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The Insurance Act 2015: What you need to know

The long awaited reforms to business insurance law have now been enacted in the Insurance Act 2015. It received Royal Assent on 12 February 2015 and will come into force in August 2016 and apply to all policies entered into or varied after that date.

Particularly with regard to certain remedies available to Insurers, it makes the English law less draconian and more in line with the US position and the concepts of proportionality in the EU.

The Act will affect policyholders who enter into insurance contracts wholly or mainly for the purposes of their trade, business or profession. These policyholders therefore need to be aware of the changes the Act will introduce.

The reforms considered in this alert include (1) disclosure, the duty to make a fair presentation of risk, breach of that duty and misrepresentation; (2) warranties and breach; (3) insurers' remedies for fraudulent claims; and (4) contracting out.

From a policyholder's perspective, the most important change is the prohibition of 'basis' of the contract clauses, which previously had the effect that innocent mistakes could constitute a breach of warranty and enable insurers to avoid the contract.

Warranties must also now be relevant to the claim and a breach of warranty will only suspend the insurer's liability for a claim. If the breach of warranty can be remedied, the insurer will be liable for losses which occur after it has been remedied.

Given the importance of the reforms ushered in by the Act, policyholders must now begin to focus their minds on how these changes will impact the placing and management of their cover and claims.

Disclosure and fair presentation of risk

Under the Act, there will be a duty on the prospective Insured to make a fair presentation of the risk to the Insurer.

(a) What is a fair presentation?

- *Disclosure of every material circumstance which the proposed Insured knows or ought to know, or*

- *Disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make additional enquiries (which would in turn reveal the missing material information).*

  This is intended to deal with the problem of insurers not paying real attention to the information disclosed until a claim is made, when they review the information and assert that it was inadequate.

- *Disclosure must be made in a manner which would be reasonably clear and accessible to a prudent insurer*

  The objective here is to prevent an Insured from dumping on the Insurers a vast amount of information where no attempt has been made to select the appropriate information. Provision of excessive data or in a cryptic manner could put an Insured in breach of this duty to make a fair presentation of the risk.

- *Every material representation as to a matter of fact must be substantially correct, and material representations as to expectations or belief must be made in good faith.*

(b) Exceptions

There are exceptions to the duty on the Insured to make a fair presentation, in the absence of enquiry by the Insurer. It is not necessary for an Insured to disclose a circumstance if: (a) it diminishes the risk; (b) the Insurer knows it; (c) the Insurer ought to know it; (d) the Insurer is presumed to know it; or (e) it is something as to which the Insurer waives information.

(c) Whose knowledge counts?

(i) The Insured

- The Act seeks to give more clarity as to what knowledge an Insured will be fixed with for the purpose of the duty to make a fair presentation.

- In the context of corporate entities, although the class of individuals whose knowledge is relevant is narrowed, the burden remains quite a heavy one for the prospective Insured.

  - *Actual knowledge of the Insured* - The relevant knowledge will be that of anyone who is either part of the Insured's senior

management or is responsible for the prospective Insured's insurance.

- o *Information which the prospective Insured 'ought' to know* – this encompasses information which should have been revealed by a reasonable search of information, either within the Insured's own organisation or by an agent, in particular the knowledge of the Insured's broker.

Risk managers will have to (a) make enquiries of board directors and senior management and (b) make reasonable enquiries in the appropriate business divisions for material circumstances. Insureds should therefore consider with their brokers the ability to restrict this burden, by including a provision in the policy wording that narrows the definition of the identity of people whose knowledge is relevant for the purposes of disclosure.

(ii) The Insurer

- *Information known by an insurer:* The knowledge of individuals involved in the underwriting decision.
- *Information which ought to be known by an insurer:* Information which an employee, or agent, has and should reasonably have been passed on to the underwriters, or is held by the Insurer within its own organisation and is readily available to the underwriters.
- *Information deemed to be known by an insurer:* Insurers will be expected to have a reasonable in depth understanding of their particular industry or class of business, and will also be deemed to know matters which are common knowledge.

The broad definition of an Insurer's knowledge is aimed at encouraging Insurers to be more proactive in seeking out relevant information.

(d) Breach of the duty to make a fair presentation: Remedies

The marked change here is to the remedies available to Insurers in the event of a breach of warranty. Previously, the remedy for breach of the duty of good faith was the Insurer's ability to avoid the policy.

In order to have a remedy for this type of breach, the Insurer will need to demonstrate that, but for the breach of duty, it would not have entered into the contract of insurance at all, or it would have done so on different terms. The new legislation will distinguish between breaches of duty which are deliberate or reckless and those which are innocent or negligent.

Deliberate or reckless breaches will enable an Insurer to avoid a contract of insurance, refuse all claims and retain the premium paid.

The remedy for innocent or negligent breaches are on a sliding scale and will vary depending on how the Insurer would have acted had there been a fair presentation of the risk (e.g. if the insurer would not have written the policy

at all, or if the Insurer would have entered into the contract but at a different premium or on different terms).

The scale includes:

- Avoid the contract and refuse to pay all claims, but the Insurer must return the premium
- The contract remains effective, but the Insurer will be entitled to reduce proportionately the amount to be paid on a claim
- Treating the contract as if it had been entered into on different terms. This could have the effect of defeating a claim, even though the policy would remain intact

The remedies in the Act will inevitably lead to much evidential controversy.

Warranties

The legislation introduces three positive changes for Insureds in respect of the treatment of warranties. Breach of a warranty will no longer automatically result in discharge of the Insurer's liability under the contract.

(a) Prohibition of 'basis of contract' clauses

Clauses which convert all statements made by an Insured at the placement of entry or renewal into warranties will be ineffective. This provision may not be contracted out of. However, parties may agree to include specific warranties relating to the same issues, provided they are explicitly set out in the policy.

(b) The temporary effect of a breach of warranty

Breach of a warranty will suspend, rather than discharge, an Insurer's liability for a claim. An Insurer will have no liability for losses which arise while an Insured is in breach of warranty, but will be liable for losses which occur after the breach is remedied. There are exceptions to this provision, such as if the warranty ceases to be applicable because of a change of circumstances; or because a subsequent change in the law renders compliance with the warranty unlawful; or because the Insurer waives the breach of warranty.

(c) Breach of irrelevant warranties

The breach of warranty must be relevant to the claim. Breach of a warranty, except a warranty which affects the risk as a whole, will not discharge the Insurer from liability if the Insured can prove that breach of the warranty was irrelevant to the loss suffered.

Remedies for fraudulent claims

The new regime aims to clarify the effect of fraud on an insurance contract. The Act allows an Insurer to treat an insurance contract as terminated with effect from the time of the fraudulent act.

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If a fraudulent claim is made, the Insurer may treat the contract as terminated with effect from the time of the fraudulent act. Following termination (a) the Insurer will remain liable for any prior legitimate claims arising before the fraudulent act; (b) the fraudulent claim(s) and all subsequent legitimate claims will be invalid; (c) an Insurer may recover any payments made in respect of the fraudulent claim(s); and (d) an Insurer will be entitled to retain any premium paid.

The meaning of the word 'fraudulent' is not defined in the Act. While there is a distinction between a fraudulent claim and a fraudulent act, again, it does not attempt to define what is a 'claim' for this purpose, but leaves the matter to common law.

However, the distinction is important for identifying the point at which the insurance contract may be terminated. For example, when there is no genuine loss the fraudulent act will be the submission of the claim, but where a genuine loss has been suffered but the loss exaggerated, the fraudulent act will be when the exaggerated element is communicated to the insurer.

Where a policy provides cover for persons not party to the contract of insurance, the Act provides that if a fraudulent claim is submitted by one of the beneficiaries to the policy, the Insurer will be entitled to treat that group member's cover as terminated at the time of the fraudulent act, but the cover of others will remain unaffected.

Contracting out

The Act allows commercial parties to contract out of the new provisions by agreeing alternative terms, with the exception of basis of contract clauses, which will remain ineffective.

In order to successfully contract out, Insurers will need to satisfy certain transparency requirements. Insurers must ensure that any terms which would put the Insured in a worse position than before the Act are clear and unambiguous as to their effect, and sufficiently drawn to the Insured's attention before the policy is entered into. In determining whether this requirement has been met, the Insured's characteristics and the circumstances of the transaction will be taken into account.

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