Insurance/ Reinsurance

7 May 2015

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:

1. **Regulation and legislation**
   Australia: Amendments to the wording of notifications to insureds regarding their duty of disclosure, by Susannah Fricke, Associate.

2. **Market developments**
   International: Cyber risk enters top 10 risks to global organisations, by Lucinda Rutter, Associate.

3. **Court cases and arbitration**
   England and Wales: Reinsurance: order of presentation of losses, by Ben Atkinson, Associate.

4. **HFW news**
   Australia: New South Wales super storm declared a catastrophe, by Lucinda Rutter, Associate.
   Nepal: Earthquake losses could reach US$10 billion, by Lucinda Rutter, Associate.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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1. Regulation and legislation

Australia: Amendments to the wording of notifications to insureds regarding their duty of disclosure

The Insurance Contracts Amendment Regulation 2015 (No 1) (Cth) has recently been enacted. This instrument makes important changes to the recommended wording of notifications (contained in the Insurance Contracts Regulations 1985 (Cth)) to be provided to insureds regarding their duty of disclosure pursuant to s22 of the Insurance Contracts Act 1984 (Cth).

These changes will impact insurers who underwrite contracts of general insurance, life insurance and "eligible" contracts of insurance ("eligible" meaning contracts of motor vehicle, home building or contents, sickness and accident, consumer credit and travel insurance).

For insurance contracts entered into prior to 28 December 2015, insurers may continue to use the wording as prescribed in the previous form of the regulations, but the new wordings will need to be adopted for contracts entered into on or after this date. On the renewal of "eligible" contracts of insurance on or after 28 December 2015 the wording as outlined in Part 4 of schedule 1 of the amended regulations will need to be adopted.

It is important that insurers ensure that their notifications reflect the new wordings well in advance of 28 December 2015, and seek legal advice should they require assistance. The amended Insurance Contracts Regulations 1985 (Cth) can be reviewed at the following link: http://www.austlii.edu.au/au/legis/cth/consol_reg/icr1985329/index.html

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2. Market developments

International: Cyber risk enters top 10 risks to global organisations

In a recent survey by Aon concerning global risk management, cyber security threats have entered the top ten risks to global organisations for the first time, coming in at ninth place. This reflects the increasing importance with which global organisations regard cyber risk.

Damage to brand and reputation was the number one concern identified by Aon's global client base, further highlighting the emergence of cyber risk as a key risk factor since it has been repeatedly linked to these issues following data breaches. Chief Innovation Officer, Stephen Cross, at Aon Risk Solutions stated *"it's little surprise to see cyber risk enter the top 10 at the same time we are seeing increasing concern about corporate reputation as the two issues are a great example of the interconnectivity of risk"*.

Other risks found in the top ten include regulatory changes, business interruption, property damage and failure to innovate.

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3. Court cases and arbitration

England and Wales: Reinsurance: order of presentation of losses

In previous Bulletins we reported on the Supreme and lower Court decisions in *Teal Assurance Co Ltd v W R Berkley Insurance Europe Ltd*. We now report upon a further Commercial Court decision in this case, in which W reinsured T in respect of a "top and drop" layer of a programme of excess professional liability insurance provided by T (a captive insurer) to the original insured, B. Importantly, cover under the underlying policies was broad, covering risks on a worldwide basis. Cover under the top and drop layer and its reinsurance was narrower, excluding US and Canadian claims.

In the previous proceedings, T argued against W that B's losses eroded the liability tower in the order in which they were settled by T and that it was therefore open to T to order B's losses however it chose for reinsurance recovery purposes. If correct, this would allow T to collect US losses from the lower layers of the tower, and non-US losses from the top and drop layer, giving T access to W's reinsurance of that layer.

However, in his Commercial Court judgment (which was subsequently upheld by both the Court of Appeal and the Supreme Court) Mr Justice Andrew Smith held that it was not open to T to order the losses in this way and that those losses instead eroded the liability tower in the order in which B's liability to third party claimants was established and ascertained.

The new decision involved the determination of a separate preliminary issue which arose as a result of T revising its case. T now argued not that it was entitled to order B's losses howsoever it chose to settle them but instead that, on the facts, B's liability to third party claimants was established and ascertained in an order which meant that the non-US losses impacted the top and drop layer.

One particular non-US loss had been settled by way of an agreement providing for payment by B into escrow and subsequent draw down upon the escrow funds by the third party claimant, upon certain conditions being fulfilled. T argued against W that B's liability was established and ascertained at the (relatively late) point at which the escrow funds were drawn down upon by the third party claimant. Against this, W argued that B's liability was instead established and ascertained on an earlier date at which the payment into escrow was made.

The Court preferred T's arguments on this preliminary issue, holding that B suffered a loss for the purposes of its professional liability programme as and when the third party claimant drew down on the escrow funds. The programme provided an indemnity in respect of sums which B became "legally obligated to pay as damages". Central to the court's conclusion was its determination that the agreement by B to pay money into escrow was not an agreement to pay damages; such damages were only payable as and when the third party became entitled to draw down upon the funds.

As well as providing useful clarification that a payment into escrow will not ordinarily (assuming equivalent circumstances and contract language to those in this case) amount to a loss for the purposes of a liability policy, the case also raises interesting questions regarding the use of escrow accounts in commutations/policy buy-backs to settle uncrystallised (potential) claims and generate corresponding reinsurance recoveries in situations where a straightforward commutation of outstanding loss/IBNR reserves would not amount to settlement of a "loss" for reinsurance collection purposes.

If payments from escrow funds which have been deposited to meet future liabilities can trigger an indemnity under a liability policy then, provided care is taken not to release the reinsurer from liability before draw-down, a policy buy-back/commutation could potentially be structured by way of payment into escrow in such a way that future reinsurance/retrocession collections are not prejudiced, and so that time (for limitation purposes) does not start to run against the cedant until drawdown has taken place.

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4. HFW news

Australia: New South Wales super storm declared a catastrophe

The Insurance Council of Australia (IAC) has declared the recent cyclonic storms to be a catastrophe. At the end of April, the insured damage bill had reached AUS$295 million (approximately US$235 million). The ICA confirmed that insurers had received 41,500 claims, the majority of which relate to home and contents cover as well as a smaller number of motor and commercial claims.

Additional resources will be rallied in an effort to assist with enquiries and claims processing as a result of the catastrophe declaration. The number of claims is expected to rapidly rise as home owners and businesses assess the damage suffered to their properties. The ICA's chief executive, Rob Whelan, has said *"though most claims so far have been for low-level property damage, mainly from water and wind damage to homes and damage to cars, insurers are also receiving claims for severe damage to houses and roofs...Claims are also being received for stormwater inundation"*.

Only limited information has so far been provide by individual insurers regarding the financial impact on them as a consequence of the catastrophe. Insurance Australia Group previously confirmed that it had received over 10,000 claims related to the storms. Suncorp said it had received 7,500 claims and that its reinsurance

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programme would limit its financial hit to a maximum of AUS$135 million.

Some estimates are that the total damages bill could reach as much as AUS$1 billion.

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Nepal: Earthquake losses could reach US$10 billion

The magnitude 7.8 earthquake which struck Nepal on 25 April has caused economic losses in the region of US$2 billion. According to Kinetic Analysis Corp. (KAC), only a tiny proportion of that cost, which includes property damage and long-term business interruption costs, will be incurred by insurers. KAC indicated that less than 1% of the losses are covered by insurance.

The Insurance Information Institute confirmed that Nepal's insurers collected premiums of approximately US$277 million in 2013, the majority of which concerned life coverage. Nepal's annual property-casualty coverage expenditure is under US$4 per capita. In contrast, this figure is nearly US$2,300 in the US.

It has also been suggested that Indian state reinsurer GIC Re, the largest international insurer in Nepal, will bear a large proportion of the insured loss.

Early estimates suggest that the earthquake may have caused economic losses up to or even exceeding US$10 billion.

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