public policy which applies both to the formation and to the performance of the contract.
- If a "change of circumstances" that was not predictable at the time of the conclusion of the contract arises and renders its performance "excessively onerous for one party", this party may ask the judge to amend the contract or to put an end to it (Article 1195).
- Any clause (such as a limitation of liability clause) which contradicts the "essential obligation" of the contract is deemed unwritten (Article 1170).

The new provisions will enter into force on 1 October 2016 and a great part of them will only apply to contracts concluded after this date.

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- In contracts whose general conditions were not negotiated, any clause which creates a "significant imbalance in the parties' rights and obligations" may be deemed unwritten (Article 1171).

The new provisions will enter into force on 1 October 2016 and a great part of them will only apply to contracts concluded after this date.

The reform of French contract law is of interest to insurers and brokers because it will impact insurance policies, but also because it will have consequences on the insureds' business and the way the new provisions are applied by French courts in the coming years will need to be monitored carefully.

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UK: The Prudential Regulation Authority's take on longevity risk transfers

On 9 February 2016 the Prudential Regulation Authority (PRA) published a letter[1] setting out its views on the general issues arising from longevity risk transfers (LRT), including its expectations of UK insurers and reinsurers carrying out these transactions as either the buyer or seller of longevity protection.

What is LRT?

Longevity risk is the risk that actual survival rates and life expectancy of policyholders, pension scheme members or other beneficiaries will exceed expectations or pricing assumptions, resulting in greater than anticipated retirement cash flow needs.

The need to manage longevity risk has come to the forefront as insurers have increasingly become aware of their exposure to longevity risk and, the PRA recognises that the Solvency II Directive (2009/138/EC) (Solvency II) may provide an added incentive for firms to transfer longevity risk using reinsurance.

PRA's concerns

The PRA is concerned that insurers utilising LRTs may expose themselves to significant levels of counterparty risk by entering into LRTs with a single or small number of counterparties and accordingly, that capital held under the solvency capital requirement in relation to counterparty default risk with respect to LRTs may not be adequate to mitigate the risk. Furthermore, the PRA notes that additional mitigating measures may be necessary. In that note, the PRA reminds firms of their

1 http://www.bankofengland.co.uk/pra/Documents/solvency2/insdirectorsletter09022016.pdf

Make sure the transaction has a clear rationale that is consistent with the firm's risk management principles.

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regulatory obligations with respect to risk management, particularly under Solvency II, relating to monitoring, managing and mitigating concentration risks.

The PRA rules on concentration risk management are particularly relevant in such circumstances, which can be viewed at http://www.bankofengland.co.uk/pra/Documents/solvency2/insdirectorsletter11nov2015.pdf.

What you need to do

- Work with your PRA supervisors early on. The PRA expects to be notified of proposed LRTs well in advance of their execution.
- Prepare a thorough risk management strategy that will satisfy the PRA's scrutiny.
- Make sure the transaction has a clear rationale that is consistent with the firm's risk management principles.

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2. Court cases and arbitration

New Zealand: Christchurch earthquakes – rights of election and effect of delay: *Tower Insurance Ltd v Domenico Trustee Ltd*[1]

In our October 2015 bulletin[2], we considered three cases arising out of the Christchurch earthquakes of 2010 and 2011 which considered the meaning of *"physical loss or damage"* to property.

One of those cases, *C&S Kelly Properties Ltd v Earthquake Commission and Southern Response Earthquake Services Ltd*[3] also considered issues relating to insurers' rights of election and delay in exercising such a right. In *Kelly*, it was held that delay by the Earthquake Commission (EQC) in making an election to reinstate the subject property meant that its purported election was ineffective and the discretion to choose between payment or reinstatement should be exercised by the court. The court then provided the property owners with the choice between payment of a monetary sum by EQC or holding EQC to its purported (but ineffective) election to reinstate.

The decision in *Kelly* followed the High Court judgment in *Domenico Trustee Ltd v Tower Insurance Ltd*[4] which similarly had held that an insurer's right of election must be exercised within a reasonable time and that delay in exercising that right could result in it being lost with the election being made by the court instead.

The High Court's decision that, by reason of delay by the insurer, it was appropriate for the court to make the election instead has been overturned by the Court of Appeal in *Tower Insurance Ltd v Domenico Trustee Ltd*[5] and the proceeding has been sent back to the High Court for a rehearing.

The Court of Appeal decision should provide some relief to insurers of Christchurch properties. However, it should be noted that the Court of Appeal did not determine whether unreasonable delay by an insurer could, in some circumstances, entitle the court to make an election for the parties. It will be interesting to see how these issues are addressed and dealt with in the High Court rehearing, if settlement is not reached first.

Facts

Domenico was the owner of a house which was damaged by the Christchurch earthquakes and became a total loss. The house was insured by Tower Insurance under a policy which provided that, in the event of a total loss:

- Tower Insurance could elect to satisfy a claim for full replacement value by choosing whether to reinstate the property or pay cash.
- If Tower Insurance elected to pay cash, the insured could choose to rebuild on the original site or another site (capped at the cost of rebuilding on the original site) or buy another house (capped at the cost of rebuilding on the original site).
- If the insured chose to rebuild, Tower Insurance was only required to pay rebuild costs actually and reasonably incurred.

1 [2015] NZCA 372
2 http://www.hfw.com/Insurance-Bulletin-22-October-2015
3 [2015] NZHC 1690
4 [2015] NZHC 981
5 [2015] NZCA 372

- An insured who did not wish to repair, replace or rebuild was limited to payment of the present day value (which was defined effectively as an indemnity sum).

Tower Insurance admitted liability for the damage, but Domenico and Tower Insurance were unable to agree on an amount payable under the policy. This was despite lengthy negotiations, including a cash settlement offer made by Tower Insurance based on the full replacement cost of rebuilding the house even though Tower Insurance was not obliged to pay for the costs of rebuilding the property before that cost had actually been incurred.

Domenico issued proceedings in the High Court claiming that Tower Insurance had elected to settle the claim by paying to Domenico in cash the costs to rebuild the house without the need for Domenico to actually rebuild or incur these costs. In the original statement of claim, the rebuild cost were said to be $842,392, but this figure had reduced to $370,000 by the time of the High Court trial.

Whether an election had been made?

In the High Court, Associate Justice Gendall considered commentary and case law (including from the United Kingdom and Australia) and set out eight general principles applicable to the concept of election with the first of these being that: *"election is an irrevocable act between two or more inconsistent rights that must be unequivocal, unqualified and communicated to the other party."*

Having reviewed the negotiations between the parties, the judge held that Tower Insurance had not at any stage, by either words or conduct, unequivocally made an election to make payment (or to reinstate). Instead, he found that Tower Insurance had made it clear that it stood willing to settle by reinstatement of the property and, when Tower Insurance was faced with a claim which it considered exaggerated, its inclination was towards the rebuild option, while at the same time holding out hope that the parties could reach a sensible cash settlement outside the strict terms of the policy.

Without deciding the point, the Court of Appeal expressed reservations as to whether the judge was correct to conclude that the court can itself make the election for an insurer by reason of delay.

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The Court of Appeal also considered the negotiations between the parties and held that the judge was correct to find that there was no unequivocal election made by Tower Insurance as to the mode of settlement.

Effect of delay

Following on from these findings, the High Court and Court of Appeal then considered the effect of delay when an election has not been made.

In the High Court, Associate Justice Gendall held the party entitled to elect had only a reasonable time in which to make an election and, if no election was made, then the law would make the election for that party. As the election must be for an option under the policy, the election deemed by the court was for Tower Insurance to make an immediate payment of indemnity value, unless Domenico decided to rebuild or buy another house, in which case Tower Insurance's liability would likely increase.

The Court of Appeal held that it was not open on the pleadings for the High Court to find that Tower Insurance had made an election through delay or for the court to itself make the election on that ground. The judgment noted that:

"If the Judge was contemplating a finding that was plainly outside the pleadings and argument, he ought to have given the opportunity to both sides to address the issue and to seek an amendment to the pleadings. That did not occur."

The Court of Appeal found that Tower Insurance was seriously prejudiced by this course of events and it allowed Tower Insurance's appeal on the issue of election through delay. The Court of Appeal ordered that the judgment of the High Court be set aside and the proceeding has now been sent back to the High Court for a rehearing. The Court of Appeal offered no view as to the correctness of the judge's finding on the facts that there had been an unreasonable delay.

Without deciding the point, the Court of Appeal expressed reservations as to whether the judge was correct to conclude that the court can itself make the election for an insurer by reason of delay. The Court of Appeal noted that other approaches are available. For example, there may be circumstances where an insurer's words or conduct are consistent with an election having been made. Alternatively, if an insurer is in breach of its obligation to make a decision within a reasonable time, the court may order the insurer to make an election, or an award of damages may also be an available remedy.

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UK: Claiming under FSMA 2000 – when is a "private person" not a private person?

In light of the recent PPI and other financial products mis-selling scandals, banks have been paying out billions of pounds in compensation to consumers. Section 138D of The Financial Services and Markets Act 2000 (FSMA 2000) (as amended by the Financial Services Act 2012) provides a basis on which an applicant may make a claim for the mis-selling of a financial product.

s.138D of FMSA 2000 states that:

*"A rule [any rules contained in the Handbook] made by the [Prudential Regulation Authority] may provide that contravention of the rule is actionable at the suit of a **private person** who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty." [emphasis added]*

The definition of "private person" is contained in section 3 of The Financial Services and Markets Act 2000 (Right of Action) Regulations 2001 which states that a private person is:

"... any individual, unless he suffers the loss in question in the course of carrying on any regulated activity ... and, any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind."

This case is a good example of the court demonstrating the fact that the consumer protections under FSMA 2000 are intended for consumers only.

In *Sivagnanam v Barclays Bank plc*[1] the applicant, a director of a company (the Company) that was sold interest rate hedging products by Barclays, claimed that he was entitled to claim under section138D of FSMA 2000 notwithstanding the fact that it was the Company that was the counterparty to the financial products.

The claimant stated that he had suffered loss as a result of alleged contraventions by Barclays of the Conduct of Business Rules or rules in the Conduct of Business Sourcebook and that he was a "private person" within the meaning of section138D of FMSA 2000. It was agreed by the parties that the claimant was a "private person", but the court was directed to consider whether the claimant was entitled to make a claim in light of the lack of *locus standi*. The parties also agreed that the Company would not be a "private person" within the meaning of this regulation as it was carrying on a business.

The court agreed with the defendant in its assertion that the claimant was not intended to be protected by the rules of either COB or COBS as the claimant was not one of the types of persons who were intended by parliament to be protected by the relevant legislation or rule.

The court held that the particulars of claim were drafted by reference to the loss suffered by the Company. Section 138D of FSMA 2000 was designed to protect the customers who constituted "private persons" within the meaning of that section and was not intended to apply to a different group of people who fell outside that category to whom no duty was owed and in respect of whom no breach of duty has even been pleaded. The claimant was not therefore a person whom the legislation was designed to protect.

This case is a good example of the court demonstrating the fact that the consumer protections under FSMA 2000 are intended for consumers only and that applicants will not be able to, no matter how fanciful their pleadings, persuade the court otherwise if they do not have the necessary locus standi. This note concentrated on the court's analysis of section138D of FSMA 2000 but the court was minded also to reject the claimant's claim on other grounds.

To read the case in full please go to http://www.bailii.org/ew/cases/EWHC/Comm/2015/3985.html

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1 [2015] EWHC 3985 (Comm)

3. HFW publications and events

HFW attends the AMRAE conference

On 3, 4 and 5 February 2016, HFW Partners Guillaume Brajeux and Pierre-Olivier Leblanc attended the Management des Risques et des Assurances de l'Enterprise (AMRAE) conference in Lille.

HFW publishes a briefing on the EU-US Privacy Shield

HFW has published a briefing[1] on the political agreement between the European Commission and the United States which attempts to fill the void in EU-US data transfer. The political agreement creates a new framework for transatlantic data flows, labelled the "EU-US Privacy Shield".

The briefing considers the content of the new deal, analyses whether the EU-US Privacy Shield plugs the void in EU-US data transfer and sets out what businesses should do now.

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1 http://www.hfw.com/Safe-Harbour-2-0-will-the-EU-US-Privacy-Shield-stand-up-to-scrutiny-February-2016

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