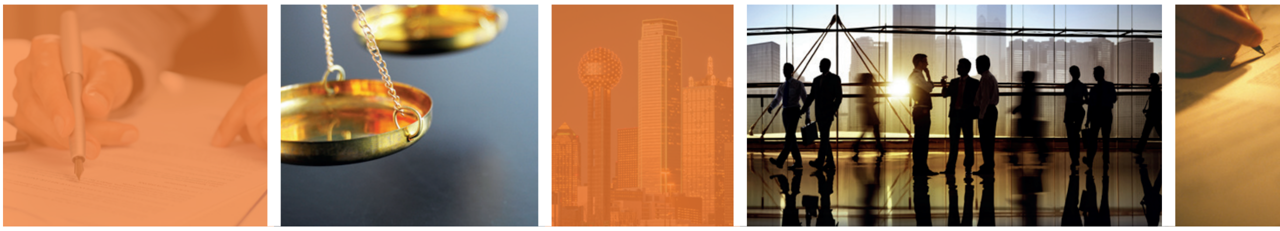
Insurance/ Reinsurance

27 February 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:

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

1.1. Personal accountability of senior managers in the insurance industry (UK)

The Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) are considering a new regime under which senior officials working for insurance firms will become increasingly directly responsible for failings by their firms.

The new regime will apply to senior managers with responsibility for running insurance companies, or those who are responsible for certain key functions within the company. However, the new regime will not entirely replace the existing "approved persons" regime, which will still govern those to whom the new regime will not apply.

The approach likely to be adopted by the FCA and PRA is that where an individual has responsibility for a specific area, that manager will be the first in line for questioning in relation to any perceived failures. The PRA will set out the core responsibilities that the senior managers should take, including fitness and propriety, oversight of capital and liquidity, regulatory reporting and integrity as well as the effectiveness of the firm's whistle blowing procedures.

Whilst the regime will not be identical to that proposed for the banking industry and will not give the FCA and PRA the same powers to prosecute insurance managers criminally for misconduct, it is intended that there will be a suitable level of alignment of the conduct standards for the insurance industry and the banking industry. What is clear in both sectors is that there is a move towards holding senior management increasingly responsible for misconduct.

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2. Market developments

2.1. Low cyber insurance take up by UK companies (UK)

According to research carried out by the Corporate Executive Programme (CEP), an executive level forum that brings together representatives from Fortune 500 companies to share knowledge on security risk, only 13% of UK businesses have cyber insurance cover. This is compared with 40% of businesses in the US.

In conducting its research, CEP interviewed officials at 30 UK and 10 US businesses that operate in a range of areas – financial services, manufacturing, retail and IT services. Over half of those companies generate an annual turnover in excess of £1 billion. Whilst a quarter of the companies had reportedly suffered a business impacting cyber incident within the last year, less than 30% of those companies had dedicated cyber insurance cover.

CEP's research revealed that 25% of the companies interviewed set aside their own money to deal with incidents, 23% relied on their general insurance cover to address cyber risk, and a fifth of the businesses had no cyber cover at all. Query whether the new data breach and cyber incident notification requirements set to be introduced under new EU legislation will encourage more UK companies to purchase dedicated cyber insurance cover in the future.

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2.2. Health insurer could exhaust US$100 million cyber programme (US)

Anthem, the US health insurer, has been affected by a large scale data breach, in which up to 80 million customers may have had their personal data, including credit card details, stolen. As a result, it looks likely that Anthem will exhaust its US$100 million cyber cover.

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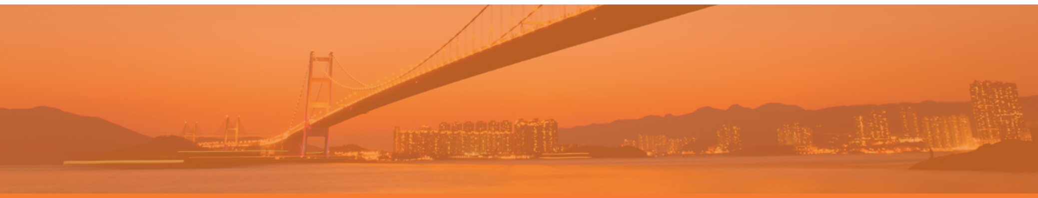

3. Court cases and arbitration

3.1. *Barclays Bank PLC v Grant Thornton UK LLP* – for the first time the English High Court decides that Bannerman disclaimers in non-statutory audit reports are fair

On 12 February 2015, Cooke J. awarded summary judgment to Grant Thornton (GT) in respect of claims by Barclays that in two non-statutory audit reports GT had failed to uncover frauds by officers of the Von Essen Hotels Group (VEH). Each report contained Bannerman type disclaimers stating that GT did not accept/ assume responsibility to anyone other than VEH/its Director. VEH provided the GT reports to Barclays in support of the bank continuing to provide a £250million loan facility.

Following VEH's insolvency, Barclays claimed that its borrower's financial position was negligently overstated by GT in the audit reports such that the bank should recover from GT a loan repayment shortfall of some £45million. The bank pleaded that the disclaimers were unreasonable contrary to UCTA 1977 and thus ineffective. GT applied for summary judgment on this issue.

Applying the three-stage test from Caparo, Cooke J. held that it was reasonable for GT to rely on the disclaimers that negated any duty GT might be said to have owed to Barclays. The Court took into account that (i) sophisticated commercial parties were involved; (ii) no engagement existed between Barclays and GT (yet Barclays had engaged GT directly on other VEH matters where liability caps and limits on use of GT's work products had been agreed); (iii) it is now a well-known commercial practice for auditors to include such disclaimers in reports of which Barclays was aware; (iv) the disclaimers were in clear terms which anyone at Barclays would have understood; and (v) Barclays could be taken to have read them (even though the bank maintained otherwise).

Cooke J. considered that absent any disclaimer it was clearly arguable that a duty of care between GT and Barclays could exist. Disclaimers therefore continue to be invaluable, if not essential, for professionals to include in work products that may end up in the hands of third parties. The Courts will probably continue to examine the fact-sensitive circumstances in which disclaimers are made in order to determine whether they are effective, so professionals should still be careful not to do anything inconsistent with their terms. Thought might also be given as to whether some of the wording relevant to audit reports from the specimen hold harmless and release letters appended to ICAEW Technical Release 04/03 (Access to Working Papers by Investigating Accountants) can be incorporated into disclaimers, for example if clients and/ or third parties will not agree to hold harmless or release terms (which do not appear from the judgment to have been features of this case).

In the meantime, and in the event that an appeal is pursued, it will be interesting to see whether the Court of Appeal agrees with this summary judgment decision.

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3.2. Claims for only select periods of overall asbestos exposure successful in NSW Court of Appeal (Australia)

Two recent decisions, which were heard together in the NSW Court of Appeal[1], have interpreted the operation of s151AB(1) of the *Workers Compensation Act 1987* (NSW) and its application to dust disease matters in a way which may see an increase in successful claims against worker's compensation insurers.

Section 151AB(1) provides that an employer's liability for an occupational disease (which includes dust diseases) is taken to have arisen, for the purpose of their insurance policies *"when the worker was last employed by the employer in employment to the nature of which the disease was due"*.

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Section 151AB(1) provides clarity regarding whom should indemnify in circumstances where an employer had a number of policies over a prolonged period of employment where exposure to harmful substances occurred. However, where an insurer cannot be identified for the date on which employment with the relevant employer ceased, the operation of s151AB(1) can leave the employer (seemingly) without coverage for the period of exposure entirely.

1 See: *Allianz Australia Insurance Ltd v Pomfret* [2015] NSWCA 4; CGU Insurance Ltd v Davies [2015] NSWCA 5)

It argued that when Mr Pomfret was "last employed" in conditions to the nature of which his disease was due (i.e. December 1978), Allianz had not been "on risk". A similar (though not identical) factual scenario arose in the matter of *CGU v Davies*, so the matters were heard together.

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In this case, Mr Pomfret concluded his employment with Ceeco Products P/L (Ceeco) in December 1978. Ceeco had held an applicable policy of insurance with Allianz, but only until January 1978. During his employment with Ceeco, Mr Pomfret was exposed to asbestos dust. Mr Pomfret was diagnosed with asbestosis decades later, at which time Ceeco had been deregistered. Mr Pomfret brought proceedings directly against Allianz for compensation, pursuant to section 6 of the *Law Reform (Miscellaneous Provisions) Act 1946*. Importantly, Mr Pomfret's pleadings only claimed compensation for his injury as caused by his exposure to asbestos up until 31 January 1978 (being the last date that Allianz had been "on risk"). Allianz relied on section 151AB(1) to deny indemnity. It argued that when Mr Pomfret was "last employed" in conditions to the nature of which his disease was due (i.e. December 1978), Allianz had not been "on risk". A similar (though not identical) factual scenario arose in the matter of *CGU v Davies*, so the matters were heard together.

The NSW Court of Appeal determined (in a unanimous judgment) that:

1. The "disease" referred to in section 151AB(1) is the occupational disease for which the employer **is liable in damages**. That liability may only be for injury or harm caused by a particular period of overall exposure.
2. In order for the employer (and by extension the insurer) to be liable for this particular period, the plaintiff must establish that the pleaded period of exposure caused or substantially contributed to the harm or injury. In *Pomfret* (as in *Davies*), the plaintiff could do so, therefore the Court determined that it was arguable that Allianz was liable to indemnify.

It is possible for the plaintiff to successfully restrict their claim to a period which will attract known insurance cover. Insurers cannot assume that, because they were not the insurer "on risk" at the time that a worker's employment ceased with its employer, that they will be afforded the protection of section 151AB(1), as this will depend on how the pleadings are framed (and, possibly) the nature of the disease contracted.

The full text of these decisions can be found here: http://www.caselaw.nsw.gov.au/decision/54d457f8e4b0268efc6f13d9; http://www.caselaw.nsw.gov.au/decision/54d4584be4b0268efc6f13dc

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3.3. Political risk indemnity not deducted from BIT damages

In the recent case of *Hochtlef AG v Argentine Republic*, submitted to arbitration under ICSID, it has been held that indemnity received by the claimant under its political risk insurance arrangements should not be deducted from the amount due to it by reason of a breach of the Bilateral Investment Treaty between Germany and Argentina.

The tribunal found that Argentina had breached certain obligations under the BIT to grant the claimant fair and equitable treatment under the BIT, and awarded the claimant damages in respect of those breaches. The claimant was considered to be entitled to 26% of the damages caused to the investment vehicle, equal to its share in the equity in the investment vehicle.

The claimant received a significant payout under the political risk insurance it had in place with the German Government. The tribunal held that the insurance payment was a benefit which the claimant had arranged on its own behalf, and for which it had paid. The tribunal did not consider that any principles of international law required that such an arrangement should reduce the respondent's liability. The tribunal had no cause to consider whether the claimant would be under any obligation to account to insurers for sums recovered as damages, i.e. by way of subrogation.

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3.4. Solicitors' PII policy responds to claims arising in relation to disbursement loans (UK)

The Court of Appeal has held that a solicitors' professional indemnity insurance policy responds to claims arising in relation to disbursement loans made by litigation funders, and such claims cannot be excluded under the "trading debts" exclusion in the minimum terms and conditions (*Impact Funding Solutions Limited v Barrington Support Services Limited*). This is a departure from previous first instance decisions.

Impact Funding Solutions (Impact) is a finance company which funded disbursements incurred by claimants for the purpose of advancing their claims. In the event of a successful claim, the cost of the loans would be recoverable from the defendant. If unsuccessful the costs would be recoverable from the claimant's litigation insurance. In circumstances where insurance was not available or had been avoided, Impact would seek recovery from the claimants' solicitors.

Impact successfully pursued Barrington Support Services Limited (Barrington) for recovery of the loans, but Barrington went into liquidation before the judgment could be satisfied. Impact therefore brought proceedings against the PI insurers. The PI insurers argued that they were entitled to rely on an exclusion in the minimum terms which provided that an insurer could exclude liability for any breach by an insured of the terms of any contract or arrangement for the supply of any insured goods or services. The court at first instance agreed that by failing to repay the loan, Barrington was in breach of contract for the service and allowed the PI insurers to rely on the exclusion.

On appeal by Impact, the Court of Appeal found that the main purpose of the clause was to prevent solicitors seeking an indemnity from insurers for personal liabilities (i.e. insurers would not be required to pay out if the solicitor fell behind with rent). The court held that the impact loans were *"part and parcel of the obligations assumed by a solicitor in respect of his professional duties to his client rather than obligations personal to the solicitor"*, and that the liability was incurred as part of Barrington's professional advice and was not a debt or trading liability. The appeal therefore succeeded.

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In the event of a successful claim, the cost of the loans would be recoverable from the defendant. If unsuccessful the costs would be recoverable from the claimant's litigation insurance.

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4. HFW events

4.1. HFW seminar on preparing for the Insurance Act 2015 (UK)

On Tuesday 17 February, HFW Consultant Peter Schwartz and Associate Will Reddie presented a seminar on the Insurance Act 2015 (the Act) to the Insurance Institute of Leeds. The seminar analysed the reforms that the Act will to make to English marine and non-marine insurance law in the areas of disclosure in business insurance, warranties and an insurer's remedies for fraudulent claims.

The presenters explained the new law that the Act will introduce, discussed the abolition of parts of the Marine Insurance Act 1906 and suggested some practical steps that those in the market should take before the Act comes into force in August 2016. It was advised that:

- In the context of the duty of fair presentation, policyholders and brokers on the one hand and insurers on the other should initiate discussions upon how best to obtain, identify and communicate material information.
- Insurers and brokers should draft sample clauses to remove basis, utmost good faith and/or "contracting out" clauses.
- In order to utilise the proportionate remedies for a breach of the duty of fair presentation, insurers should implement systems to keep evidence of what terms/premium they would have agreed if they had known the true position, but would not have avoided the contract.

The seminar was presented to a capacity audience and the speakers received a substantial number of requests for follow-up information.

HFW have also published two Briefings on the Act (which at the time of publication was before Parliament in the form of a Bill) which explain the changes that it will make in detail. The Briefings can be found here: http://www.hfw.com/The-Insurance-Contracts-Bill-July-2014 and here: http://www.hfw.com/Insurance-Bill-makes-progress-through-UK-legislative-process-February-2015

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