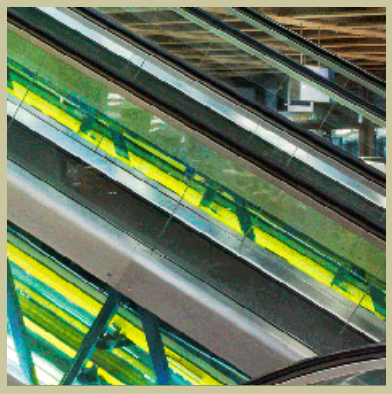

INSURANCE ACT 2015

Quick reference guide to key provisions and their practical effects for underwriters and claims handlers

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This guide is for use by those involved in business (i.e. non-consumer) insurance

IUA OF LONDON
INTERNATIONAL UNDERWRITING ASSOCIATION

INSIGHT CONSENSUS INFLUENCE

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This guide has been prepared by Harry Wright, barrister of 7 King's Bench Walk, in association with:

INTRODUCTION

This practical guide has been produced for those involved in underwriting business (i.e. non-consumer) insurance and reinsurance contracts. It summarises some of the key changes to the law contained in the Insurance Act 2015 ("the Act"), which will come into force on 12 August 2016, and further changes introduced by the Enterprise Act 2016, which will come into force on 4 May 2017. This guide is designed to be read in conjunction with the LMA and IUA full guide to the Act, which contains more detailed commentary and explanation, and is available from the LMA website: www.lmalloyds.com/act and the IUA website: www.iua.co.uk/insuranceact.

It is very important to emphasise what this guide does and does not set out to do. The "Points to consider" referred to below are designed to inform underwriters of some of the points they may need to consider under the reformed law. They are not, and are not intended to be, prescriptive lists of questions which an underwriter must go through slavishly every time a risk is underwritten.

In some (or perhaps many) cases, it will not be necessary to go through all, or even any, of the "Points to consider". Whether it is necessary will depend upon (amongst other things) the sophistication of the insured; the class of business; and the method of acceptance. Therefore, and for the avoidance of doubt, any failure by an underwriter to go through all or any of the "Points to consider" in respect of a given risk will not mean that the underwriter has failed to underwrite that risk properly and carefully.

It should be noted that many of the points below may be relevant and applicable in circumstances where an insurer is buying reinsurance.

I. PLACING

REASONABLE SEARCH BY THE INSURED

Summary of law: *The insured must disclose to the insurer all material circumstances which it knows, or ought to know. An insured "ought to know" information that should reasonably have been revealed by a reasonable search of information available to it.*

The insured must therefore undertake a reasonable search of such information (such as by making enquiries, or performing an electronic search). The information searched may be held by the insured, or by any other person or organisation.

Points to consider:

- Has the broker/insured made a representation about the search which has been performed (orally, or in writing – including in the slip)?
- **If so**, was the search, as represented, satisfactory?
    - Whose information was searched? Did the insured search information held by all of the people/organisations likely to know about the risk?
    - Did the insured search information held by all those people/organisations who will be covered by the policy?
    - When was the search performed? Was it so long ago that it may be out of date?
    - How was the search performed? By making enquiries, or reviewing paper or electronic files?
    - Was the search proportionate, bearing in mind the size and complexity of the risk, and the sum insured?

- **If not**, consider asking the broker/insured about the search which has been performed and record the answers.
- If the search seems unsatisfactory in some way, say so. If the insured agrees to extend/repeat the search, record this in the slip information section, the underwriting system, or in some other appropriate place.
- You are not obliged to agree with the insured or the broker that the search represented to you amounts to a "reasonable search", and you may well prefer not to do so. If you agree that the search was reasonable, you will not be able to assert (at a later date) that the insured did not conduct a reasonable search.

KNOWLEDGE OF INDIVIDUALS WITHIN THE INSURED

Summary of law: *As well as the information that should have been revealed by a reasonable search, an insured that is not an individual (such as a limited company) will be taken to know material information which is known to certain individuals. These include (i) its senior management and (ii) the people responsible for procuring its insurance.*

Points to consider:

- Are there any people whose knowledge is or may be particularly important to the risk you are underwriting?
- Are those people part of the insured's senior management, or responsible for procuring its insurance?
    - For example, members of the legal department may know particularly material information, in certain circumstances, but will probably not come under either of these categories.
- If there are people whose knowledge is or may be particularly important, but who are neither senior management, nor responsible for procuring the insured's insurance, consider whether you should agree with the insured (or broker) that their knowledge will nonetheless count as that of the insured, for the purposes of the risk presentation.
    - For example, you may agree an express contractual term that the knowledge of X and Y in the legal department will qualify as the knowledge of the insured, for the purposes of its risk presentation.

CONFIDENTIAL INFORMATION KNOWN TO THE BROKER

Summary of law: *If the insured's broker acquires confidential information through its business relationship with a third party who is not connected with the insurance, then the insured will not be taken to know that information, and will not have to disclose it under the duty of fair presentation. This is an exception to what information may qualify as the knowledge of the insured.*

The LMA/IUA consider that only information which is objectively confidential will be caught by this exception. If, for example, material information is made subject to a confidentiality agreement between the broker and a third party merely to engage the exception described above, it is not considered that this information will be subject to the exception.

THE RISK PRESENTATION

Summary of law: *The insured must give a fair presentation of the risk to the insurer – either by disclosing all material information known to the insured, or (and unlike the previous law) by giving sufficient 'signposts' to put the insurer on notice that it should ask further questions, which may reveal a material matter. The information presented in the risk presentation must be reasonably clear and accessible (so that, for example, the insured may not engage in data dumping as part of the risk presentation).*

The intentional withholding by an insured (or its broker) of information which it knows to be material will be a breach of the duty of fair presentation. The LMA/IUA consider that, in such circumstances, the insured will be in breach even if it (or its broker) arguably gave the insurer sufficient 'signposts' to put the insurer fairly on notice that it should ask further questions.

Points to consider:

- Does the risk presentation (whether oral or written) contain any representations which appear to be incomplete, or unclear?
    - Does it beg any unanswered questions?
    - Are there any hints that there may be further material information which has not been stated explicitly?
- **If so**, you should ask the broker/insured to clarify the position, and keep a record of the significant questions asked and answers given.
- Has the information in the risk presentation been presented to you in a way which you cannot process or understand?
    - For example, does the risk presentation include a large 'data dump' of unprocessed information?
- **If so,** you should ask the broker/insured to identify any material information contained in the 'data dump', or for a summary, and keep a record of the response.
- If you have asked for further information which has not yet been given and which you think may be important, the risk should not be underwritten until a satisfactory response has been received. Alternatively, the risk may be underwritten, but on the basis of limited disclosure and on appropriate terms which accord with your firm's underwriting guidelines.

IMPORTANCE OF KEEPING RECORDS

Summary of law: *The insured must disclose material information which it knows or ought to know. Material information may include special or unusual facts relating to the risk, or particular concerns which led the insured to seek the insurance.*

If the insured breaches its duty of fair presentation, the remedies available to the insurer will depend on what the insurer would have done if the risk had been presented fairly. For example, if the insurer would have insisted on different policy terms (such as the insertion of a warranty or exclusion clause), the contract will be treated as if it contained those terms. If the insurer would have charged a higher premium, the insured's claim will be subject to a proportionate reduction.

The keeping of appropriate records is therefore even more important, since under the Act, insurers may need to prove the precise way in which they were induced to a much finer degree than under previous law.

Points to consider:

- Consider keeping a complete and accurate record (in your underwriting system, or elsewhere) of:
    - Any special or unusual facts relating to the risk you are underwriting. #
    - Any particular concerns which caused the insured to seek the cover.
    - Any particular factor(s) which influenced the level of premium you charged, or the terms which you agreed.
    - Any particular factor(s) and/or representations which influenced your decision on whether to write the risk.
    - Declinatures and/or quotes not taken up, with reasons. These may provide valuable evidence of underwriting policy and practice in the event of a dispute concerning a risk which you have underwritten.
    - Other people involved in the underwriting decision, such as actuaries, risk modellers or other specialists.
    - Any underwriting manuals, guidelines or rating models to which you have referred during the underwriting process.
    - The reasons for any departure from your usual underwriting approach, if you depart from it at any time.
- Ensure that these records, and any other underwriting notes, are easily retrievable, in case of a dispute.

INFORMATION KNOWN TO THE INSURER

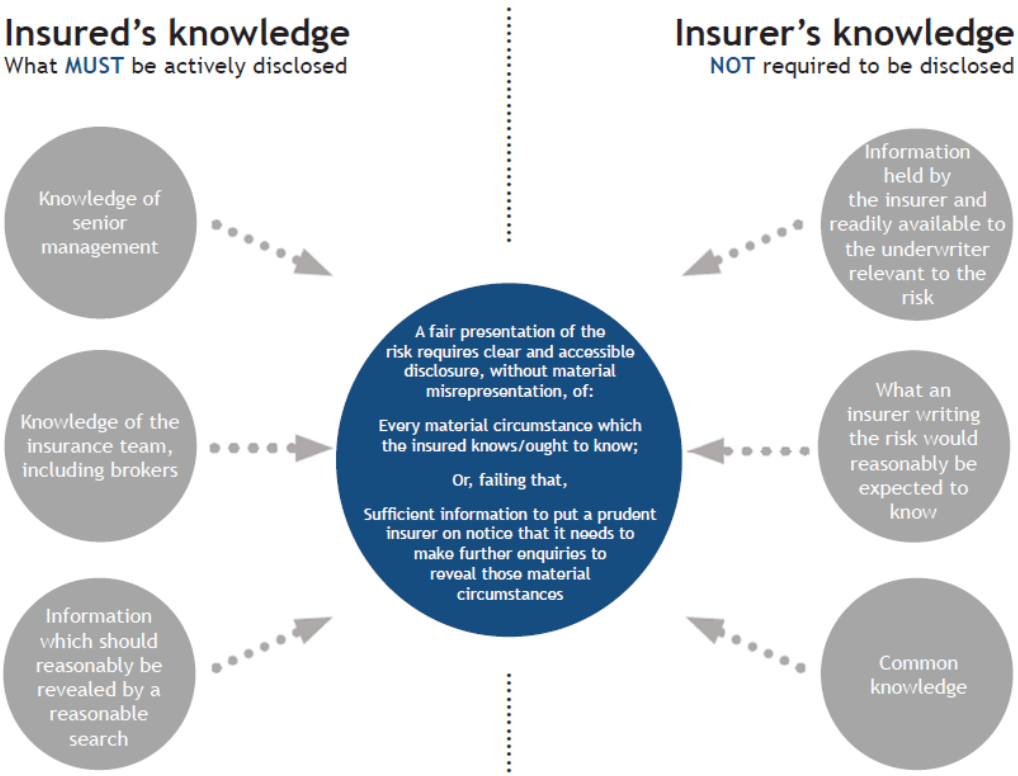
Summary of law: *In respect of any risk, the insurer will be taken to know information that is readily available to anyone who participates in the underwriting decision in respect of that particular risk, provided that information is held by the insurer. Participants in the underwriting decision could include not just underwriters, but also (for example) account managers, risk modellers, claims personnel and wordings specialists. Because the insurer is taken to know this information, the insured does not need to disclose it.*

Points to consider:

- Does your organisation hold readily available information which is or may be relevant to this particular risk?
    - Is there a hard copy or electronic file regarding the insured, including archived files which are readily available?
    - Is there information related to the risk you are writing on the intranet of your organisation?
    - Is there information related to the risk you are writing on some other database to which you have ready access (such as claims records or reports)? This may include an external subscription database to which your organisation subscribes.
    - **If so,** check the information contained in these places. If you do not, you may be taken to know it in any event.
- Consider drafting an internal record of resources which are considered to be readily available to underwriters in a given class of business.

Note: a diagram indicating the way in which the duty of fair presentation fits together appears on the next page (opposite).

THE DUTY OF FAIR PRESENTATION
HOW IT FITS TOGETHER



This is based on a diagram contained in the BIBA/Mactavish 'Insurance Act 2015: An Introductory Guide', available from www.biba.org.uk.

II. WORDINGS

BASIS CLAUSES

Summary of law: *Basis clauses have been abolished from all insurance contracts. This means that it is not possible to convert information, contained in a proposal form, application or similar document, into a warranty by stating that it forms 'the basis' of the contract, or similar. It is not possible to contract out of this provision.*

Points to consider:

- Remove all basis clauses from existing wordings, proposal forms and similar documents, since they will be of no effect after 12 August 2016.
- Has the insured made a particular representation, about which you require the insured to warrant its truth, in order to make you feel more comfortable about the risk?
    - **If so,** consider including a provision in the policy which makes the truth of that representation a condition precedent to the insurer's liability under the contract.
    - For example: "*It is a condition precedent to the insurer's liability under this policy that none of the insured's directors has a criminal record*."

WARRANTIES

Summary of law: *The Act does not change the classification of what is or is not a warranty, but does change the legal effect of warranties. Under the Act, if the insured breaches a warranty, this will no longer automatically discharge the cover from the date of breach. Instead, the insurer's liability will be suspended until the insured remedies its breach of warranty (if the breach can be remedied). If the insured remedies the breach before a loss occurs, the insurer will be liable, unless the loss is attributable to something that happened before the breach was remedied.*

Points to consider:

- Do you wish to maintain the previous effect of warranties, so that any breach of a warranty by the insured will automatically and permanently discharge the insurer's liability under the policy?
    - **If so**, you may wish to contract out of section 10 of the Act. Ensure that you abide by the transparency requirements (see below under "Contracting out of the Act").
    - It should be noted that you may contract out of section 10 in respect of all warranties in the policy, or only in respect of one or more specific warranties.
    - For example, if you wish to preserve the previous effect of a premium payment warranty, you may contract out of section 10 only as regards that warranty.
- You should also consider whether to contract out of section 11 of the Act (relating to terms not relevant to the actual loss). If you contract out of section 10, but not section 11, the previous effect of warranties may not be preserved in certain cases. This is discussed below.

TERMS NOT RELEVANT TO THE ACTUAL LOSS

Summary of law: *Most policies contain terms which, if complied with, would tend to reduce the risk of loss of a particular kind, or loss at a particular location or time. This is not limited to warranties, and may include conditions precedent and exclusions. If the insured breaches such a term, the insurer cannot rely on the breach to reduce or extinguish its liability if the insured proves that the breach could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.*

This will prevent an insurer from relying on breach of any term by the insured if that breach is entirely unconnected with the actual loss which the insured has suffered. It will not apply to a term which defines the risk as a whole.

Points to consider:

- Do you wish to avoid the legal position described above?
    - **If so**, you may wish to contract out of section 11 of the Act. Ensure that you abide by the transparency requirements (see below under "Contracting out of the Act").
- You should also consider whether to contract out of section 10 of the Act (relating to warranties). This is discussed above.
- Does the policy contain a term which defines the whole risk, such as:
    - A term which defines the age/identity/qualifications of the owner or operator of a vehicle, aircraft, vessel or item of personal property?
    - A term which defines the geographical areas in which a loss must occur if the insurer is to be liable?
    - A term which excludes loss occurring while a vehicle, aircraft, vessel or item of personal property is being used commercially?
    - A term that a vessel will be kept in class?
- **If so**, you may wish to describe the term expressly as one that "defines the risk as a whole" in the policy wording, so that the intention is clear that it should not be caught by section 11; and set out the consequences of breach of this term (for example, suspension or termination of the policy) to create further clarity.

CONTRACTING OUT OF THE ACT

Summary of law: *Any policy term which would put the insured in a worse position than that provided for under the Act is called a "disadvantageous term". It will be effective only if the insurer fulfils two requirements. First, it must draw the disadvantageous term to the attention of the insured or broker. Secondly, the term must be clear as to its effect.*

Points to consider:

- Do you wish to contract out of any provision in the Act (other than the abolition of basis clauses) in the context of a business insurance contract?
    - **If so**, you must draw the disadvantageous term to the attention of the insured, or the broker, before the contract is concluded (or variation agreed).
- If the policy wording has been prepared by the broker, this requirement will be fulfilled.
- If not, or if a broker is not involved in the placement, you should clearly flag the disadvantageous term to the insured, in writing (either in the policy itself, or elsewhere).
- You must also ensure that the disadvantageous term is clear as to its effect.
- The disadvantageous term should describe the provision in the Act which does not apply. It should also state its effect (as in the examples below).
- For example: "*Section 10 of the Insurance Act 2015 shall not apply to any warranty in this insurance contract. If any such warranty is breached, the Insurer's liability shall be discharged from the time of the breach of warranty, regardless of whether the breach is subsequently remedied.*"
- For example: "*Section 11 of the Insurance Act 2015 shall not apply to any term of this insurance contract. Where this insurance contract contains any term which, if complied with, would tend to reduce the risk of loss of a particular kind or at a particular location or time, and such term is not complied with, the Insurer may rely upon such non-compliance to exclude, limit or discharge its liability, even if non-compliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.*"
- As suggested above, these two examples may be used in conjunction. These wordings are given by way of example only. Any contracting out provision should be considered in the context of the particular risk: the method of the placement; the proposed wording; the usual practices in the class of business; and the sophistication of the proposed insured.

III. OUTWARDS REINSURANCE

DUTY OF THE REINSURED AT PLACING – REASONABLE SEARCH

This part of the guidance addresses a situation where an underwriter is buying facultative reinsurance.

Summary of law: *The reinsured must give a fair presentation of the risk. Its knowledge, for these purposes, is defined (in part) by what should reasonably have been revealed by a reasonable search of information available to it (whether the information is held by the reinsured, or by others). A party seeking facultative reinsurance which is arranged after the underlying cover should therefore perform a reasonable search, and may be subject to a new duty of care to its reinsurer.*

Points to consider:

- The reinsured should consider documenting (in writing) the following matters:
    - The nature and extent of its search.
    - Whose information it has searched (whether individuals or organisations).
    - Who qualifies as part of the reinsured's "senior management" (see the section on knowledge of the insured, above).
    - How the search was performed, and by whom.
    - The date when the search was performed, and the dates from and until when the information was searched.
    - The reinsured may consider providing the written records of its reasonable search to the reinsurer, and seeking the reinsurer's agreement that the search is sufficient.

IV. LATE PAYMENT OF CLAIMS

Summary of law: *every insurance contract concluded on or after 4 May 2017 will be subject to an implied term that if an insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time ("the Implied Term"). If the insurer fails to pay claims in a reasonable time, it may be liable for additional losses suffered by the insured.*

Points for underwriters to consider:

- Do you wish to contract out of liability for late payment damages? If so:
    - Is your contract a business contract? If so, you may contract out of liability in respect of breaches of the Implied Term which are not deliberate or reckless. You may achieve this by excluding all liability in damages for breach of the Implied Term which is not deliberate or reckless.
    - Alternatively, you may consider limiting liability in damages for breach of the Implied Term which is not deliberate or reckless. For example, you may limit your liability to compound interest only.
- In the context of reinsurance, you should consider:
    - Whether the reinsurance contract provides cover for breach of the Implied Term by the reinsured.
    - Whether the reinsurer wishes to exclude or limit its liability for breach of the Implied Term which is not deliberate or reckless.

Points for claims handlers to consider:

- You have a reasonable time to investigate and assess the claim. During this time, you should keep the insured informed of the progress of its claim.
- The amount of time which is reasonable will depend on the circumstances, including:
  - The type of insurance
  - The size and complexity of the claim
  - Whether you have complied with relevant statutory or regulatory rules
  - Factors outside your control
- The relevant statutory or regulatory rules may include the following:
  - FCA Principles for Businesses
  - FCA Insurance: Conduct of Business Sourcebook (ICOBS)
  - For managing agents, the Lloyd's Minimum Standards
- You will not breach the Implied Term by failing to pay a claim, provided:
  - You have reasonable grounds for disputing the claim, and
  - You handle the claim reasonably.
- You should consider how to keep records of advice received from experts (such as loss adjusters or lawyers) which show that you have reasonable grounds to dispute a claim.

Subscription agreements – delegation of claims-handling authority to leader/agreement party:

- If you are a slip leader or agreement party, you may be handling the claim on behalf of the following market under a subscription agreement (if a company), or under the Lloyd's Claims Scheme (if a managing agent). Ensure that you keep followers informed of significant developments and delays during the claims handling process.
- The leader/agreement party should consider whether it should limit its liability to the following market for liability the followers may face if the Implied Term is breached:
  - If the claims handling process is governed by the Lloyd's Claims Scheme, a limitation of liability is already in place.
  - Otherwise, it may be necessary to insert into the claims handling agreement a term limiting the leader's liability to the following market for any breach(es) of the Implied Term.

Coverholders/third party administrators (TPAs) – delegation of claims-handling authority:

- If the coverholder or TPA fails to investigate or assess a claim within a reasonable time, the insurer may be liable for breach of the Implied Term.
- Ensure the binding authority or TPA agreement contains appropriate service levels for claims-handling, safeguards (e.g. management information, audit) and terms specifying the consequences of breach.

V. APPLICATION OF THE ACT

Summary of law: *All contracts and variations to contracts concluded after 12 August 2016 will be governed by the Act, if they are expressly or impliedly subject to the law of England and Wales, Scotland or Northern Ireland. If there is no express choice of law in the policy, contracts brokered in London, or with London arbitration/jurisdiction clauses, are likely to be subject to English Law.*

The Act will not apply to contracts which were concluded before 12 August 2016. However, if such a policy is varied after 12 August 2016, the variation may be subject to certain parts of the Act.

The provisions in the Act relating to Late Payment Damages, which were introduced through the Enterprise Act 2016, will come into force on 4 May 2017. Every contract of insurance concluded on or after that date will therefore be subject to the Implied Term, discussed in section IV above.

If a policy is of long duration, it will continue to be governed by the old law until it is renewed. Care should be taken in the context of open covers, floating policies, and treaty reinsurance, where the making of declarations may amount to the conclusion of new contracts. It is therefore possible that the original policy may be governed by the old law, but individual risks declared after 12 August 2016 may be subject to the Act.

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