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"Overall, firms that had set clearly defined outcomes fared better in developing effective monitoring frameworks."

REGULATORY

FCA publishes insurance multi-firm review of outcomes monitoring under the Consumer Duty

The FCA has recently published the results of its review of outcomes monitoring under the Consumer Duty in the insurance sector adding to a growing collection of literature analysing firms' compliance with the Duty.

This review follows an FCA request, at the end of 2023, for board and committee reports from 20 larger insurance firms across different sub-sectors of the insurance market. The FCA asked firms to show how they monitor, assess and test their customer outcomes.

The FCA evaluated the information it received against the monitoring requirements as set out in the FCA Handbook, along with published guidance on the Duty, and has provided detailed examples of good and poor practice.

Good practice

Overall, firms that had set clearly defined outcomes fared better in developing effective monitoring frameworks. Firms with clear reporting were also likely to be better positioned to take action based on the results of that monitoring.

The FCA highlighted the following examples, amongst others, as instances of good practice that are likely to comply with a firm's obligations under the Duty:

1. careful thought given to the metrics and data required to monitor customer outcomes;
2. clear risk-based approaches to testing customer journeys; and
3. introducing second-line scrutiny of monitoring.

Poor practice

In contrast to firms demonstrating 'good practice' in relation to outcomes monitoring, the FCA found that other firms were not collecting enough, or the right, data to perform effective monitoring, and such firms were preparing reports that lacked a clear presentation of the data included. This poor practice is seen as potentially preventing senior management from identifying where action needs to be taken, and impeding the ability of boards effectively to challenge the outcomes that are being delivered.

In particular, the following examples were highlighted, amongst others, as areas of poor practice:

1. repackaging existing data with limited consideration of the outcomes that data is intended to monitor;
2. lack of monitoring of outcomes for specific groups of customers, such as vulnerable customers; and
3. overreliance on process completion rather than good outcomes.

Next steps

In a similar vein to other reviews that the FCA has conducted scrutinising firms' compliance with the Duty, there is a sense that, whilst some firms are making good progress, the FCA expects more than it is currently seeing. The review points out that, whilst inadequate outcomes monitoring in and of itself will not necessarily result in poor customer outcomes, monitoring is nonetheless important for firms to be able to identify when poor customer outcomes arise, and to address them accordingly.

The FCA states that all firms operating within the insurance sector should consider the review's findings and has suggested that the review could be used by firms to support them as they work on their first Consumer Duty annual report, which is due by 31 July 2024.

The FCA has also reminded firms that, when they do identify gaps in their compliance with the Duty, they should act immediately and put in place robust plans to address shortcomings.

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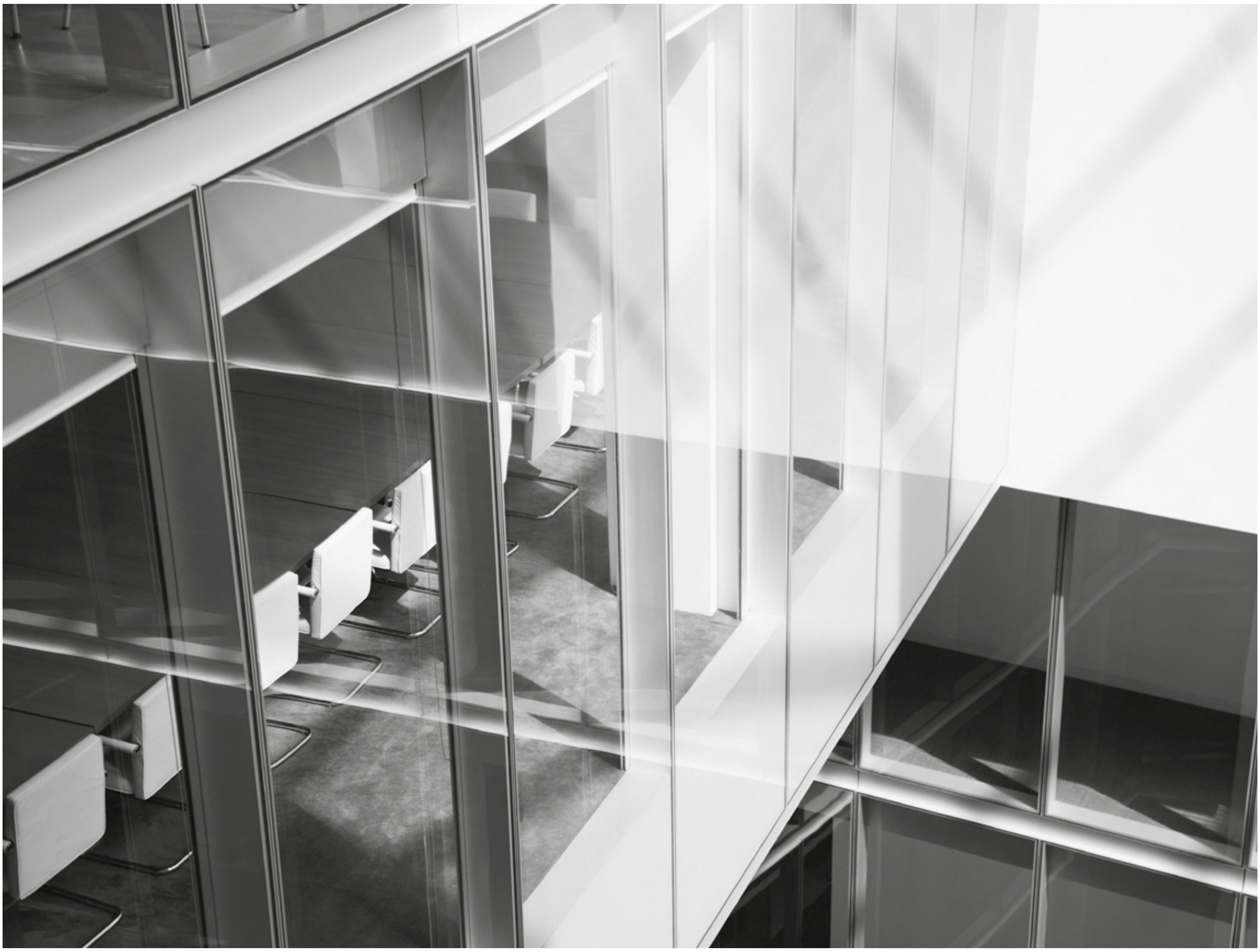

Overseas appointed representatives: FCA expectations for principal firms

The FCA has published additional guidance for firms with overseas appointed representatives, which provides examples of challenges, regulatory expectations and practical considerations for those principal firms.

Background

As part of its 2021 consultation on improving the appointed representatives regime, the FCA identified various concerns as to principal firms appointing overseas appointed representatives (OARs) (i.e. appointed representative firms or persons whose head office is located outside the UK).

In particular, the FCA considered that the extra-territorial element of OAR arrangements could lead to an additional level of complexity and potential risk, impacting the ability of principals to oversee adequately an OAR's activities. The FCA was concerned that inadequate oversight of OARs could cause harm to consumers and market integrity.

The FCA acknowledged feedback to its consultation in Policy Statement PS22/11, and has now, more recently, published a new webpage for firms with OARs which informs principals of the FCA's expectations, and provides additional guidance, as to the oversight of OARs moving forward. The key points on the new webpage are set out below.

Challenges and expectations for principals with OARs

Consistent with its findings in PS22/11, the FCA has identified that principals may have challenges overseeing and communicating effectively with their OARs due to:

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"The FCA has identified that principals may have challenges overseeing and communicating effectively with their OARs."

1. differences in legal, accounting and regulatory requirements for each jurisdiction;
2. geographical distance; and
3. cultural and language differences.

The FCA expects principals of OARs to account for any of the extra challenges listed above that may arise in monitoring and overseeing OARs.

Principal firms should also consider whether customers dealing with an OAR will receive equivalent services, protections and outcomes as those dealing with UK-based appointed representatives. Firms should draw any differences to customers' attention through the provision of suitable information.

On a continuing basis, principals must also establish on reasonable grounds that the activities of their OARs do not result in undue risk of harm to consumers or market integrity.

Practical considerations for principals with OARs

The FCA provides the following practical guidance as to how principals can overcome the challenges outlined above:

1. When completing their annual self-assessment document, principals should consider the additional risks of having OARs when assessing their controls and resources as per SUP 12.4.2(3).
2. The application of the approved persons regime to OARs (including individuals within OARs performing a customer function) depends on, among other things, whether the activities are carried on from an establishment in the UK and how long individuals performing a customer function spend in the UK annually (firms can find further guidance in SUP 10A).
3. Principals must ensure that AR agreements require their OARs to comply with relevant FCA rules (e.g. SUP 12.5.5 R and the communication requirements in GEN 4.4.1 R).

The FCA also highlights that if a principal cannot adequately monitor the activities of an OAR, or if an OAR does not carry on regulated activity in the UK, the principal should consider terminating the relevant appointed representative agreement.

Looking ahead

In working to embed the FCA's expectations, principals can use the following resources:

1. the FCA's guidance on principals' responsibilities; and
2. the content of CP21/34 and PS22/11. Although those papers contained limited guidance on OARs, the FCA acknowledged in CP21/34 that the issues and harm in appointing OARs have some similarities with those in principals providing regulatory hosting services. As such, principals of OARs can also consider the FCA's guidance in respect of regulatory hosting services.

The FCA indicates that it will continue to collect and use data to inform its approach to preventing harm from OARs, including as to whether any targeted supervisory engagement with principals is necessary in the future. Given that the FCA acknowledged the legitimate uses and benefits of OARs in PS22/11 (e.g. intra-group arrangements), it is likely that it will continue to permit the OAR model and not take a uniform approach to all such arrangements.

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EIOPA publishes final report on greenwashing risks

The European Insurance and Occupational Pensions Authority ("EIOPA") published in June its final report to the European Commission on greenwashing risks and the supervision of sustainable finance policies. It has also published an Opinion, containing a framework designed to assist national regulators in monitoring adherence to common principles in relation to sustainability claims. The report discloses a number of interesting practical examples of greenwashing in an insurance context, and recommendations on regulatory approach to this issue.

In this article we summarize the main aspects of the report and opinion.

Background to the Report

This report was produced as a result of a call from the European Commission to provide advice in the area of greenwashing risks[1]. It follows an earlier progress report and focusses on the supervision of greenwashing and potential improvements to the regulatory framework.

Greenwashing[2] is a practice where sustainability-related statements, declarations, actions or communications do not clearly and fairly reflect the underlying profile of an entity, financial product or financial service. This may be misleading to consumers, investors or other market participants.

Report

The report's key conclusions include:

- Sustainability claims made by insurance and pension providers should be accurate, substantiated, accessible and up to date;
- Although providers report generally complying with sustainability-related requirements, EIOPA sees room for improvement;
- The understanding of what constitutes a non-life product with sustainability features varies;
- Consumers' investments in insurance-based investment products are significantly exposed to investments that have some sustainability features (although there are data gaps);
- The 2024 EIOPA survey sees an increase in supervisory attention in this area; and
- EIOPA considers that a common approach to supervising sustainability claims and greenwashing in the insurance sector needs to be developed. This is the aim of the framework contained in the Opinion document (more about which below).

The EIOPA report explains that a sustainability claim is any claim related to the sustainability profile of an entity or product, and such claims state or imply that an entity or product benefits the environment or people. It can also include claims misrepresenting sustainability risk to portray a more environmentally or socially responsible profile. The report sets out how sustainability claims (and hence potential greenwashing) can occur across the various stages of the insurance life cycle and sets out some examples of where possible greenwashing has been seen.

Entity level

It is noted that insurers are increasingly highlighting the sustainability credentials of their underwriting activities and making long-term commitments to transition underwriting and investment to net zero. Insurers are also highlighting credentials of the board, senior management and employees and establishing sustainable finance committees. Reporting has grown under the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation and will grow further under the Corporate Sustainability Reporting Directive (CSRD).

Bad practice highlighted in this area includes spotlighting strong credentials in making investments in companies with low greenhouse gas "GHG" emissions but not disclosing that most emissions are in companies with high emissions. Good practice includes integrating firm-level strong management sustainability considerations, whilst making sustainability a strategic priority for five years with a detailed public action plan.

Product level

In line with consumer demand, this implies the consideration of sustainability in product manufacturing and the potential use of third party data. An example of a misleading claim here would be a multi-option product named "climate protection" but where most of the investment options proposed are not aimed at protecting the climate.

Delivery of products

This includes promotional strategy and interaction between customers and providers at point of sale. Some insurers are using sustainable language in product names or advertising using visuals such as green colours or pictures of trees. Product distributors might advise on sustainability features of products and assess them with regard to consumer preferences. Bad practice highlighted here involves carrying out advertising claiming to contribute to the protection of marine eco-systems without any additional explanation.

Product/scheme management

Insurance providers monitor how products are working in practice, in line with the Insurance Distribution Directive ("IDD") Product Oversight and Governance ("POG") rules. The claims management process may have sustainability features, which might have been outlined in the product's marketing documentation.

An example of good practice seen here is reducing the deductible on motor insurance if customers repair with recycled parts, with clear information on this process, benefits and the amount of reduction. An example of bad practice is portraying an insurance product as having a claims management process that is "very sustainable" without explaining or substantiating this.

The report notes that the risks and impacts of greenwashing include consumers not buying products aligned with their sustainability preferences, and reputational and financial damage for the insurer.

Supervision

EIOPA carried out two sustainability activities and a survey of national competent authorities ("NCAs") on greenwashing to inform its views.

The report discusses EIOPA's findings on SFDR disclosure (applicable to certain providers such as insurers offering insurance-based investment products). The report also notes that the integration of sustainability-related objectives in the POG process had not been performed by a considerable number of undertakings within this regime.

One key issue that the report draws out is that there is no common understanding as to what a non-life insurance product with sustainability features is. Some insurers worked on their classification based on the Taxonomy Regulation; others understood this to mean any product that relates to environmental aspects, including benefitting the environment and reducing environmental risks; and a few included social aspects within this such as products targeting vulnerable customers or strengthening social inclusion. EIOPA notes that the lines of business with the most products with sustainability features are household insurance, motor insurance and natural catastrophe.

In terms of supervisory experiences, the report indicates that there has been a noticeable increase in supervisory attention on sustainability-related requirements and greenwashing. More NCAs reported potential occurrences of greenwashing (an increase from 3 to 5), most at insurance product level. In addition, more NCAs were investigating potential greenwashing occurrences (from

5 to 6). However, the majority of NCAs still did not identify any occurrences of greenwashing (19). EIOPA considers this is likely due to limited availability of products with sustainability features in the markets of those NCAs, and others noted that insurers sometimes engage in so-called "green-bleaching" i.e. taking a cautious approach to branding products with sustainability features.

The report notes that NCAs are dedicating more resources to the issue of greenwashing and developing more tools, but some note issues such as resource constraints, and lack of data.

Non-life insurance framework

A key conclusion is that EIOPA considers that the current regulatory framework does not set explicit standards for non-life insurance products that can claim to have sustainability features (in contrast to certain other pension products and schemes and IBIPs). EIOPA considers that this gap should be addressed, although notes that further work and stakeholder input would be needed.

It is suggested that there may be merit in developing a product categorisation and disclosure regime, and that only products fitting within the categorisation should be able to claim sustainability features. There might also be a requirement that these features are shown in the existing Insurance Product Information Document in a specific section.

Opinion and framework

In its separate Opinion document, EIOPA has set out a number of principles to assist NCAs in monitoring insurance providers' sustainability claims[3]. The four principles are:

1. Sustainability claims must be accurate and precise and fairly represent the provider's profile and/or the profile of the products.
2. Sustainability claims should be substantiated with clear reasoning, facts and processes.
3. Sustainability claims and their substitution should be accessible to targeted stakeholders.
4. Sustainability claims should be kept up to date, and any material change should be disclosed in a timely manner with a clear rationale.

The document outlines some further details of how the principles may be complied with and an annex at the end of the document sets out further examples of good and bad practices. The document indicates that although it is addressed to NCAs, entities and products within its remit should follow it.

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Footnotes:

1. The request was to the three European Supervisory Authorities ("ESAs")– we do not cover the European Banking Authority or European Securities and Markets Authority reports in this article.
2. This is the ESAs' common understanding of greenwashing
3. This follows a consultation that closed in March 2024

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The corporate sustainability due diligence directive (CSDDD): What you need to know

The Corporate Sustainability Due Diligence Directive (CSDDD) entered into force on 25 July 2024.

The legislation will place due diligence obligations relating to actual and potential human rights, and environmental adverse impacts, on large companies operating in the EU. These may apply to a company's own operations, those of its subsidiaries, and those of its business partners/supply chains, thus affecting both upstream and downstream activities. Although financial institutions will only be subject to upstream due diligence requirements there is provision for this to be re-assessed in coming years. In this briefing we set out more details.

Court of Appeal considers key issues in interpretation of appointed representative agreement

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"In his leading judgment, Males LJ emphasised the responsibility of principals to supervise properly the activities and systems of their representatives, and the case as a whole serves as a timely reminder of that responsibility."

In *KVB Consultants Limited & Ors v Jacob Hopkins McKenzie Limited & Ors*,[1] the Court of Appeal considered the extent to which a principal can limit its responsibility for the acts of an appointed representative (AR). The case deals with the application of section 39 of the Financial Services and Markets Act 2000 (FSMA) and serves as a useful reminder to principals of the importance of ensuring, first, that the scope of any AR agreement is clearly defined at the outset of the relationship, and secondly that ARs are properly supervised throughout. Although this case does not concern insurance, it will be relevant to all types of AR agreements. We covered the High Court decision in this case in the September edition of our Insurance Bulletin, but for ease of reference we repeat the background and facts in this article.

Background

The claimants comprised a number of companies and individuals who, between October 2015 and March 2019, had invested a total of approximately £1.7 million in eight investment schemes. Those schemes were devised, managed, and promoted through a company known as Jacob Hopkins McKenzie Limited (**JHM**). The schemes allowed investment in property development opportunities, which would be developed (or partly developed) and sold at a profit, to be split between the investors and JHM. The ventures failed, with half of the properties being repossessed by lenders.

JHM was acting as the AR of Kession Capital Limited (**KCL**). Under the AR agreement between JHM and KCL (**the Agreement**), the "Relevant Business" that JHM was permitted by KCL to undertake was defined as:

> *"… regulated activities which the [Appointed Representative] is permitted to carry out under this Agreement which are subject to the limitations of the Appointer's part IV permission… for the avoidance of doubt, the AR is not permitted to carry out any investment management activities…*
>
> *The Appointer acknowledges that the [Appointed Representative] will offer advisory and arranging services to third party investors with regard to residential property investment. There is no pooling of capital and no CIS."*

CIS means a collective investment scheme, an arrangement that enables investors to contribute to, and effectively 'pool' their respective assets within, a fund scheme and have these managed by a separate person or entity.[2] Additionally, the Agreement provided that JHM would only market and provide its services to professional and sophisticated clients and would not be permitted to conduct business with retail clients. Notably, KCL did not have authorisation to operate, promote or approve CIS, nor was it authorised to provide advice to any retail clients.

The Claim

The claimants applied for summary judgment against KCL (by that point the only remaining active defendant).

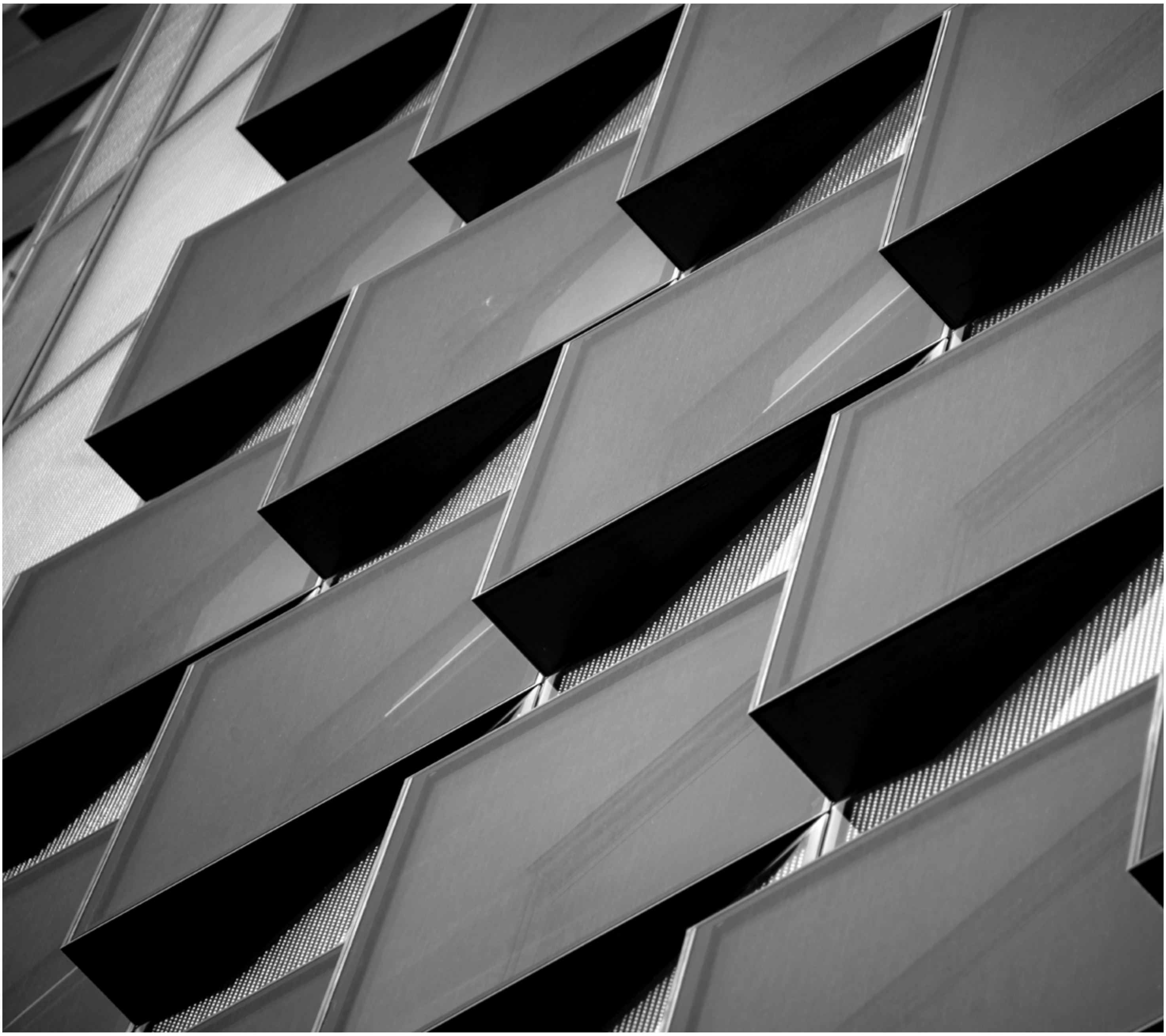
The claimants advanced arguments under three separate heads:

(i) KCL had accepted responsibility for JHM's conduct and was therefore liable, under section 39 of FSMA as principal, for any losses caused by JHM's conduct in relation to CIS.

(ii) KCL's failure to properly supervise its appointed representative was otherwise a breach of the FCA SUP rules.

(iii) KCL had unlawfully approved promotions so as to become liable to the claimants under section 241 of FSMA.

KCL argued that it had only appointed JHM on the strict understanding that there would be no CIS; given that the Agreement



excluded such schemes from the ambit of "Relevant Business", they were not something for which KCL had accepted responsibility. Additionally, KCL noted that the claimants were retail investors, and the terms of appointment expressly prohibited JHM from dealing with them. Whatever was done, therefore, was outside the terms of KCL's acceptance of responsibility and so not subject to section 39 of FSMA.

It was not disputed that each scheme was a CIS within the meaning of section 235 of FSMA and in the High Court it was found beyond doubt that they were.

Awarding summary judgment in favour of the claimants, the High Court held that:

(i) KCL had not accepted responsibility for the operation by JHM of CIS, as the operation of CISs was outside the scope of the activities for which KCL had accepted responsibility under the Agreement.

(ii) KCL *had*, however, accepted responsibility for the promotion and marketing of such schemes by JHM.

KCL's appeal

KCL appealed the judgment on the following two grounds:

(i) On its true construction, the Agreement prohibited JHM from conducting CIS business and therefore KCL neither gave permission nor accepted responsibility for the conduct of such business by JHM under section 39 of FSMA.

(ii) The Agreement prohibited the promotion of the Schemes to retail clients, this being a prohibition which restricts what can be done, not how it can be done. The 'what/how' distinction was drawn by the Court of Appeal in *Anderson v Sense Networks Ltd*[3]. In that case, the Court held that a principal can limit its permission (and the corresponding responsibility which it accepts) to a particular kind of activity, but cannot avoid accepting responsibility by a stipulation as to the way in which the activity must be carried on by the AR.

Court of Appeal decision

The Court of Appeal (Lord Justice Males delivering the leading judgment) dismissed KCL's appeal on both grounds.

Ground one – CIS

The key question for the Court was whether the Agreement, properly construed, prohibited the promotion and marketing of CIS. Lord Justice Males rejected KCL's submissions on this point.

The business which JHM was permitted to conduct was set out in Schedule 5 of the Agreement. It was clear that KCL did not give permission to JHM to operate CIS and did not accept responsibility for the operation by JHM of such schemes. However, that did not detract from the permission granted to JHM in the earlier parts of Schedule 5 to "*market and promote its services, arrange business and give advice*", and to "*offer advisory and arranging services to third party investors*". The distinction between the promoting and marketing on the one hand and the operation on the other hand of a CIS was already set out in the relevant legislation,[4] and it was not possible to read the Agreement as a blanket prohibition on the AR having anything to do with CIS. Males LJ agreed with the High Court that the sentence "*There is no pooling of capital and no CIS*" was a statement of the parties' (mistaken) understanding of the position, not a limitation on the permission granted by the remainder of the Agreement.

Ground two – retail clients

It was clear that the Agreement prohibited JHM from giving advice to or arranging deals for retail clients. The key question for the Court was whether such a limitation on the scope of the permission given to JHM by KCL was permitted by section 39 of FSMA. This exercise of statutory construction was assisted by the distinction drawn by the Court of Appeal in *Anderson* – was the prohibition on conducting business with retail clients an effective limitation as to what activity may be carried on, or was it an ineffective limitation which sought to prescribe *how* the permitted activity may be carried out?

The Court of Appeal held that the stipulation in the Agreement that JHM should deal only with professional clients and eligible counterparties was a contractual term between JHM and KCL. However, it did not affect the scope of the permission given by KCL, or the responsibility which it accepted, for the purposes of section 39 of FSMA. In reaching this decision, Males LJ noted that the type of business which an appointed representative is permitted to conduct is distinct from the question of for whom that business is undertaken. The decision whether a client should be classified as a professional client or eligible counterparty forms part of the way in which the business activity in question is carried on. If a client is mistakenly classified as a professional client or eligible counterparty, the principal should be responsible for the representative's error. It would make no legal or commercial sense to say that a principal entrusts that decision to the representative when the representative gets it right, but not when it gets it wrong – this was in effect what KCL were arguing. It would also have been contrary to the underlying statutory purpose of section 39, namely investor protection, to have found otherwise.

Lord Justice Lewinson, giving a minority judgment, reached a different conclusion on ground two. In his view, it was at least arguable that a person is not authorised except to the extent that his carrying on of regulated activities is authorised by the FCA. If a principal purports to appoint a representative to carry on business that principal is not authorised to carry on, the agreement is not with an "authorised person". KCL's authorisation did not authorise it to advise retail clients. As the FCA is empowered to grant permission for such of the regulated activities as are specified in the permission, the exclusion of retail clients, in Lewinson LJ's view, fell into the "what" not the "how". Therefore, Lewinson LJ would not have granted summary judgment on this part of the case.

Conclusion

In his leading judgment, Males LJ emphasised the responsibility of principals to supervise properly the activities and systems of their representatives, and the case as a whole serves as a timely reminder of that responsibility. The case also highlights the importance of ensuring that AR agreements are clearly drafted – something that is in the best interests of both principals and their representatives.

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Footnotes:

1. [2024] EWCA Civ 765.
2. The full definition of a CIS is set out in section 235 of FSMA.
3. [2019] EWCA Civ 1395.
4. Sections 235 and 237(2) of FSMA.

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"The Judge found the insurer would not have entered into or renewed the policies of insurance if Mr Khosla's insovlency history and the fact he was a de facto director of the Claimant companies had been disclosed."

Non-disclosure of shadow director's insolvency history means no fair presentation

In *Tynefield Care Ltd (and others) v the New India Assurance Company Ltd*[1] the indemnity claims of the insured Claimant companies were dismissed, and policies avoided from inception for breach of the duty of fair presentation under the Insurance Act 2015. The breach related to the insolvency history of one of the de facto or shadow directors of the Claimant companies.

This judgment therefore adds to the post-2015 Act case law considering breach of the duty of fair presentation.

It demonstrates the significance of the disclosure of insolvency histories and offers some helpful analysis of the disclosure obligations of insureds where issues of de facto and shadow directorship arise.

The case also highlights, with regard to expert evidence on materiality, the importance of underwriting experts dealing specifically with the objective test of the prudent underwriter and not the subjective issue of an insured's conduct.

Facts

The insured Claimant companies were involved in operating care homes, including Tynefield Court Care Home. The Claimant companies took out insurance policies with New India Assurance Company (the "Insurer"). Policies relating to the various Claimants were incepted at different times from 2013 to 2015. This summary focuses on the inception/renewal of the policies caught by the 2015 Act, although the facts relating to the non-disclosure set out below are materially similar for all of the inceptions/renewals of the policies and the earlier part of this lengthy judgment deals with pre-2015 Act non-disclosure.

Mr Khosla was a de facto director of the Claimant companies for much of the relevant time (in other words he was acting as a director even though not properly appointed as such).[2] He had also been a de jure director (ie a duly appointed director) of a company that went into administration in 2006. The Insurer argued that the fact Mr Khosla's insolvency history was not disclosed amounted to material non-disclosure.

The following question was contained in the Insurer's proposal form/statement of facts, to which the Insured answered "No":

> *"Have you or any director or partner been declared bankrupt, been a director of any company which went into liquidation, administration or receivership…"*

In August 2019, Tynefield Court Care Home suffered fire damage. The Claimants argued that the question in the statement of facts required disclosure only where a de jure director of the insured companies had been a director of a company which went into liquidation. The Claimants said the non-disclosure was not material given the time that had passed since the administration. The first and second Claimants sought a declaration that they were entitled to be indemnified under their policies for rebuilding and other costs, and all of the Claimants made claims for the additional costs of arranging insurance with an alternative insurer after their policies were terminated.

Issues

Some of the findings of the court are summarised below.

Was answering "No" to the question in the statement of facts a misrepresentation?

The Claimants admitted that Mr Khosla was a de facto / shadow director of the insured companies.

Rawlings HJJ held that a reasonable person would not conclude that the meaning of the word "director" in the question contained in the statement of facts meant a de facto or shadow director. Furthermore, it was held that the concepts of de facto director and shadow director carry a significant level of uncertainty and a reasonable person would not understand the meaning of the terms. Therefore, there was not a misrepresentation.

Was there a failure to disclose material circumstances for the purpose of s.3 of the 2015 Act?

Section 3 provides that the insured must make to the insurer a fair presentation of the risk. This requires that the insured disclose every material circumstance that it knows or ought to know.

The Judge decided that Mr Khosla's insolvency history was a material circumstance[3]. The test for materiality is a low threshold for the insurer to cross, and it is sufficient that a prudent underwriter would have been influenced or affected by the undisclosed facts. The underwriting expert said that the interest of the prudent underwriter lies in those who are actually running the company and he or she would therefore not distinguish between a de jure or a de facto/shadow director. It is noteworthy that the Judge preferred the Insurer's expert evidence on this issue, in part as the Claimants' expert was not asked to address the question of whether the information would have been material to a prudent underwriter.

The Judge considered that a prudent underwriter would be influenced by the combination of facts that Mr Khosla was acting as a shadow director of the Claimant companies at inception of the policy and that he had previously been a de jure director. He continued that this raised two concerns: (i) why the de jure directors of the companies were taking instructions from Mr Khosla and (ii) Mr Khosla was a director of a company that had gone into administration 10 years ago. The fact that 10 years had elapsed since the administration did not affect materiality.

The Judge dismissed the cases of *Young*[4] and *Norwich Union*[5] as of little assistance as the question of materiality is fact-specific.

Did the Insurer waive any duty to disclose such material circumstances?

The question was whether the wording adopted by the Insurer in the statement of facts meant it had waived any requirement on the part of the Claimant companies to disclose insolvency events not mentioned in the question[6]. In other words did the use of the word "director" waive any requirement to provide information about de facto/shadow directors?

It was held that a reasonable man would not consider the use of the word "director" to waive any requirement for the Claimant companies to tell the Insurer that Mr Khosla ultimately controlled them even though he was not a de jure director. The fact that the de jure directors of the Claimant companies acted in accordance with the instructions of Mr Khosla was considered to be unusual and material and the Insurer was not taken to have waived any requirement for the Claimant companies to disclose that material fact.

This case was distinguished from *Ristorante Limited t/a Bar Massimo v Zurich*[7] where the insured had not issued a proposal form, but was asked to confirm whether it agreed or disagreed with certain statements of fact including the following:

> *"no owner, director, business partner or family member involved with the business: … has ever been the subject of a winding up order or company / individual voluntary arrangement with creditors, or been placed into administrative receivership or liquidation."*

The question in *Ristorante* was directed at owners and directors and did not refer to the liquidation of companies of which the Insured's directors had been directors. This, the Judge held, was to be distinguished from the question in the statement of facts in this case which asks if a director of the Insured had been a director of a company which had gone into administration.

Was there a qualifying breach i.e. was the Insurer induced to provide cover in consequence of the material non-disclosure?

Whether the Insurer would have refused to insure the Claimant companies if it had disclosed Mr Khosla's insolvency history is a subjective question. The burden falls on the Insurer to prove that, on the balance of probabilities, it would not, in those circumstances, have incepted the policy.

The Insurer's pre-March 2018 underwriting guidance contained the following statement:

> *"Any proposal which reveals that the proposer has been declared bankrupt, been a director of any company which went into liquidation or been convicted of various specified offences…must be declined…"*

Evidence was accepted from the underwriter that dealt with the proposal, and from a technical control manager, that underwriters took the guidance to mean that if a director of a proposer had been a director of a company that had gone into liquidation or administration then a proposal must be declined.

The Insurer's March 2018 Manual provides:

> *"Business must not be accepted from any proposer or any director or partner who has been declared bankrupt, been a director of any company which went into liquidation, administration or receivership…"*

Despite there being no documentary evidence that the Insurer declined insurance in these circumstances, the Judge concluded that there was no suggestion in the Insurer's policy that there was any discretion either to incept or renew a policy of insurance where a director of the insured discloses an insolvency history. Accordingly, it was held that the material non-disclosure had induced the underwriter to provide cover.

Deliberate or reckless

To date there has been little judicial focus on the question what constitutes "deliberate or reckless" for the purposes of breach of the duty of fair presentation. If a breach of the duty is deliberate or reckless, the insurer is able to avoid the policy, treat it as if it never existed, and retain the premium[8]. In this case it was held not to be deliberate because evidence was accepted that:

(i) Mr Khosla would not have deliberately withheld information from the Insurer in order to secure a smaller premium, at the risk of the Insurer refusing to indemnify a claim.

(ii) Mr Khosla did not read the statement of facts, and those completing the form did not understand what the terms "de facto director" and "shadow director" meant and would not have understood that they ought to disclose Mr Khosla's position or insolvency history as part of their duty of fair presentation of the risk.

(iii) Mr Khosla did not believe he had to disclose his insolvency history because he was not a de jure director of the Insured.

The Judge held that any recklessness in not checking the proposal form was not causative of the non-disclosure because the Claimant companies did not believe the insolvency histories of de facto directors was relevant.

Remedy

The Judge found the Insurer would not have entered into or renewed the policies of insurance if Mr Khosla's insolvency history and the fact he was a de facto director of the Claimant companies had been disclosed.

Therefore, it was held, in accordance with paragraph 4 of Schedule 1 to the 2015 Act, that the Insurer was entitled to refuse the Claimants' claims but must refund their premiums. The Claimants had also claimed for increased costs of obtaining insurance because the Insurer had wrongly terminated their policies. These claims accordingly failed because the Insurer did not wrongly terminate their policies of insurance.

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Footnotes:

1. [2024] 5 WLUK 700
2. From November 2017 Mr Khosla again became a de jure director of a number of the Claimant companies.
3. S7(3) 2015 Act provide that a circumstance or representation is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms.
4. Young v RSA
5. *Norwich Union Insurance Ltd v Meisels* [2007] Lloyds IR 89
6. This point had not been pleaded so the claimants were not entitled to raise it, but the judge nonetheless dealt with the points.
7. [2022] Lloyd's Rep. IR 109
8. Section 8 2015 Act, and Schedule 1 paragraph 2