HFW

INSURANCE BULLETIN
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In this week's Insurance Bulletin:

Andrew Bandurka, Partner, andrew.bandurka@hfw.com

NAZIM ALOM
ASSOCIATE

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1. REGULATION AND LEGISLATION

UK: Prudential Regulation Authority's Report on General Insurance Actuarial Function Reports (AFR)

On 5 February 2018 the Prudential Regulation Authority (PRA) reported back, following its review of AFRs from a number of general insurance firms over the past year. The PRA wanted to consider whether the Solvency II requirements were being met and whether the AFR findings were communicated effectively to the board of their principal firm.

Effective engagement with the chief actuary community is important to the PRA as the chief actuary makes an important contribution to the board's decision-making processes and is well placed to provide effective analysis and advice to help the board navigate the issues arising from the insurance market and external environment.

The letter sets out the areas where the PRA thinks that Solvency II requirements are not always being met and summarises good practice in AFRs, with the primary focus on the requirement that the actuarial function is effective in carrying out its tasks.

The PRA noted that many firms had areas where improvements are required in order to be fully compliant with Solvency II. The AFR is key to the board fulfilling its responsibility of managing the insurer prudently as it informs the board of the reliability and adequacy of technical provisions.

A summary of the PRA's key findings are:

- it is a requirement of Solvency II to highlight deficiencies, with recommendations for remediation. These were not always highlighted clearly for the board. In addition, in some AFRs there was insufficient information on how conclusions have been reached and the alternative approaches and recommendations considered by the actuarial function;
- the PRA noted that, on the whole, reports clearly informed the board of the reliability and adequacy of the calculation of technical provisions, however this was not always backed up by the level of analysis required. The absence of this made the extent to which the board could effectively rely on the work carried out unclear;
- there was a lack of comparison and justification of any material differences in the calculation of technical provisions from year to year and a lack of analysis and explanation of the degree of uncertainty in the estimates of the technical provisions (including limitations of the data used);
- the PRA noted that the written analysis in some AFRs were disproportionately limited compared to the materiality and complexity of the risk profile and reinsurance programme concerned and did not always cover all applicable reinsurance types, including group-wide reinsurance covers where the effect on the entity in stressed scenarios should be analysed.

The PRA welcomes feedback and intends the letter to be part of an ongoing dialogue between it and the chief actuary community and recommends chief actuaries to share the letter with their boards. Firms have the discretion to decide how to structure their actuarial function in order to ensure the necessary level of objectivity and independence. The PRA holds the view that, although Solvency II requirements are mandatory, the AFR should not be treated as an administrative task. Reports that addressed the requirements with the level of analysis appropriate to the materiality and complexity of the areas in question are those that the PRA held to be effective as they also clearly communicated the key issues and recommendations to the board.

The PRA is providing specific feedback to individual firms and has already met several chief actuaries and will be meeting more throughout this year to discuss their experiences, the challenges they face, and how the actuarial function can best support the board.

A copy of the full letter can be viewed at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2018/review-of-actuarial-function-reports-in-general-insurance-firms.pdf

NAZIM ALOM
Associate, London
T +44 (0)20 7264 8760
E nazim.alom@hfw.com

2. COURT CASES AND ARBITRATION

UK: Fundamental dishonesty overrides substantial injustice argument

Further to our last bulletin's report[1] of the decision in *LOCOG v Sinfield* on the test for fundamental dishonesty in personal injury claims, in *Razamus v Ministry of Justice* the High Court has strictly applied that test.

The claimant alleged that medical professionals had failed to diagnose a tumour. It was subsequently discovered that the claimant had lied about seeking treatment during the relevant period.

Section 57 of the Criminal Justice and Courts Act 2015 provides that, in relation to personal injury claims, the court shall dismiss a claim unless it would cause substantial injustice, where a claimant has been found to be fundamentally dishonest (on the balance of probabilities) in relation to the primary claim or a related claim. The claimant argued that he would suffer substantial injustice if his claim was dismissed on account of the lie, due to the 'gross disproportion' between the dishonesty and the effect of depriving him of an award.

Mrs Justice Cockerill found the claimant had one main claim and his lie had substantially affected the presentation of his case, either in respect of liability or quantum, in a way which would potentially adversely affect the defendant in a significant way. She did not consider there could be any 'way out' of the fundamental dishonesty rule via the argument on substantial injustice. It was held that it could not be right to say that substantial injustice would result in *'disallowing the claim where a claimant has advanced dishonestly a claim which if established would result in full compensation'*. Mrs Justice Cockerill stated that to allow this way around the test for fundamental dishonesty would *'cut across what [section 57] is trying to achieve'*.

POPPY FRANKS
Associate, London
T +44 (0)20 7264 8065
E poppy.franks@hfw.com

UK: P.I. insurance: notification requirements – time bar-excess/deductible

This case[1] applied the principles which were established in *Kajima*[2], regarding valid notification of circumstances under claims made policies; it also dealt with insured loss mitigation expenses as first party costs for time limitation purposes; it contains an interesting discussion of the insured's ability to "appropriate" insurer's interim payments to time-barred claims, as well as a point regarding whether the "Insured's Contribution" should be deducted from the recoverable policy limit.

The claimant insured was a specialist in installing and outfitting swimming pools, and it sought indemnity for what it argued were separate circumstances/claims under its two consecutive annual PI policies, which each had a £5m limit and materially identical wordings. Much of the claims consisted of loss mitigation expenses incurred to avoid/minimise liability to third parties and the costs of pursuing the third party pool designers.

Whether the insured could maximize its recoveries from both policies depended on whether its notification(s) to the insurers of relevant circumstances (which later gave rise to third party claims)

POPPY FRANKS
ASSOCIATE

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1. http://www.hfw.com/Insurance-Bulletin-February-2018-Edition-2

1. Euro Pools plc v Royal and Sun Alliance Insurance plc [2018] EWHC 46 (Comm), Moulder J.
2. Kajima UK Engineering Limited v The Underwriter Insurance Company Limited [2008] EWHC 83 (TCC)

ANDREW BANDURKA
PARTNER

"The insured's attempt to circumvent the limitation problem by appropriating interim payments to satisfy time-barred insurance claims was only partially successful, in that, although bona fide appropriation of non-specific payments to claims of choice is permissible in general terms, this was not possible after commencement of proceedings, and so interim payments received after the relevant date (6 years before proceedings were commenced) should be divided pro rata between the expenses incurred before, and those incurred after that date."

attached those later claims to the first policy and/or the renewal. The relevant loss mitigation expenses were incurred in dealing with failures of metal flotation tanks which raised and lowered the "booms" which, using an "air drive" system, could divide the claimant's pools into different sections, and later in dealing with the development of the problems into a change of design to abandon the air-drive system in favour of a hydraulic system of raising and lowering the booms.

The Judge found the first problem was notified to insurers during the first policy. Following *Kajima* she rejected the insurer's argument that this notification was a "hornet's nest" or "can of worms" type of circumstance, and held that the scope of that notification could extend only to circumstances of which the insured was actually aware at that time. She also held that the claims which could be deemed to arise from that notification must necessarily be causally (and not merely coincidentally) linked to those circumstances. At the time of the notification under the first policy, the insured was only aware of a problem with the tanks and not with a wider design problem regarding the air drive system, and there was no causal link between the tank failures and the later change to a hydraulic system. Hence the insured established that the first notification was limited in scope, thus allowing a finding that a later notification of the need to move to a hydraulic system attached the resulting claim to the second policy, thus making a further £5 of cover available.

The Judge went on to decide that a policy condition which entitled the insurer to take over the defence of any third party claim against the insured and to prosecute any claim against a third party (the pool designer) in the name of the insured, which was silent as to liability for associated legal expenses, gave rise to an implied term that the insurer would (when "prosecuting" such a claim) indemnify the insured against adverse costs orders made in the proceedings against the third party. However, there was no reason (based on necessity) to imply a term that the insurer would indemnify the insured against costs incurred by the insured in bringing the claim, since the insurer would pay legal fees directly to the lawyers concerned.

As for loss mitigation expenses incurred by the insured more than 6 years before it commenced proceedings against the insurer, these were held to be time-barred, since, although these were liability policies, the mitigation expenses were first party losses, and the insured's cause of action arose immediately the expense was incurred (as opposed to when demand for indemnity was made or refused), consistent with Lord Mance's speech in the *Teal Assurance*[3] case.

The insured's attempt to circumvent the limitation problem by "appropriating" interim payments to satisfy time-barred insurance claims was only partially successful, in that, although bona fide appropriation of non-specific payments to claims of choice is permissible in general terms, this ceased to be possible after commencement of proceedings, and so interim payments received after the relevant date (6 years before proceedings were commenced) should be divided pro rata between the expenses incurred before, and those incurred after that date.

Finally, the Judge ruled in favour of the insured in determining that the "Insured's Contribution" should be treated as an excess, over which the policy limit applied, rather than a deductible, which eroded the available policy limit, on the grounds that the policy was ambiguous in this respect and should be construed against the insurer.

ANDREW BANDURKA
Partner, London
T +44 (0)20 7264 8404
E andrew.bandurka@hfw.com

3. Teal Assurance Company limited v W R Berkley Insurance (Europe) Limited [2013] UKSC 57

UK: Is privilege secure in regulatory investigations?

Following on from the recent *Serious Fraud Office (SFO) v Eurasian Natural Resources Corporation Ltd* case[1], the Chancery Division (Financial List) has published a judgment in which it confirmed that litigation privilege applied to interview notes created during an internal investigation. This judgment is good news for corporates, and the principles applying to privilege, as it goes against the widely criticised position taken in *SFO v ENRC*, in which the appeal is scheduled for July.

Bilta (UK) Ltd (in liquidation) & ors v Royal Bank of Scotland Plc & anor[2], was a case involving alleged fraud leading to HMRC threatening an assessment against RBS with a view to clawing back some £86million of over-claimed VAT. The facts are complex, but in essence the VAT applicable to various trades of 'carbon credits' was paid to Bilta who subsequently went into liquidation, depriving HMRC of that VAT. RBS instructed its external lawyers to carry out an investigation into the alleged fraud. The case concerned the disclosure of the interview notes created during the investigation.

In relation to the privilege point, the court held that notes created by the bank and its lawyers were produced for the sole or dominant purpose of the contemplated litigation by HMRC, and were therefore covered by litigation privilege. In support of his decision, Vos LJ cited the Court of Appeal's decision in Re Highgrade Traders [1984] BCLC 151 (CA) (in which reports into a fire were sought where the insurer suspected arson), in which it was held that these were created to enable advice to be given in relation to the litigation.

Although Vos LJ stated that cases determining privilege will be fact specific, the Bilta judgment is widely seen as supporting the position on privilege in investigations pre-*SFO v ENRC*.

By way of reminder, in *SFO v ENRC* the court took a very narrow approach to the question of whether documents created in the course of an investigation were for the dominant or sole purpose of the litigation. The court took the view that investigating the facts of an allegation with a view to then deciding on a course of action, were not in themselves sufficient to satisfy the dominant purpose test. The judgment has also created uncertainty by attaching privilege to documents created in order to take legal advice in the litigation, but not those created to avoid the litigation. The appeal is scheduled for July.

NICOLA GARE
Professional Support Lawyer (Disputes)
T +44 (0)20 7264 8158
E nicola.gare@hfw.com

3. MARKET DEVELOPMENTS

Paris: A report to encourage cyber insurance

While cyber risk is increasing significantly and keeping pace with or outstripping the evolving technologies of computing and electronic systems, insurance solutions remain, for their part, at an embryonic state in Europe, which represents less than 10% of the world cyber insurance market.

The French Cyber Risk Commission, chaired by the President of the French Insurance Federation (FFA) has just published a report aimed at convincing the various actors influencing the cyber insurance market to favour the development of the offer of cyber insurance, as a condition precedent to a better protection against such risk.

The report explores a wide range of solutions to contribute to the emergence of a true cyber insurance solution, through the creation of a sound legal and economic environment that effectively supports the development of cyber protection.

It puts forward ten recommendations:

1. Accelerate the development of a cyber risk culture;
2. Clearly explain the content of the different cyber cover options and make it easier to compare insurance offerings;
3. Strengthen the relationship of trust between insurers and the insured in managing cyber insurance contracts;
4. Develop a digital security framework for micro businesses and SMEs;
5. Pool the data collected from cyber incidents;
6. Manage risk exposure and accumulated risk of insurers and reinsurers;
7. Define a European set of technical standards to make it easier to assess the level of security of the policy holders;
8. Establish the conditions for fair competition between cyber insurers;
9. Set up a European and international regulatory watch and follow-up of market evolution;
10. Orient public and private sector investment towards the creation of a French and European chain of excellence in cyber technology;

Check out the full Commission report on the following link: http://www.leclubdesjuristes.com/wp-content/uploads/2018/01/cdj_insuring-cyber-risk_janvier_2018_uk.pdf

PAULINE ARROYO
Partner, Paris
T +33 1 44 94 40 50
E pauline.arroyo@hfw.com

CHARLOTTE GONON
Associate, Paris
T +33 (0)1 44 94 31 91
E charlotte.gonon@hfw.com

1 [2017] EWHC 1017 (QB) (08 May 2017)
2 [2017] EWHC 3535 (Ch)

4. HFW PUBLICATIONS AND EVENTS

Asia: HFW has been ranked as one of the top insurance law firms in Asia-Pacific

HFW has been ranked as a top insurance law firm in the Asia-Pacific region, in the APAC Insurance Law Report. The report, by Gracechurch Consulting, is based on interviews with more than 120 specialist claims technicians, adjusters, managers and directors at the world's largest insurance companies.

Clients praised HFW's "industry knowledge" and "global connections", while HFW lawyers Mert Hifzi, Ranjani Sundar, Stephen Thompson and Patrick Yeung were all named as leading practitioners for insurance work across the region. It's another win for our global insurance and reinsurance practice, having recently been named insurance law firm at the year at the MENA IR Insurance Awards for the second year running.

UK: HFW partners Christopher Foster and Andrew Bandurka named as "Star" lawyers

HFW partners **Christopher Foster** and **Andrew Bandurka** have been named as "Star" insurance lawyers by market research company Acritas.

The Star nominations are based on interviews with more than 4,300 senior in-house counsel around the world, who were asked to identify the best lawyers they had worked with in the previous year – and to explain what made those lawyers stand out.

HFW has over 500 lawyers working in offices across Australia, Asia, the Middle East, Europe and the Americas. For further information about our Insurance/reinsurance capabilities, please visit http://www.hfw.com/Insurance-Reinsurance-Sectors

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