

Update

The Insurance Act 2015

The Insurance Act 2015 received Royal Assent on 12 February 2015. When it comes into force in August 2016, it will (together with the consumer insurance reforms that came into effect in 2013), represent the greatest change to insurance contract law in this country in over 100 years. It will amend certain key sections of the Marine Insurance Act 1906, although it is worth noting that (despite suggestions in some quarters to the contrary) the 1906 Act has not been repealed.

We set out below the key changes being implemented by the Act.

Utmost Good Faith/Non-Disclosure

These changes will apply only to business (i.e. non consumer)¹ insurance (consumer insurance having already been dealt with by the Consumer Insurance (Disclosure and Representations) Act 2012).

The duty to volunteer information is being retained (unlike the position for consumer policies). An insured will have to make a fair presentation, which will include putting a prudent insurer "on notice".

The Law Commissions criticised the practice of convoluted presentations and "data dumping": "A lack of structuring, indexing and signposting may mean that a presentation is not fair". Hence, disclosure must be "in a manner which would be reasonably clear and accessible to a prudent underwriter" (section 3(3)(b) of the Act).

When deciding what an insured knows, what matters is the knowledge of senior management (which will include the board of directors but also those who play significant roles in the making of decisions about how the insured's activities are to be managed or organised) and of those responsible for arranging the insurance which matters (and blind-eye knowledge is included). An insured must carry out a reasonable search for information, and what is reasonable will depend on the size, nature and complexity of the business.

The insured will be deemed to know what "should reasonably have been revealed by a reasonable search" (section 4(6) of the Act) and so information held by non-senior management (but by those who, say, perform a managerial role) may still be imputed to the insured. Information held by any other person with relevant information (even those outside the company, such as the company's agents or beneficiaries of cover) will also be imputed to the insured if a reasonable search should have revealed that information.

¹ A "consumer" in this context refers to insureds who are individuals who purchase insurance which is unrelated to their trade, business or profession

However, the insured's knowledge does not include confidential information acquired by the insured's agent (e.g. its broker) through a business relationship with someone other than the insured who is not connected with the insurance.

The Act creates a positive duty of inquiry for the insurer too. An insurer "ought reasonably to know" something if it is known to an employee/agent who ought reasonably to have passed it on, or relevant information which is readily available and held by the insurer (section 5(2) of the Act). An insurer will also be presumed to know things which are common knowledge, or which an insurer offering insurance of the class in question to insureds in the field of activity in question would be expected to know in the ordinary course of business.

Remedies

The remedies for material non-disclosure or misrepresentation will change as follows:

It will be possible to avoid a policy and keep the premium only where the misrepresentation or non-disclosure was deliberate or reckless. In all other cases (even where the insured is innocent), a scheme of proportionate remedies will apply, as follows:

- Where the insurer would have declined the risk altogether, the policy can be avoided, with a return of premium
- Where the insurer would have accepted the risk but included a contractual term, the contract should be treated as if it included that term (irrespective of whether the insured would have accepted that term)
- Where the insurer would have charged a greater premium, the claim should be scaled down proportionately (for example, if the insurer would have charged double the premium, it need only pay half the claim). This contrasts with some other jurisdictions, where only the additional amount of premium is payable to the insurer. The Law Commissions have explained that this is because it was felt the insured should have something to lose (i.e. more than just paying the amount of premium they should have paid in the first place)

It is also worth noting that the test of what the insurer would have done had it known the true facts is entirely subjective. In practice, it may be hard for insureds to disprove that (for example) a particular insurer would have viewed a certain breach as so serious that he/she would not have written the risk at all. The issue will become one of credibility.

In order to have any remedy at all under the Act for non-disclosure or misrepresentation (even a relatively modest one, e.g. a 20% reduction of the claim), the insurer will have to meet the same burden of proof that is currently required for avoidance of the policy. However it may be that judges and arbitrators will be more willing to conclude that the threshold has been met once they are able to grant a remedy that is proportionate to the degree of mischief.

Warranties and other policy terms

Basis of the contract clauses will be prohibited (as is already the case now for consumer contracts) and it will not be possible for business insurers to contract out of this particular change (section 9 of the Act). Thus any provision in a proposal form which purports to convert answers in the proposal into a warranty will be ineffective.

All warranties will become "suspensive conditions" (section 10 of the Act). This means that an insurer will be liable for losses that take place after a breach of warranty has been remedied, assuming this is possible.

Thus, for example, if an insured breaches a warranty that an alarm system will be inspected every six months, that breach will be "remedied" if the system is inspected after seven months, and so coverage will be suspended for only one month in such circumstances.

A new provision has been introduced for any term (not just a warranty) designed to reduce the risk of a particular type of loss, or of loss at a particular time or in a particular place (section 11 of the Act). It will not apply to terms which define the risk as a whole (e.g. a requirement that a property will not be used commercially).

Where there is non-compliance with such a term, insurers will not be able to rely on that non-compliance as a defence if the insured can demonstrate that such non-compliance could not potentially have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

So, for example, where there is a requirement to install a burglar alarm, and that is not done, insurers will not be able to refuse an indemnity on that ground for flood loss.

However, where the non-compliance could potentially have had some bearing on the risk of the loss which actually occurred, there may be no need to establish that any non-compliance did directly cause the loss in question. So, for example, a failure to install a burglar alarm is likely to afford insurers a defence to a theft claim, even where the theft in fact resulted from an "inside job" which would not have been prevented by a functioning alarm. However, there are likely to be many grey areas.

Accordingly, in order to limit the scope for dispute, it would be advisable for insurers to specify in their policies what requirements they wish to impose, what risk of loss that requirement is intended to address and what consequence non-compliance will have.

Fraudulent claims

Currently, an insurer is not liable to pay a fraudulent claim and can recover any sums already paid in respect of it. It is not clear whether an insurer can refuse to pay genuine claims for losses suffered after the fraudulent act but before discovery/termination of the policy.

Under the Act (section 12), an insurer will also have the option of terminating the contract from the date of the fraudulent act (not the discovery of it), without any return of premium. The Law Commissions believed that insurers would want this option, rather than an automatic remedy, because it allows them more commercial flexibility. The insurer can then refuse to pay any claims from that point onwards (but will remain liable for legitimate losses before the fraud).

The Act does not seek to define what a fraudulent claim is, so there is no distinction between someone who presents a completely fraudulent claim (i.e. claims for something that never happened) and someone who has genuinely suffered a loss but has used a fraudulent device to increase his chance of being paid. There is also nothing in the Act concerning whether the fraud must be substantive.

The Act also provides that, in the case of a group insurance policy, where a fraudulent claim is made by one of the beneficiaries to the policy (who is not a party to the policy), the insurer may treat cover for the fraudulent beneficiary only as having been terminated at the time of the fraudulent act (and cover will remain in place for the other “innocent” beneficiaries) (section 13 of the Act).

The explanatory notes to the Act explain that this clause applies not just to, for example, employment group policies, but potentially also to insurance arranged by one company for a group of companies (if that is how the policy is structured). In a non-consumer context, the Act also now makes it clear that, if an insurer wants to contract out of this provision, it must comply with the transparency requirements to bring that to the attention of the group company beneficiary.

Good faith

The remedy of avoidance for a breach of the duty of utmost good faith will be abolished (although, as mentioned above, the ability to avoid will be retained in some cases where the insured breaches the duty in relation to disclosure/misrepresentation) (section 14). The Law Commissions did not suggest a remedy of damages instead (despite contemplating introducing that remedy at one point). Rather, they suggested that the courts will allow good faith to be used as “a shield rather than a sword”, i.e. insurers may be prevented from exercising an apparent right if they have not exercised it in good faith. It is perhaps unclear, however, how a legitimate right can be exercised in a manner which amounts to bad faith (and the Law Commissions acknowledged that there is conflicting case law on how far the courts will recognise this concept).

Contracting out

The changes being introduced by the Act are intended only to be a “default regime” for non-consumer insurance. While the Law Commissions have previously indicated that they wish to discourage boiler-plate clauses which opt-out of the default regime as a matter of routine, particularly in the context of mainstream business insurance, they add that: “In sophisticated markets including the marine insurance market, we expect contracting out will be more widespread”.

In other words, business insurers cannot expect to restore the current position and carry on “business as normal” simply by inserting a clause into a policy to the effect that the changes in the new Act (when it comes into effect) do not apply. Instead, insurers will need to identify each and every change which they do not intend to apply and cater for an opt-out for that change separately in the policy. It will probably be best if insurers focus on what is truly important to them, and set out the consequences of breach of any policy terms. Accordingly, very careful consideration will have to be given to the drafting of business insurance policies in the future.

Where insurers do intend to opt out (and hence include a “disadvantageous term”), they must take sufficient steps to draw that to the insured’s attention before the contract is entered into and the disadvantageous term must be “clear and unambiguous as to its effect”.

The Act also provides that “. . .the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account” (section 17(4)). Guidance from the Law Commissions explained that additional steps by the insurer would be needed where a small business purchases insurance online but, conversely, more leniency will be allowed where a sophisticated insurance buyer purchases cover at Lloyd’s (“This is a fast-paced market, and we would not want to interfere unnecessarily with its operation”). The more lenient approach applies where a broker is involved, even if the insurance buyer is unsophisticated.

For both consumer and non-consumer insureds, the contracting-out provisions will not apply to settlement agreements (and hence an insured will still be able to enter into a settlement on less favourable terms than the default rules).

Finally, as mentioned above, it will not be possible for business insurers to contract out of the prohibition for basis of the contract clauses (although they can still specifically agree a warranty in respect of any particular matter in the policy).

Further information

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Third parties (Rights against Insurers) Act 2010

The Act includes various minor provisions relating to the Third Parties (Rights against Insurers) Act, which received Royal Assent on 25 March 2010, but which is still awaiting a further statutory instrument to bring it into force. A review of the main provisions of this 2010 Act is beyond the scope of this update, but the 2010 Act is, broadly, intended to make it easier for third party claimants to bring direct actions against insurers where an insured has become insolvent. The changes included in the Insurance Act allow the Secretary of State for Justice greater scope to make further regulations and amend the definition of an “insured” (and, more specifically the type of insolvency event which the insured must undergo in order to trigger the application of the 2010 Act). Although no deadline to bring the 2010 Act into force is set out in the Insurance Act, it is worth noting that the powers being passed to the Secretary of State come into force two months after the Act receives Royal Assent (i.e. 12 April 2015). Accordingly, it might be anticipated that the aim is to bring the 2010 Act into force at some point during 2015.

Further reform?

A clause on damages for late payment or non-payment of a claim was omitted from the Bill before it was presented to Parliament. There was criticism of this proposal and HM Treasury decided to drop it because the Bill was following the special procedure for uncontroversial Law Commission Bills. However, during its passage through Parliament, it was suggested that the Government supports this proposal “and it is hoped that legislative opportunities will arise to include that measure with other insurance-related provisions”.

The Law Commissions have indicated that they are aiming to produce a third and final report in 2015 on various issues which were not addressed in the Act but which have been the subject of review and proposals in earlier papers. These include the proposed abolition of the need for a formal marine policy (section 22 of the Marine Insurance Act 1906); reform of section 53(1) of the 1906 Act, which makes a broker liable for payment of premium in respect of marine insurance policies; as well as reform of various anomalies regarding insurable interest. Whether there will be further political appetite to implement these changes in the near future remains to be seen.