



THE UK INSURANCE ACT 2015

On 12 February 2015, the Insurance Act 2015 (the Act) received Royal Assent. The Act will come into force on 12 August 2016 and will make reforms in areas such as disclosure by policyholders and their agents in business insurance, warranties and an insurer's remedies for fraudulent claims. The Act will introduce new law (replacing the existing common law) and, significantly, will also amend parts of the Marine Insurance Act 1906 (the MIA 1906). The MIA 1906 states the English common law for all classes of non-life insurance.

The Act 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 (CIDRA 2012).

Background

A simplified Parliamentary procedure for non-controversial Bills was used for the Act. This is available only for Bills that attract a broad consensus of support. For this reason, certain proposals that proved controversial amongst stakeholders when the Commissions consulted on the draft Act, such as damages for late

payment, the reform of a broker's liability for marine insurance premium and a statutory definition of "insurable interest", were not included in the Act.

We understand that some of these proposals may be considered again by the Commissions and, at the time of writing, the Law Commission is consulting on a reform of the requirement for an insurable interest.

Content of the Act

Disclosure in business insurance

Section 3(1) of the Act 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. Section 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. Section 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.

Section 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 Act 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, Section 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 Act, 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 Act, these remedies have become enshrined in statute.

Knowledge

This is the most complex part of the Act, 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 Act’s prescriptive approach to determining attribution of knowledge has been successful in eliminating any perceived unfairness or uncertainty in the existing case law.

Under Section 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.

Section 5 sets out the tests for 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 Section 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 Act 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 who is not connected to the contract of insurance. In the context of the duty of fair presentation, this Section will prevent an insured having to disclose to the insurer confidential information which his broker learnt from another client who is not connected with the contract of insurance in question. Section 4 of the Act states that persons “connected with a contract of insurance” are any insured or beneficiary of the contract, and, in the context of reinsurance, any such persons who are connected with the underlying contract(s) of insurance.

Section 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 Section 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 CIDRA 2012. Section 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.

Section 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).

Terms not relevant to actual loss

Section 11 of the Act limits an insurer’s remedy for the breach of a contractual term (such as a warranty) by the insured to circumstances where the loss suffered by the insured is of the kind contemplated by the term, or at the time or place contemplated by the term. If an insured which is in breach of a term can show that its non-compliance with the term could not have increased the risk of the loss which actually occurred, and in the circumstances in which it occurred, the insurer cannot rely on this breach to exclude, limit or discharge its liability. Although the insured is not required to prove the actual cause of the loss, or prove what would have happened if it had complied with the term, it is not enough for the insured to show that compliance with the term would not have made a difference in the circumstances – the insured must demonstrate that its breach could not have made a difference.

Section 11 is intended to apply only to terms which refer to specific risks; it would not apply to terms which define the risk as a whole. The Section further restricts the ability of an insurer to rely on a breach of warranty to limit or discharge its liability.



Insurer's remedies for fraudulent claims

Where the insured makes a fraudulent claim, Section 12 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 Act distinguishes between a "fraudulent act" and a "fraudulent claim", although the difference is not clear. We understand that the distinction is 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 Act 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 Act 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.

Section 13 provides an insurer with remedies in respect of a fraudulent claim which is made by one beneficiary under a group insurance contract. The insurer has the same remedies as are available under Section 12 and the remedies apply regardless of whether the cover provided would have been a consumer or non-consumer contract. The remedies apply only in relation to the fraudulent beneficiary; and the cover provided for the insured or any other beneficiary remains unaffected.

Contracting out

Section 15 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 Act is invalid.

Section 16 permits the insured to contract out of the provisions of the Act in a non-consumer insurance contract. It is not possible for parties to contract out of Section 9 (the prohibition on basis clauses). In order to vary the provisions of the Act, the insurer must comply with the transparency requirements in Section 17 to make the insured aware that it is agreeing to a reduced level of protection. The terms that vary the provisions of the Act 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.

Section 18 states that any term in a group insurance contract which contracts out of Section 13 is invalid (in respect of a consumer insured) or is subject to the transparency requirements in Section 17 (in respect of a non-consumer insured).

Amendment to the Third Parties (Rights Against Insurers) Act 2010

The Act contains new provisions amending the Third Parties (Rights Against Insurers) Act 2010 so that it can be brought into force. An omission in the Third Parties (Rights Against Insurers) Act 2010 regarding the definition of insolvency events had previously prevented this.

Next steps

Before the Act comes into force on 12 August 2016, insurers, brokers and others in the market should consider how their systems and procedures may need to be updated. HFW is currently advising various parties on the practical steps that they should take in order to prepare for the implementation of the Act.



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