THE INSURANCE ACT 2015

HOW IT EFFECTS YOU FROM 12th AUGUST 2016

Commercial Insurance Law is being transformed with what the UK Government describe as the "biggest reform to insurance contract law since the Marine Insurance Act (MIA) of 1906", the current legislation. The MIA contains provisions which entitles insurers to avoid cover for non-disclosure and terminate for breach of warranty. It is now outdated.

The Insurance Act 2015 (The Act) modernises how insurers approach commercial insurance policies, including reinsurance and retrocession policies that are entered into (or are varied) after 12th August 2016 and are governed by the laws of England, Wales, Scotland and Northern Ireland ("English Law").

While accurate disclosure by you as the insured party remains central to the new law, the Act provides a fairer approach for insurers to follow in the event of a breach of policy requirement and/or your duty to present information. This is intended to give you more protection in the event of a claim being rejected by the insurer on a technicality that hasn't increased the risk of loss. We think the new law will lead to stronger relationships between the insured and insurer.

What you need to do next

This bulletin explains how the Act changes the duty of disclosure for commercial insurance policies, the new treatment of basis of contract clauses, warranties and policy terms applied that are irrelevant to the loss at your next renewal or change after 12th August 2016.

Insurers are updating their policy wordings and proposal forms. Don't leave your preparation for the anniversary review of your insurance to the last minute. Talk to us in good time so that we can help you ensure that your duty of fair presentation of the risk is settled in a way that maximises the new protections embedded in the Act.

At-a-glance analysis, The Insurance Act 2015

1) Duty of fair presentation replaces the Duty of disclosure.

This is a subtle but fundamental shift of emphasis in the new legislation.

a) Previously policy holders were required to disclose every circumstance that they knew, or ought to have known, which would influence an insurer in fixing a premium or deciding whether to insure a risk and on what terms. This required insured parties to predict what factors a hypothetical prudent insurer would be influenced by. The same obligation extended to brokers acting on behalf of insured parties.

b) The Act has created a new 'duty of fair presentation' requiring:

   i. The Insured must disclose material facts they know or ought to know. The Insured must disclose sufficient information for a prudent insurer to dig deeper where clarification of the risk to be insured is required. This places the onus on insurers to be proactive and not simply base policy terms on assumptions and a one-way flow of information.

   ii. The Act says it's unreasonable for an insurer to assume that the insurance buyer in any business has every single material fact to hand. The Act defines knowledge as including senior management knowledge, the knowledge of the insurance buyer and including information held in the business that could be established by a reasonable search.

   iii. The information disclosed must be done in a way that gives a clear indication of risk and circumstances to a prudent insurer. This prevents disclosure submissions that are too brief as well as those that are a blizzard of un-signposted data. The broker can demonstrate value – guiding, reviewing and collating the information into a fair risk presentation.

   iv. Where the insured has had a relationship with the insurer for a while, so that the insurer already holds information relating to the insurance cover, the Act recognises that the insurer will be taken to already know some of the information, particularly where it is readily available to the underwriter. This produces a rounded and relevant picture of the risk.

We can help you prepare a fair presentation of your business risk

a) Are you providing enough/the right detail?

b) Do you need input from your senior management or access to a wider range of records within your business?

c) Are you consulting all and appropriate parts of the business where there's risk – from public and employers' liability and professional indemnity to more specialist areas like cyber risk, business interruption, directors' and officers' liability and Personal Accident for directors and/or your staff?

d) How best do you collate and deliver a fair presentation of information at renewal time?

e) How do you demonstrate that they have run reasonable searches and that those searches are authorised at the appropriate level?

f) How do you best check that you are making a fair presentation when it comes to specialist policies that protect individuals e.g. directors' and officers' liability (D&O)policies or those covering negligence or malpractice?

2) The new remedies available to an Insurer for breach of disclosure.

Previously an insurer was able to avoid the policy and so refuse all claims under an insurance contract if the pre-contractual disclosure duty was breached – even if the breach was committed by the broker. The Act sets out a range of remedies in the event of a breach of an insured's duty of fair presentation.

a) **Deliberate or reckless breach:** the insurer can void the policy and retain the premium but ONLY if it can prove a deliberate or reckless breach of fair presentation. The onus of proof lays with the insurer not the insured.

b) **Non-deliberate or non-reckless breach:** There will be multiple remedies available but the responsibility lies with the insurer to show how they would have behaved had they known all the material information.

   i. If the insurer would not have entered into the contract the claim can be refused. The insurer can void the policy but must refund all premiums from inception.

   ii. If the insurer would have entered into the contract at a higher premium they can reduce any claims payment in proportion to the underpayment of premium.

   iii. If the insurer would have entered into the contract at new or different terms e.g. conditions and exclusions, the extra terms can be applied retroactively and the claims settlement made under the new terms.

3) Warranties and basis of contract clauses

A warranty is a clause in which the insured indicates that a state of affairs exists and/or that it will comply with a particular requirement.

Previously, basis of contract clauses could convert all representations made in the course of a non-consumer contract into contractual warranties. Breaching of a warranty would completely discharge an insurer from liability for all risks covered by this policy from the time of the breach, even if the warranty had no bearing on the risk. The Act changes this and insurers are no longer permitted to turn information given by an insured into a warranty, so that any change or error in that information could result in the insurer cancelling the policy. Examples of Basis of Contract clauses that are no longer permitted:

- **In proposal forms –** "I/We agree that this proposal form and all other written information which is provided are incorporated into and form the basis of any contract of insurance."
- **In policy wordings –** "All information supplied by the insured in connection with the application for insurance including any proposal form, application form or otherwise and supplied by or on behalf of the insured will be incorporated into and form the basis of the policy."

a) The Act introduces a suspensory effect to warranties which means that if the breach is remedied, cover is suspended for the period prior to the date of remedy. Insurers cannot cancel the policy and are obliged to deal with claims that are made after the remedy date.

b) Where a loss occurs when an insured is not in compliance with a term which 'tends to reduce the risk' of loss, the insurer will not be able to rely on non-compliance to limit or discharge its liability, if the insured can show that its non-compliance did not increase the risk of loss which occurred in the circumstances in which it did. In other words, the Act requires Insurers to demonstrate a causal link between the breach and the loss. The provision will not apply if the term in question is one which 'defines the risk as a whole'.

4) Fraudulent claims

Previously, in the event of fraud, there was case law to suggest that an insured party would forfeit the whole claim and insurers could also void the whole contract.

Under the Act, an insurer is not liable to pay a fraudulent claim but must pay valid claims prior to the fraudulent claim. The Act sets out a clear statement of insurer remedies in the event of fraudulent claims brought by policy holders.

a) The insurer is not required to pay the fraudulent claim and can recover any money that has already been paid in respect of that claim.

b) The insurer can give notice to the insured to terminate the Policy from the date of the fraudulent claim. The Policy does not automatically become void.

c) The Act provides that insurers will have the same remedies available in respect of a fraudulent claim which is made by one beneficiary under a group insurance contract. Importantly, the remedies apply only in relation to the fraudulent beneficiary.

5) Insurers can contract out of the Act

Parties to non-consumer insurance contracts can agree less favourable – disadvantageous terms – than those in the Act provided that the alternative provisions are clear and unambiguous and sufficient steps are taken to draw them to the attention of the insured or you, their broker, before the contract is concluded.

- Parties to consumer (SME and retail customers) insurance cannot opt out of the Insurance Act.
- Insurers of consumer and non-consumer customers cannot contract out of the new prohibition on 'basis of contract' clauses.
- It is likely that contracting out will be a rare occurrence and, unless there are clear advantages to agreeing to any 'contracting out', we recommend you use insurance policies that are in line with the Act.

Our conclusions

We think there is much to be applauded in the Insurance Act 2015. In the event of disclosure breach it offers you fair and varied options instead of the hard impact that comes with a voided policy.

The Act comes into force 12th August 2016 for all new policies and policies renewed after this date. The duty of fair presentation under the Act also applies to any changes made to existing policies after this date.

The Act shares the disclosure responsibilities equitably between insured and insurer and is far better suited to how commercial organisations are structured, organised and deployed today.

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