Insurance/ Reinsurance

21 May 2015

INSURANCE BULLETIN





Welcome to HFW's Insurance Bulletin, which is a summary of the key insurance and reinsurance regulatory announcements, market developments, court cases and legislative changes of the week.

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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

England and Wales: Lloyd's publishes guidance on the Counter-Terrorism and Security Act

Lloyd's has published guidance for the market on the impact of amendments to the Terrorism Act 2000 (TACT) on kidnap and ransom (re)insurance business. The amendments to TACT were made by the Counter-Terrorism and Security Act 2015 (CTSA), which received Royal Assent earlier this year.

CTSA inserted a new section 17A of TACT, which makes clear that reimbursing terrorist ransoms is illegal and that (re)insurers are prohibited from reimbursing ransom payments made to terrorists. However, the new section does not affect insurers' ability to resolve kidnapping/hijacking cases where terrorism is not involved ("terrorism" is defined in the TACT). HFW has previously considered CTSA in the Insurance Bulletin (see: http://www.hfw.com/Insurance-Bulletin-26-March-2015#page_1) and has also published a Briefing on CTSA, which at the time was before Parliament in the form of a Bill. This Briefing can be found here: http://www.hfw.com/UK-Counter-Terrorism-and-Security-Bill-ransom-payments-2-November-2014.

Lloyd's guidance, contained in Market Bulletin YA895, states that managing agents should:

- Maintain a robust compliance framework.
- Implement risk mitigation strategies.
- Carry out appropriate due diligence in order to prevent an illegal payment being made.

The due diligence should include assessing whether the kidnappers' actions could give the managing agent knowledge of or a reason to suspect that the actions fall within the definition of "terrorism" and, if necessary, undertaking, or instructing experts to undertake, further investigation into the activities. If any claims payment to be made by the managing agent would reimburse monies paid by to a terrorist, the payment must not be made.

A copy of Market Bulletin YA895 can be found here: http://www.lloyds.com/~/media/files/the%20market/communications/market%20bulletins/2015/05/y4895.pdf.

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UK: Financial Conduct Authority (FCA) publishes findings of premium finance thematic review

The FCA has published its findings of its review of the provision of premium finance in the retail general insurance market.

The FCA found that firms are not ensuring that customers are able to make informed decisions when they are offered premium finance. Shortcomings were identified in three main areas:

- Firms do not always provide clear and appropriate information on payment options and the different costs associated with these choices, i.e. the difference between paying upfront and paying using premium finance.
- Firms do not always provide appropriate information about the instalment option which they are offering, i.e. firms are not providing an adequate explanation of the credit agreement.
- Firms do not always provide sufficient, clear and consistent information which will ensure that customers understand the role that the firms are carrying out, i.e. that the firms are acting as credit brokers.

The FCA's report directs firms to consider the issues which have been identified, to assess their compliance with relevant rules, and to assess whether they are meeting the FCA's expectations. The FCA also intends to take action against individual firms that it has identified as having specific failings or poor practice.

This is clearly an issue which concerns the FCA, and firms should identify any deficiencies in their policies and processes, and take steps to improve them accordingly, in order to avoid

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the spotlight falling on them. With the FCA indicating that it will engage with consumer bodies to increase customer understanding and awareness, consumers are likely to become more aware of sub-standard documents and procedures and, consequently, more likely to complain to the regulator and/or to the FSCS. It seems that the FCA is encouraging firms to take action now by indicating that it may save the firms greater trouble further down the line.

A copy of the FCA's report can be found here: http://www.fca.org.uk/static/documents/thematic-reviews/tr15-05.pdf.

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2. Market developments

United States: Superstorm Sandy claims to be reviewed by Federal Emergency Management Agency (FEMA)

Following on-going allegations that some Superstorm Sandy flood insurance claims were handled fraudulently, the US Federal Emergency Management Agency (FEMA) will, starting this week, offer victims insured through its National Flood Insurance Program (NFIP) the option to review their claims.

The allegations were raised following accounts of unlicensed engineers preparing insurance reports, and of some of the engineering reports being fraudulently altered to reduce insurance payouts. Among FEMA's concerns is that some victims of fraud have not made complaints nor filed lawsuits, and in light of this, a FEMA representative has made it clear that *"if [victims] are owed money, we pay"*.

Letters will be sent to all Sandy victims who submitted flood insurance claims under the NFIP, explaining the review process which has been *"designed to protect victims from systemic underpayments and fraudulent operators"*. Anyone who believes they were treated unfairly or defrauded will have the opportunity to submit their claim for review.

This news comes shortly after FEMA requested around 3,600 households to return a total of US$24 million of overpaid emergency funding that was paid out to families immediately following the disaster. So far, FEMA funding assistance to individual Sandy survivors has totalled approximately US$1.4 billion, aside from assistance to local governments, and the review will likely cause this figure to rise.

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3. Court cases and arbitration

Australia: Lessons regarding expert evidence in "totally and permanently disabled" (TPD) claims

The recent judgment of *Shuetrim v FSS Trustee Corporation*[1] provides important lessons to life insurers regarding their treatment of expert evidence in deciding whether an insured is TPD.

Mr Shuetrim was a beneficiary of policies of life insurance held by the trustee of his superannuation fund, which covered him if he became TPD. To be classified as TPD under the policies, Mr Shuetrim was required to prove that he was *"incapacitated to such an extent as to render him unlikely to ever engage in or work for reward in any occupation or work for which he is reasonably qualified by reason of education, training or experience"* at the relevant times of assessment (defined in the policies as being three and six months after the insured ceased his employment).

Mr Shuetrim sustained an elbow injury, and also an anxiety and adjustment disorder, which arose from his employment as a police officer and claimed he was TPD. The insurers denied indemnity on the basis that Mr Shuetrim did not fit the definition of TPD.

However, the Court took issue with the means by which the insurers had reached this decision. One insurer had deemed all medical evidence dated after the time of assessment as irrelevant to its determination, despite the fact that these later reports still shed light on the severity of the insured's condition at the time of assessment. The other insurer drew a conclusion from a vocational assessment report that further employment options were available to the insured by reason of his education, training or experience, even though the substance of the report did not support this conclusion.

As a result of these issues, the Court determined that the insurers' consideration of the claim was so unreasonable as to constitute a breach of its obligations of good faith and fair dealing. The question as to whether Mr Shuetrim was TPD was therefore open to be determined by the Court. As the insurers had not provided evidence which properly countered the plaintiff's assertion that he was unlikely ever to engage in work for which he was reasonably qualified by reason of education, training or experience, the Court found in favour of the insured and determined that he met the definition for TPD.

This judgment provides a good reminder of the pitfalls of "picking and choosing" expert evidence, or drawing conclusions that may not be properly be substantiated by evidence, in the assessment of TPD claims.

The full text of this decision can be found at: https://www.caselaw.nsw.gov.au/decision/55397dfde4b0fc828c996486.

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1 [2015] NSWSC 464

The *OCEAN VICTORY*: Can insurers recover money paid out from a co-assured through subrogation?

In *Gard Marine & Energy Ltd v China National Chartering Co Ltd (the OCEAN VICTORY)*[1], the Court of Appeal examined whether an insurer can have a subrogation action against a co-assured, a point of great general significance. It was held in the judgment that the underlying contract must be scrutinised to identify whether or not there is an intention that the insurance is for the joint benefit of the parties.

A vessel, the *OCEAN VICTORY*, was demise chartered by its owners, OVM, to OLH (demise charterers), a company in the same group. The vessel was time-chartered to China National Chartering Co (CNCC, intermediate charterers), and sub-time-chartered to Daiichi Chou Kisen Kaisha (DCKK, sub-charterers). All the charterparties contained a safe port warranty (that the vessel would only trade between safe ports). The vessel was insured for US$70 million with a number of insurers, including Gard, and covered both OVM and OLH (as co-assureds) for their respective rights and interests.

During adverse weather conditions in the port of Kashima, Japan, to where the vessel had been ordered by sub-charterers, the Master navigated the vessel from her berth out to open sea where she was driven onto a breakwater wall and became a total loss, for which the insurers paid. Gard took an assignment of the rights of both OLH and OVM in respect of the total loss and commenced proceedings against intermediate

1 [2015] EWCA Civ 16

charterers for breach of the safe port warranty. Intermediate charterers in turn brought third-party proceedings against sub-charterers.

The first instance judgment in the High Court held that, due to the breach of the safe port warranties in the chain of charterparties, the sub-charterers were liable in damages to the intermediate charterers, and that intermediate charterers were in turn liable to Gard (who had taken an assignment of the demise charterers' rights). Further, it was held that the charterparty between OVM and OLH had not provided for OVM to be able to waive any claims against OLH in favour of a claim against insurers only. Sub-charterers and intermediate charterers appealed the decision.

In the appeal hearing, there were three principal issues for determination:

1. Whether, as a matter of law, there had been a breach of the safe port warranty.
2. Whether, even if there had been a breach of the safe port warranty, the cause of the casualty was not the breach but rather the Master's decision to navigate out to sea in extreme conditions, rather than stay at the berth.
3. Whether, on a true construction of the terms of the demise charterparty, the demise charterers, who had insured the vessel at their expense, had any liability to the owners in respect of insured losses, notwithstanding that such losses may have been caused by a breach of the safe port warranty (the recoverability issue).

The Court of Appeal reversed the first instance judgment and held that Kashima was not an unsafe port and that the sub-charterers were therefore not in breach of the relevant safe port warranty. As such, it was unnecessary for the Court to determine the recoverability issue, but the Court chose to deal with it anyway as it raised an important issue of principle, in relation to the construction of the demise charter, and subrogation rights in general.

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OVM had demise chartered the vessel to OLH on an amended BARECON 89 form, and Clause 12 contained terms providing for the demise charterers to take out insurance on behalf of themselves and owners. Sub-charterers had argued in the first instance that Clause 12 provided for an insurance-funded solution between owners and demise charterers for the insured losses. If this had been the case, then on breach of the safe port warranty, owners would claim on the insurance, for the joint benefit of owners and demise charterers, with Gard unable to pursue a subrogated claim against their insured. The Court of Appeal held that the BARECON demise charter excluded rights of recourse between owners and demise charterers, in favour of an insurance-funded solution, and that the parties to the demise charter had agreed to look to the required hull insurance and not to each other in the event of a total loss.

In the judgment, Lord Justice Longmore stated that, *"it would be nonsensical, in a case in which it was agreed that the parties were to be insured 'in joint names as their interest may appear' and they further agreed that in the event of a total loss the demise charter would come to an end, that they envisaged that either party could sue the other for breach of contract, at any rate once the insurance money was paid and distributed in accordance with the interest of the parties as they appeared"*.

As such, even had the demise charterers been in breach of the safe port warranty, they would not have been liable to Gard for the loss of the vessel, as demise charterers had no liability to owners to pass down the chain to sub-charterers. The effect was such that once the insurance monies had been paid out, liability between the parties was discharged.

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4. HFW publications

Australia: Suspect cladding may spark litigation against builders and developers and may have implications for insurers

HFW has published a Briefing on the recent testing which found that certain cladding did not pass Australian combustibility standards and may as a result leave builders, developers, engineers and architects at risk of legal action and may have implications for insurers.

A copy of the Briefing can be found here: http://www.hfw.com/Suspect-cladding-may-spark-litigation-May-2015.

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