MARSH

June 2016

INSURANCE ACT 2015
A COMPREHENSIVE GUIDE

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

MARSH & McLENNAN COMPANIES

CONTENTS

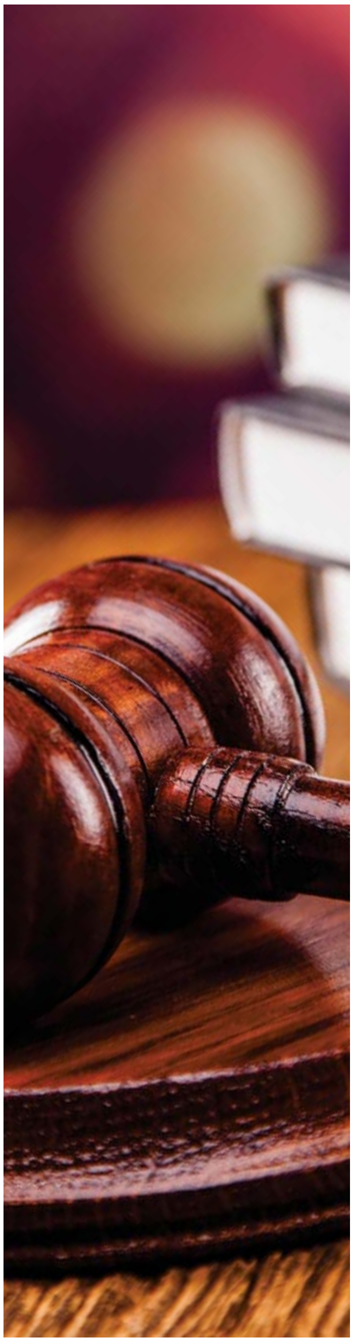
1.	Client Adviser 1: A short summary of the changes under the Insurance Act. June 2015	1
2.	Client Adviser 2: How to prepare for the new disclosure obligations. July 2015	5
3.	Client Adviser 3: The new duty of fair presentation with tips on how to prepare. December 2015	9
4.	Client Adviser 4: The new regime of proportionate remedies. March 2016	16
5.	Guidance Note: The Duty of Disclosure and Fair Presentation.	21
6.	Client Adviser 5: The Enterprise Act 2016 — New right for policyholders to claim damages for late payment of insurance claims. June 2016	26
7.	Client Adviser 6: Warranties and other terms. June 2016	28
8.	Webcasts	34
	– The duty of fair presentation.	
	– Proportionate remedies.	
	– Warranties and other terms.	

June 2015

ADVISER
THE INSURANCE ACT 2015

The Insurance Act 2015 (the "Act") received Royal Assent on 12 February 2015, bringing about the biggest change to English insurance contract law in more than 100 years, and will come into force in August 2016. Marsh very much welcomes the Act and has been lobbying the Law Commissions to introduce these reforms since they started their consultations in 2006.

The Act redresses an imbalance in the existing law, which is sometimes overly in favour of insurers. For example, it abolishes basis of contract clauses; clarifies the insured's duties relating to pre-contractual disclosure of information, and introduces fairer and more proportionate remedies for non-disclosure and breach of warranty. Here at Marsh, we look forward to helping you prepare for and reap the benefits of the Act.



KEY CHANGES

The Act will affect all policies subject to the laws of England and Wales, Scotland and Northern Ireland that incept, are renewed, or are varied after August 2016 (unless insureds reach an agreement with insurers that the provisions of the Act will apply straightaway to policies which incept, renew, or are varied before then).

The Act updates the statutory framework for insurance and reinsurance contracts in the following key areas:

- Disclosure and misrepresentation in business and other non-consumer contracts.
- Insurance warranties in consumer and non-consumer insurance contracts.
- Fraudulent claims in consumer and non-consumer insurance contracts.

The Act will also bring into force the Third Parties (Rights against Insurers) Act 2010, which is not yet in force.

The tables below compare the existing law with the key changes to be implemented by the Act.

DISCLOSURE: KEY CHANGES

CURRENT LAW	INSURANCE ACT 2015
The insured has a duty to disclose every material circumstance which is known to the insured.	The insured has a duty to make a **"fair presentation of the risk"** to the insurer. This means that the insured must: • Disclose every material circumstance which it **knows or ought to know**; or • Failing that, the insured must give the insurer **sufficient information to put a prudent insurer on notice that it needs to make further enquiries** for the purpose of revealing those material circumstances. The insured must also: • Make the disclosure **"in a manner which would be reasonably clear and accessible to a prudent insurer"**; and • Must not make misrepresentations.
The insured is deemed to **"know"** every circumstance which, in the ordinary course of business, ought to be known to him. In the context of a business insured, the knowledge of the directing mind and will is attributed to the insured.	A business insured is taken to know what is known to the insured's **"senior management" and individuals "responsible for the insured's insurance"** (which includes risk managers and any employee who assists in the collection of data, or who negotiates the terms of the insurance). An insured "ought to know" what would have been revealed by a **"reasonable search"** of information available to the insured.
The duty to disclose material facts is owed by the insured and also independently by the broker.	The broker's independent duty of disclosure is abolished, but the broker's knowledge is attributed to the insured.
Single (draconian) remedy of **avoidance** ab initio for non-disclosure and misrepresentation.	A new regime of **proportionate remedies** for non-disclosure and misrepresentation is introduced. Unless the non-disclosure or misrepresentation is deliberate or reckless (in which case avoidance is still available to the insurer), the onus is on the insurer to show what it would have done had it received a fair presentation of the risk: • The insurer is still entitled to avoid the policy if it can show that, had it received a fair presentation of the risk, it would not have entered into the contract at all; but • If the insurer shows that it would have entered into the contract, but on different terms (other than premium), the insurer may treat the policy as having included those different terms from the outset; or • If the insurer would have entered into the contract but only at a higher premium, the insurer **may reduce the amount to be paid on a claim** proportionately. For example, if the premium would have been GBP400,000 rather than GBP300,000, then the insurer need only pay 75% of any claim.

INSURANCE WARRANTIES (AND OTHER TERMS): KEY CHANGES

CURRENT LAW	INSURANCE ACT 2015
Breach of warranty discharges the insurer's liability under the insurance contract in its entirety, and permanently, from the date of breach.	Warranties act only as suspensive conditions. The insurer's liability is **suspended** while the insured is in breach of warranty, but can be restored if the breach of warranty is subsequently remedied by the insured.
"Basis of contract" clauses operate to convert the insured's pre-contractual representations (including answers to questions on the proposal form) into warranties.	"Basis of contract" clauses are completely abolished.
Breach of warranty discharges the insurer's liability under the insurance contract in its entirety, even if the breach is only trivial or does not in any way relate to the insured's loss.	The insurer may not rely on the insured's breach of a warranty or other policy term to avoid paying a claim **if the breach could not have increased the risk of loss**. This applies to breaches of warranties and other terms which would tend to reduce the risk of loss of a particular kind or at a particular location or time. However, this does not apply to policy terms which define the risk as a whole.

REMEDIES FOR FRAUDULENT CLAIMS

CURRENT LAW	INSURANCE ACT 2015
Co-existing remedies of forfeiture under common law and avoidance under statute.	A new single statutory regime for fraudulent claims. The insurer: • Is not liable to pay fraudulent claims. • May elect to terminate the contract, and refuse to pay claims relating to losses suffered **after** the fraudulent act; but whether or not it terminates the contract, the insurer will remain liable for all legitimate losses suffered **before** the fraudulent act.

CONTRACTING OUT

The new Act will be a **default regime** for all business insurance contracts. However, the Act does allow parties to **contract out** of the default regime (**apart from** as regards the prohibition on basis of contract clauses), and to contract into an alternative regime, provided any "disadvantageous term" (i.e. any term which puts the insured in a worse position than it would have been in under the new default regime) meets certain **"transparency requirements"**.

These requirements are that (i) the insurer must take sufficient steps to draw the disadvantageous term to the insured's attention in advance; and (ii) the disadvantageous term must be clear and unambiguous as to its effect.

IMPLICATIONS

The Act will put insureds in a better position than under the existing law. The Act has been welcomed by insurers, as well as insureds and brokers, and some insurers have already indicated that they are willing to reflect the reforms in the language of their policies in advance of August 2016. We believe that now it has received Royal Assent, the Act is also likely to start driving practical change in the way business is placed and underwritten in the London market. As the Act does not come into force until August 2016, you may wish to consider with us whether, depending upon the terms of your existing policies, it would be advantageous for you to look to apply some or all of the Act's provisions to policies which are due to incept or renew before then.

Even though the Act does not come into force until August 2016, we recommend that you start to think about the following points:

- The changes will only affect policies governed by the laws of England and Wales, Scotland and Northern Ireland. Therefore, consider which of your policies will be affected. For example, you might have a policy placed abroad in a local market that is subject to English law, or you may be an overseas insured with a policy placed in London, subject to English law. In both cases, your overseas risk managers and directors will need to be familiar with the new law and with how it will affect the placement/renewal process after August 2016.
- We may need to start the placement/renewal process earlier than usual, so that we can look to engage and pre-agree with your insurers what information you will search for and disclose, and in what manner.
- Underwriting presentations will need to be **structured**, so as to comply with the duty to make a "fair presentation of the risk".
  - It will no longer be acceptable to deluge insurers with electronic information in the expectation that "material circumstances" will be found somewhere within it.
  - **Structuring, indexing, and signposting** should now be used in underwriting presentations, to highlight key information to underwriters; and presentations should not be overly brief or cryptic.
- Consider how best you will carry out a **"reasonable search**" for information.
  - Start thinking now about how you will collate and present the disclosure information to insurers, and who within your organisation has that information.
  - Remember that a change of broker, or a change of personnel within your organisation, could present challenges when ensuring that a reasonable search has been carried out.
  - As you may need to provide evidence that you have carried out a "reasonable search", consider your internal record-keeping procedures, and how you will verify that you have carried out a reasonable search for information. So that we can best assist you in ensuring that a reasonable search is carried out, and as the knowledge of the broker will now be treated as part of your knowledge, have a clear agreement with us regarding who will be responsible for searching for and storing information which may need to be disclosed to insurers (for example, records of historic site surveys).

We hope that these initial comments on the Act provide a useful summary, and assist in highlighting some of the key issues which will be relevant. Here at Marsh, we will be looking to help you prepare for the Act coming into force. We will also be engaging with insurers on your behalf, for example, by looking to agree protocols with insurers on the types of information required to be disclosed for different lines of insurance and different types of insured.

We will keep you updated and will issue further guidance as the market's preparations for the Act develop. In the interim, if you have any queries, please do not hesitate to get in touch with your usual Marsh contact.

GRAPHICS NO. 15-0221

ADVISER

THE INSURANCE ACT 2015 – ISSUE 2

Did you know that when the Insurance Act 2015 comes into force on 12 August 2016, it will significantly impact your disclosure obligations when you take out, renew, or vary any business insurance that is subject to the laws of England and Wales, Scotland, and Northern Ireland?

For example, under the new Act:

- If you don't comply with your new duties, insurers will have a new range of "proportionate remedies", which could include reducing your claim payments significantly.
- You will have to disclose information known by your senior management and by the individuals responsible for arranging your insurance.
- You will have to carry out a reasonable search for information you ought to know, which could include making enquiries of people outside your organisation, such as external consultants.
- You will have to disclose your information to insurers in a "reasonably clear and accessible" manner.

HOW CAN YOU START PREPARING FOR THE MAJOR CHANGES TO BE BROUGHT IN BY THE INSURANCE ACT 2015?

When the Insurance Act comes into force it will bring in the biggest change to UK insurance contract law in more than 100 years. While generally a positive step forward for insureds, it will have a significant impact on your responsibilities as regards the pre-contractual duty of disclosure, and provide insurers with a number of new remedies should you fail to comply with your duties. For example, under the Act:

- You will have a duty to disclose relevant information known by your **"senior management"** and anyone responsible for arranging your insurance. Under the Act, "knowledge" will include matters that these individuals suspect but deliberately refrain from confirming or from making enquiries about.
- **"Senior management"** will be defined as "those individuals who play significant roles in the making of decisions about how the insured's activities are to be managed or organised". In practice, this could extend beyond the board of directors.
- You will have a new duty to carry out a **"reasonable search"** for the information that you **"ought to know"**. As this requirement includes not only information held within your organisation, or information in your possession or control, but also information "held by any other person", in practice this could extend to people outside your organisation, such as external consultants. This new duty is likely to increase your disclosure burden.
- You will have a new stand-alone duty to present your disclosure information to insurers in a **"reasonably clear and accessible"** manner, which could require you to signpost, structure, and index the information. Insurers might even ask you to re-present information if they do not think it has been disclosed in a comprehensible way.
- Insurers may ask more questions during the underwriting process, so you will need to be ready for that.
- If you don't disclose all relevant information to insurers, or even if you do so but don't provide it in the appropriate manner, insurers may be able to apply new **"proportionate remedies"**. For example:
  - Insurers may be able to vary the policy terms and the policy will then be treated as if it had been written on those terms from the outset. For example, insurers could apply an exclusion which might have the effect of excluding your claim under the policy.

– If insurers can show that the different term would have reduced or extinguished their liability in respect of claims they have already paid, you may have to reimburse the insurer for those paid claims.

– Instead of charging you an additional premium, insurers may be able to **reduce your claim payments** significantly.

- As insurers will have a wider range of remedies for non-disclosure than under the existing law, they may be inclined to use them more often than they use the current sole remedy of policy avoidance.
- Provided they meet certain "transparency requirements", insurers will be able to "contract out" of much of the new Act, which could put you in a worse positon than you would be under the new Act.

As you can see from the above examples, the Insurance Act 2015 will bring in important changes. Here are some first steps that you can take to start preparing now.

PREPARE NOW FOR THE NEW DUTY TO MAKE A FAIR PRESENTATION OF THE RISK

Even though the new duty to make a "fair presentation of the risk" will only relate to policies that you place, renew, or vary as from 12 August 2016, we recommend that you start preparing now, by thinking about the following practical points in advance:

- **Which of your policies will be affected?**
  As the changes will affect all insurance and reinsurance policies governed by **the laws of England and Wales, Scotland, and Northern Ireland**, think about whether you have any policies that will be affected, even if such policies have been placed abroad, or if you are an overseas insured with policies that are subject to one of the applicable laws. In both cases, your overseas risk managers and directors will need to be familiar with the new law and with how it will affect the placement/renewal process after August 2016.
- **Start the renewal process earlier**
  Be ready to start the placement/renewal process earlier than usual, to leave enough time for data-gathering. This way, we can look to try and pre-agree with your insurers what information you will search for and disclose, and how you will search and disclose, so as to give insurers sufficient time to ask questions about what you have disclosed.
- **Identify who is your "senior management"**
  As you will have a duty to disclose relevant information known by your **"senior management"** (as defined by the Act), start considering now who within your organisation falls within the definition (set out above).
- **Identify who is responsible for placing your insurance**
  You will also have a duty to disclose relevant information known by the **individuals responsible for placing your insurance**, such as your risk managers, your employees who assist in the collection of data or who negotiate your insurance, and your broker. Again, think about and identify **who** falls within these categories.
- **Raise awareness of the Act internally**
  Think about how you will start to raise internal awareness within your organisation about the Act and the new duties of disclosure required under it.
- **Raise your board's awareness**
  Think about how you will raise awareness with your board about the Act and the important changes it will make to how you collect information for the disclosure process.
- **Review your data-gathering process**
  Think about whether you currently ask enough questions of senior management and your insurance team or whether you need to adapt your standard data-gathering process to be more in-depth.
- **Identify who has information you "ought to know"**
  The new duty to carry out a **"reasonable search"** for information you **"ought to know"** (and to disclose it to insurers) requires you to make enquiries not only within your organisation but also of "any other person" who may have relevant information. Think about which individuals or entities fall within this requirement, such as your broker and any entities (such as subsidiaries) or individuals to be covered by the insurance. The reasonableness of the search you carry out will depend on factors such as the size and complexity of your organisation. We have worked closely with the British Insurance Brokers' Association (BIBA), which recommends that, based on the structure of your business, you think about:

  – **Who** you will need to consult for the insurances you buy (for example, property damage, business interruption, public liability, and professional indemnity, etc.).

  – How much **time** you should allow for it.

  – **How** you will carry out this search, for example, whether by visits, discussions with key staff, or questionnaires.

  – For policies you buy as a business which provide cover to **individuals** (for example, directors and officers liability, pension trustee liability, and medical malpractice, etc.), how you can check that those individuals have no material information that needs to be disclosed, without each individual having to fill in a lot of forms.

- Think about how you will **record** that you have carried out a "reasonable search" so that you can verify to insurers (for example, if later challenged in court) that you have done so.

- **Prepare for personnel and broker changes by capturing information**
  Remember that a change of broker, or a change of personnel within your organisation, could present challenges when ensuring that you disclose the information that you are deemed to "know" and that you "ought to know". Start to consider what, if any, steps can be taken now to record all the relevant information prior to any changes taking place.

- **Agree what information your broker will keep**
  Your broker's knowledge will now be treated as part of your actual knowledge that is to be disclosed. Make sure you have a clear agreement with your broker regarding who will be responsible for searching for and storing the categories of the information which may need to be disclosed (for example, records of historic site surveys).

- **Think about how you will present your information**
  Think about and discuss with your broker and insurers how you will present your disclosure information and underwriting presentations in a manner that is **"reasonably clear and accessible"**, and how such information will be **structured**. Remember, once the Act comes into force:

  - It will no longer be acceptable for presentations to be overly brief or cryptic.

  - It will no longer be acceptable to "data dump", that is, to deluge insurers with an incomprehensible mass of unstructured electronic information without any signposting as to what is material.

  - Underwriting presentations will need to be **structured, indexed, and signposted**, to highlight key information to underwriters.

The above is only a starting point and we will be providing further guidance, particularly once insurers' positions become clearer, nearer the time the Act comes into force.

CONSIDER GETTING THE BENEFITS OF THE ACT NOW, BEFORE IT COMES INTO FORCE IN AUGUST 2016

While it may appear that the new duty to "make a fair presentation" under the Act is onerous and will increase the burden on you during the pre-contractual disclosure process, the Act is generally good news for insureds. For example:

- It will abolish "basis of contract" clauses.

- Where a warranty has been breached, cover will no longer be automatically and permanently terminated from the date of breach, but will simply be suspended until the breach has been remedied (provided it can be remedied).

- Insurers will not be able to rely on breach of certain policy terms (such as some warranties and conditions precedent) to repudiate liability for a loss if it is entirely unconnected with the breach that has occurred.

- Avoidance of the policy will no longer be the only remedy available to insurers for non-disclosure of material facts. Instead, a new range of "proportionate remedies" (including avoidance) will be available to insurers.

- Insurers will be required to play a more active role in the underwriting process.

- The Act will clarify the law relating to fraudulent claims.

Working with Herbert Smith Freehills, Airmic (the UK association for risk and insurance management professionals) has produced an endorsement which contains clauses you could consider using to amend some existing terms of your policies, to help you get some of the benefits of the Act now, before it comes into force in August 2016. It covers the following key areas in the Act:

NON-DISCLOSURE AND/OR MISREPRESENTATION

The Airmic endorsement incorporates the new proportionate remedies set out in the Act in the event of a non-disclosure and/or misrepresentation. The endorsement applies the new regime of remedies when there has been a breach of the current duty of disclosure, but does not incorporate the new duty of fair presentation of the risk under the Act.

BASIS CLAUSES

The Airmic endorsement disapplies any "basis of contract" clauses.

WARRANTIES

Warranties are rendered suspensory, such that the insurer's liability is suspended while the insured is in breach of warranty, but can be restored if the breach is subsequently remedied by the insured.

TERMS NOT RELEVANT TO THE ACTUAL LOSS

The Airmic endorsement reflects the provisions of the Act, which provide that, where a term is designed to reduce the risk of loss of a particular kind or at a particular time/location, the insurer cannot rely on breach of such a term to avoid paying a claim if the breach could not have increased the risk of the loss.

Do bear in mind that the Airmic endorsement isn't a "one size fits all" approach. Current policies will need to be reviewed carefully to identify which elements of the Airmic endorsement it may be beneficial to discuss with your insurers. While a number of the clauses in the Airmic endorsement are likely to benefit all policyholders in principle, care needs to be taken to ensure they are compatible with a policy's existing terms. Particular care needs to be taken in using the clause incorporating proportionate remedies for non-disclosure, and/or misrepresentation, as your existing policies may already give you better protection than the clause offers. If you are interested in amending your existing policies to get some of the benefits of the Act now, we suggest you discuss your options with your usual Marsh contact (and, where necessary, seek independent legal advice).

The Airmic endorsement is designed to provide some of the benefits of the Act in the interim period between now and the date that the Act comes into force on 12 August 2016. If you decide not to amend your policy before then, your policy wording will remain as it is, until your first placement or renewal on or after 12 August 2016.

Once the Act has come into force in August 2016, then (unless the parties expressly "contract out" of it) the Act will apply to policies placed, renewed, or to variations made after that date, if they are subject to the laws of England and Wales, Scotland, and Northern Ireland.

ATTEND OUR WEBINARS

Finally, starting in November 2015, together with Herbert Smith Freehills, we'll be running a series of webinars on discrete aspects of the Act. We'll start with one on the issue that will be of most immediate concern to you – the new duty to make a "fair presentation of the risk", and will follow up with webinars on the new "proportionate remedies" that insurers can apply, and warranties, and other policy terms. The dates are:

26 NOVEMBER 2015 –
DUTY OF FAIR PRESENTATION

20 JANUARY 2016 –
PROPORTIONATE REMEDIES

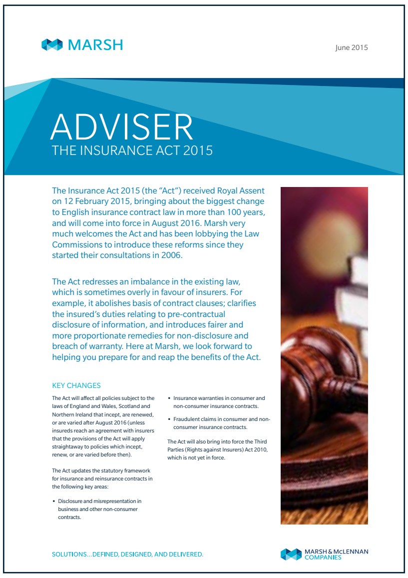
14 APRIL 2016 –
WARRANTIES AND OTHER TERMS

There will be plenty of opportunity for you to ask questions during and after the webinars and we'll send you a follow-up Adviser after each one, which will capture the important information that you need.

We hope the above pointers will help you to start preparing for the Act, and that you can attend our webinars. In the interim, if you have any queries about the Act, please do not hesitate to get in touch with your usual Marsh contact.

FURTHER READING

THE INSURANCE ACT 2015 – ISSUE 1


MARSH June 2015

ADVISER
THE INSURANCE ACT 2015

The Insurance Act 2015 (the "Act") received Royal Assent on 12 February 2015, bringing about the biggest change to English insurance contract law in more than 100 years, and will come into force in August 2016. Marsh very much welcomes the Act and has been lobbying the Law Commissions to introduce these reforms since they started their consultations in 2006.

The Act redresses an imbalance in the existing law, which is sometimes overly in favour of insurers. For example, it abolishes basis of contract clauses; clarifies the insured's duties relating to pre-contractual disclosure of information, and introduces fairer and more proportionate remedies for non-disclosure and breach of warranty. Here at Marsh, we look forward to helping you prepare for and reap the benefits of the Act.

KEY CHANGES

The Act will affect all policies subject to the laws of England and Wales, Scotland and Northern Ireland that incept, are renewed, or are varied after August 2016 (unless insureds reach an agreement with insurers that the provisions of the Act will apply straightaway to policies which incept, renew, or are varied before then).

The Act updates the statutory framework for insurance and reinsurance contracts in the following key areas:

- Disclosure and misrepresentation in business and other non-consumer contracts.
- Insurance warranties in consumer and non-consumer insurance contracts.
- Fraudulent claims in consumer and non-consumer insurance contracts.

The Act will also bring into force the Third Parties (Rights against Insurers) Act 2010, which is not yet in force.

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

MARSH & McLENNAN COMPANIES

Click here to download

GRAPHICS NO. 15-0678b

ADVISER
THE INSURANCE ACT 2015

THE NEW DUTY OF FAIR PRESENTATION

When the Insurance Act 2015 (the "Act") comes into force on 12 August 2016, it will introduce significant changes to the existing duty of disclosure that a prospective (re)insured owes to its (re)insurers. If you are a non-consumer (re)insured who is purchasing a business (re)insurance policy, which is due to incept or renew on or after 12 August 2016, or if you have an existing policy which could be varied on or after that date, you will need to be familiar with the new "duty of fair presentation" introduced by the Act and to understand what this new duty means for you in practice. We hope this Adviser provides you with some practical guidance on some of the issues you will need to consider as part of your preparations.

WHY HAS THE CURRENT LAW ON PRE-CONTRACTUAL DISCLOSURE CHANGED?

Under the existing law, the Marine Insurance Act 1906, before the policy is placed, a prospective (re)insured must disclose to (re)insurers, all material circumstances that it knows, and an insured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. For these purposes, a "material" circumstance is one which would influence the judgment of a prudent insurer in determining whether or not to take on the risk and, if so, on what terms.

The English and Scottish Law Commissions' recent consultation process identified a number of problems with the existing pre-contractual duty of disclosure. They concluded that the existing duty was poorly understood and difficult for large and medium-sized companies to comply with, as insureds find it difficult, for example, to determine what would influence a prudent insurer and what the insured "ought to know." Also, due to the uncertainty as to what needs to be disclosed, and the requirement to disclose "every material circumstance" some prospective insureds currently "data dump," that is they err on the side of caution and provide (re) insurers with a significant amount of sometimes unsorted information to try to ensure that nothing is omitted.
The Law Commissions are also concerned that insurers play too passive a role in the disclosure process and only focus on what has been disclosed when a claim is later made on the policy.

However, the Law Commissions regard pre-contractual disclosure and good faith as fundamental to the good operation of the UK insurance market. Accordingly, in place of the existing duty to disclose material facts, the Act will introduce a new "duty of fair presentation." This is a more prescriptive process, and the Act has been drafted with the aim of giving (re)insureds more guidance on what needs to be disclosed; whose knowledge within the organisation is relevant, and how that information should be presented to (re)insurers. The Act also aims to encourage more proactive engagement in the placing process by (re)insurers.

WHAT IS THE NEW DUTY OF FAIR PRESENTATION?

Once the Act comes into force, before entering into a business insurance contract[1] the (re)insured must make a "fair presentation" of the risk to the (re)insurer which means it must:

1. (a) Disclose every material circumstance that it knows or ought to know, or (b) failing that, provide the insurer with sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purposes of revealing those material circumstances; and
2. Present the disclosure in a manner which would be "reasonably clear and accessible to a prudent insurer"; and
3. Not make a misrepresentation, so that "every material representation as to a matter of fact is substantially correct and every material representation as to a matter of expectation or belief is made in good faith."

[1] A business insurance contract is any contract which is not a consumer contract. A consumer contract is an insurance contract taken out by an individual for purposes which are wholly or mainly unrelated to his business, trade, or profession.

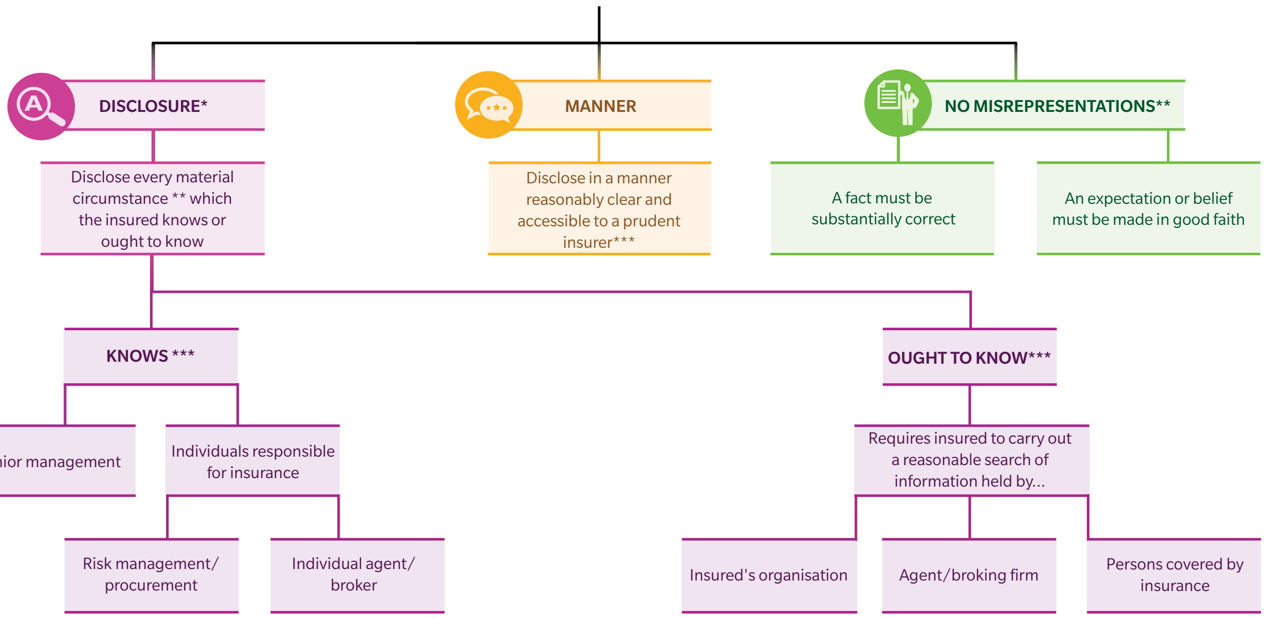
The Act does not change the definition of "material circumstance." However, the Act now gives some examples of what could constitute a material circumstance, namely:

- Special or unusual facts relating to the risk;
- Particular concerns which led the insured to seek cover for the risk; and
- Anything which (re)insurers concerned with that class of business or field of insurance activity would generally consider should be included within a fair presentation for that type of risk.

Fall-back position: while limb (1) of the duty of fair presentation appears to contain two ways to meet the duty of fair presentation, the Law Commission has made it clear that the (re)insured's primary duty is part 1(a) above, namely to disclose all material circumstances that the (re)insured knows or ought to know. Part 1(b) has been introduced only as a fall back for (re)insureds for situations where it may not be possible to disclose every material circumstance. For example, in a situation where a material circumstance has not been disclosed it may still be possible for the (re)insured to meet the duty of fair presentation if it has given the (re)insurer sufficient information (presented clearly) to put the prudent (re)insurer on notice that it needs to make further enquiries which, when answered, would reveal that material circumstance.

The following diagram illustrates this new duty of fair presentation and the matters that need to be considered under each of the three elements of this new duty.

(RE) INSURED'S DUTY OF FAIR PRESENTATION – BUSINESS INSURANCE CONTRACTS (PRE-CONTRACT)



* Fall-back position
Although there is a fall-back position if an insured has given the insurer sufficient information to put it on notice that it needs to make further enquires, the insured's primary duty is to disclose every material circumstance it knows or ought to know.
(See Adviser for more details).

** A circumstance or representation is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms.

*** Where possible, in advance of placement/renewal, the (re)insured should look to agree with (re)insurers some parameters around the components of the duty of fair presentation, for example: who falls within the definition of senior management/individuals responsible for insurance; the scope of a reasonable search, and how the information will be presented.

WHAT DOES THE (RE)INSURED ACTUALLY KNOW?

An insured must disclose every material circumstance that it actually "knows." The Act defines this as (i) the knowledge of the insured's senior management; and (ii) the knowledge of those individuals who are responsible for arranging the insured's insurance.

Within your organisation, **"senior management"** will be **"those individuals who play significant roles in the making of decisions about how the insured's activities are to be managed or organised."** This category will include the main board but could extend to other individuals if they fall within the definition of senior management. We recommend that you start preparing now by:

- Considering your corporate structure and identifying the individuals whose knowledge could fall within the definition of "senior management" (that is, the individuals who play significant roles in the making of decisions about how your activities are to be managed or organised);
- Mapping out and putting together a structure chart of the individuals you believe will have relevant information;
- Raising those individuals' internal awareness now, as it is possible that some of them have not previously been involved in the pre-contractual disclosure process and so, may need guidance on what will be expected of them under the new duty of fair presentation;
- Thinking about the scope of the information that you will need to obtain from those individuals, and how you will gather this information; and
- Seeking to agree with (re)insurers who in your organisation falls within the definition of "senior management," to give you clarity as to exactly which individuals or roles will be treated as having your organisation's actual knowledge and to limit the scope of your enquiries.

Individuals **"responsible for your insurance"** are defined by the Act as those who **"participate on behalf of the insured in the process of procuring the insured's insurance."** This category includes the insurance/risk manager or other function within your organisation that arranges the purchase of your insurance. It could also include individuals within your organisation who assist the risk management team or other functions involved in the collation of data for the insurance submission. This category will also include the individuals who give instructions to your (re) insurance broker and, importantly, will include the actual broking team that handles the placement of each specific insurance policy that you are seeking to purchase. We recommend that you start preparing now by:

- Identifying and recording the individuals who will fall within this category. This could, for example, include individuals based overseas, where you have an international risk management team;
- Considering whether or not there has been a change in personnel within your organisation that could impact your actual knowledge, for example, if colleagues have moved internally within your organisation or have left the company. Consider whether or not you need to implement measures now to capture the knowledge of the individuals identified prior to any future departures;
- Seeking (re)insurers' agreement to limit the number of individuals who fall within this category, for example, limiting it to only the risk manager, head of insurance, or any other individual within your organisation who is responsible for arranging insurance, and setting out in your policy wording the details of any such agreement reached; and
- Identifying the key personnel at your broker (or any other intermediary you use) who fall within the definition and agreeing with insurers to limit the number of persons whose "actual" knowledge is relevant to capture.

WHAT THE (RE)INSURED OUGHT TO KNOW – THE "REASONABLE SEARCH."

Under the Act the (re)insured is **also** required to disclose every material circumstance that it **"ought to know."** The Act states that a (re)insured ought to know **"what should reasonably have been revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means."** It is very important to note that the information the (re)insured ought to know includes not only material information held within the insured's organisation, but also held outside it, **"by any other person, (such as the insured's agent or a person for whom cover is provided by the contract of insurance),"** regardless of whether those agents are involved in the insurance procurement. This could, for example, include information held by surveyors and other consultants and intermediaries.

As regards your brokers, a reasonable search for material information could extend to information held by the whole broking firm (and any sub-brokers), rather than just the individual account team handling your placement, if that is reasonable in the circumstances of the placement. For example, this could include any consultancy team within the broking firm that you have instructed. Your broker will not, however, be required to provide you with confidential information relevant to your risk if that information has been obtained from another of its clients.

A reasonable search for material information held by entities or individuals covered by the policy could include, for example, co-insureds, subsidiaries, contractors of every tier under a contractors all risks (CAR) policy or current and former directors under a directors and officers (D&O) liability policy. Again you will need to consider what is reasonable in the circumstances of the placement and coverage you seek.

This new duty to carry out a reasonable search could have a significant impact on the scope of the data- gathering exercise you undertake. As to what constitutes a "reasonable search," there is no one-size-fits-all answer. What is "reasonable" is an objective test and will depend on the type, size, and complexity of your business. In order to prepare for this new statutory duty to carry out a reasonable search, we recommend you undertake the following preparations:

- Consider the scope and content of the existing enquiries you currently make when gathering information for your insurance placement or renewal if the process is not currently written down and mapped, we recommend you do so;
- Bring a "fresh pair of eyes" to your existing data-gathering process and think about whether you need to make any additional enquiries, for example, of any a technical advisers or external consultants you have engaged, or of any specific entities or individuals who are to be covered by the insurance, to see whether they hold information which could be relevant to your renewal or insurance placement;
- Consider whether or not you need to update or introduce any new internal IT systems in order to assist you in gathering the information as part of your reasonable search and storing the information obtained;
- Seek to agree, if possible, with insurers the parameters and process of what constitutes a reasonable search for your organisation in respect of each specific line of insurance that you purchase, and set out in your policy wording the details of any such agreement reached;
- Ensure that the process you undertake, including any additional enquiries you make, is documented and auditable so that you can demonstrate to insurers that your organisation understands the new duty to carry out a reasonable search;
- Consider how you are going to store all of the information gathered. In the event of a future disputed claim you may be required to prove to (re)insurers, perhaps many years after the placement, that you carried out a reasonable search and you will need to be able to evidence the scope of that search and the responses you received as part of your duty of fair presentation;
- Put in place an agreement with your broker as to who is responsible for searching for and storing the information held within its organisation that needs to be disclosed as part of your reasonable search;
- Consider any existing library of information held by the broker about your risk. Think about whether this will this be sufficient and, if not, what additional information you will need to provide;
- Think about how you will transfer the knowledge held by your broking firm if you change your appointed broker;
- Review your policy wording to identify the range and scope of insured persons under the policy, in order to establish the scope of the reasonable search you will need to undertake and how that search will be undertaken, and consider whether or not all of the potential beneficiaries can in fact be identified or contacted; and
- Seek to agree, if possible, with insurers to limit the scope of the reasonable search of persons covered by the policy. For example, can you limit the search to knowledge held by the policyholder only? Where you obtain insurers' agreement to narrow the search parameters, ensure that any agreement is clearly set out in your policy wording.

THE MANNER OF YOUR DISCLOSURE

The second element of the duty of fair presentation is a requirement to disclose the information to (re)insurers in a **"manner which is reasonably clear and accessible to the prudent insurer."** It is important to note that failure to satisfy this requirement will be a breach of the duty of fair presentation, which could give insurers a remedy – even if you have disclosed all material circumstances.

This element of the new duty focuses on the form of the presentation rather than the content and is intended to eradicate the process of "data dumping." Going forward, your underwriting presentations will need to be structured, indexed, and contain signposts as to the content of the information given.
We recommend that you consider the following practical points when putting together your underwriting presentations:

DON'T

- Provide CDs of information or data rooms that are not organised or are opaque.
- Only refer (re)insurers to your website.
- Be too brief or cryptic, even if this is previously how your disclosure information has been presented to (re)insurers.
- Rely on prior year's information and presentations, without checking that such presentations meet with the new requirement to disclose in a reasonably clear and accessible manner.

DO

- Bring a fresh pair of eyes to your existing underwriting presentation;
- Ensure the presentation is easy to navigate, using an index and headings, and that it is user-friendly for both new (re)insurers and long-standing (re)insurer partners;
- Ensure all documents have appropriate titles, to aid identification;
- Provide the same presentation to all (re)insurers, including the lead and the following market and (re)insurers on all layers (primary and excess);
- Respond to questions asked by (re)insurers and consider how you will provide the answers to all insurers. Remember, if one (re)insurer asks a question, it could indicate that it considers that issue to be material to the underwriting assessment, so ensure you provide the answer to all (re)insurers;
- Ensure you keep a complete and permanent record of the presentation which you can use as evidence that you have complied with the duty of fair presentation, in case there is subsequently a disputed claim where (re)insurers seek to argue that there has been a breach of the duty;
- If you permit electronic access to (re)insurers, consider whether or not it is possible to keep a record of who has accessed the information and what information has been reviewed;
- Ensure that the information within the data room or website is accurate and relevant to the (re)insurers' assessment of your risk, for example, whether the website gives the full picture of the operations and activities of your business that are relevant to the specific line of insurance being purchased;
- Consider how long that information will be available for review on the website or within the data room and, if the information is removed or the data room is closed, ensure you have a record of what was present and available for review at the time that the presentation was given to (re)insurers. Remember, you may need to demonstrate in the future, perhaps some years hence, the content of the fair presentation you gave to (re)insurers; and
- Agree with (re)insurers, if possible, a timeline by which you will provide and by which (re)insurers are required to submit their questions.

A DUTY NOT TO MISREPRESENT

The final element of the new duty of fair presentation is a requirement not to make misrepresentations. This duty already exists today. In practice, every material representation as to a matter of fact has to be "substantially correct," so that a prudent insurer would not consider the difference between what is represented and what is actually correct to be material.
Further, every material representation, which is a matter of expectation or belief, has to be made in good faith. A prospective (re)insured also has the ability to withdraw or correct a representation before the contract is entered into.

REINSURANCE – A BRIEF COMMENT

It is important to remember that if a reinsurance (or retrocession) policy is to be governed by the laws of England and Wales (or Scotland or Northern Ireland), under the Act the reinsured will be required to make a fair presentation to its reinsurers. This is even if the reinsured is situated overseas, for example, if a local fronting company is used and/or even if the reinsurance is placed locally abroad, but is reinsured into the London market.

In practical terms, this is likely to have a significant impact on reinsureds. Arguably, they will now owe their reinsurer a more extensive duty of disclosure, in particular, the reinsured will be required to disclose every material circumstance that it ought to know, which means the reinsured is required to carry out a reasonable search. There is also, arguably, an increased burden on the reinsured to make more thorough enquiries of the underlying insured, if the underlying presentation prompts it to do so, and to disclose to its reinsurers all material information that should have been revealed by those enquiries. This is particularly the case for captives and fronting insurers who have played only a very limited role with the underwriting process primarily taking place between insured and reinsurer.

Where the underlying policy is governed by the law of England and Wales, Scotland, or Northern Ireland, it will be critical for the reinsured to comply with the duty of fair presentation. Failure to do so could lead to a situation where the underlying insured has met its duty to make a fair presentation, by disclosing sufficient information to put the prudent insurer/reinsured on notice that it needs to make further enquiries to reveal material circumstances, but the reinsured fails to make those enquiries. In this scenario, the reinsured could be required to indemnify the underlying insured but could face difficulties collecting from its reinsurers if they can argue that the reinsured has breached its duty of fair presentation by failing to make those enquiries.

There is also a risk that the reinsurance may not respond if the underlying policy is governed by a local law, which does not require such an extensive pre-inception disclosure process, but the reinsurance contract is governed by English law, which requires compliance with the duty of fair presentation. In such a scenario, it is possible that the reinsured receives limited disclosure from its underlying insured, but is required to provide more extensive information to the London market reinsurers in order to demonstrate it has made a fair presentation of the risk.

Practically speaking, in both scenarios we would advise all parties, on both the underlying contract and the reinsurance contract, to agree in advance with reinsurers the scope of the disclosure required, and the content of and the manner in which the disclosure is to be provided.

WHAT DOES NOT NEED TO BE DISCLOSED?

Finally, under the Act the (re)insured is not required to disclose a circumstance in the absence of enquiry, if:

- It diminishes the risk.
- The (re)insurer knows it (for example, the actual underwriter or underwriting team on the risk).
- The (re)insurer ought to know it (for example, the information is readily available within the (re)insurer's organisation, such as within the claims team).
- The (re)insurer is presumed to know it (for example, the circumstance is common knowledge or something that an insurer in that class of insurance would be expected to know).
- It is something in relation to which the (re)insurer waives information.

However, in practice, we would recommend that (re)insureds do not rely on these exclusions unless the (re)insurer has provided written agreement, and details of, the information that the (re)insured does not need to provide.

KEY TAKEAWAYS

While (re)insureds currently have disclosure obligations, the new duty of fair presentation is arguably more prescriptive and places an increased burden on (re)insureds, in particular, in view of the new statutory duty to carry out a potentially wide-ranging reasonable search. In order to prepare for the new disclosure regime, we recommend that you undertake the following steps now:

- Identify with your broker which of your policies are governed by the laws of England and Wales, Scotland, or Northern Ireland and which will incept or renew (or could be varied) on or after 12 August 2016.
- Consider, in plenty of time, the new duty of fair presentation and what it means for your organisation in practice, for example, whose knowledge is regarded as the actual knowledge of your organisation, what is a reasonable search, how will you carry out the search, and how you are going to provide your disclosure information.
- Remember the need to document and demonstrate the process you have undertaken to comply with the duty of fair presentation and keep an audit trail so that you can evidence your compliance to (re)insurers at a later date.
- Raise internal awareness now, particularly with your board, and allow time to explain to relevant employees the new duty of fair presentation and what will be expected of them.
- Start your renewal process earlier than usual to build in time to comply with the duty of fair presentation, including, for example, time to seek agreement with (re)insurers on the identity of the knowledge-holders within your organisation, what constitutes a reasonable search, and time to allow (re) insurers' questions to be dealt with.

We hope the above guidance will help you navigate the new duty of fair presentation and start your preparations. If you have any queries about the new duty of fair presentation or the wider provisions of the Act, please do not hesitate to get in contact with your usual Marsh representative.

FURTHER READING

DAMAGES FOR LATE PAYMENT OF CLAIMS – PROPOSED BY THE ENTERPRISE BILL

THE INSURANCE ACT 2015

THE INSURANCE ACT 2015 – ISSUE 2

GRAPHICS NO. 15-1020a

MARSH

March 2016

ADVISER

THE INSURANCE ACT 2015 – THE NEW REGIME OF PROPORTIONATE REMEDIES

The Insurance Act will come into force on 12 August 2016 and will affect all policies subject to the laws of England and Wales, Scotland, and Northern Ireland. Under the Act, when taking out, renewing, or varying a business insurance policy on or after that date, the insured will have a new duty to make a "fair presentation" of the risk. If the insured breaches this duty, insurers will have a new range of "proportionate" remedies available to them. This Adviser looks at:

- The current law.
- The new law.
- The new duty of fair presentation – a reminder.
- How proportionate remedies will work in practice.
- Proportionate remedies in relation to variations of policies.
- How insurers will have to prove what they would have done.
- Whether you have to accept proportionate remedies.
- The potential impact of proportionate remedies on claims handling.
- Steps you should consider taking now to start preparing for the new regime.

THE CURRENT POSITION

Under the Marine Insurance Act 1906, before a policy is placed, a prospective insured must disclose to insurers all material circumstances that it knows, and an insured is deemed to know every circumstance which, in the ordinary course of business, it ought to know. A prospective insured must also ensure that every material representation made before the contract is concluded is true.

If the insured fails to comply with either of these duties, the only remedy available to the insurer, unless the policy provides otherwise, is avoidance of the policy ab initio. This means the insurer can treat the policy as if it never existed, and may refuse all claims, even if the non-disclosure was innocent and even if, had the insurer known all the facts, it would still have provided cover but charged only a small increase in premium.

THE NEW LAW

The Insurance Act 2015 (the "Act") will apply to all policies that incept, renew, or are varied on or after 12 August 2016 and are subject to the laws of England and Wales, Scotland, and Northern Ireland[1]. The Act seeks to address this overly harsh, inflexible remedy of avoidance. Under the Act, the insured will have a duty to make a "fair presentation" of the risk and, if it fails to do so, the insurer will have a range of "proportionate" remedies (which include avoidance in some instances). The remedy available to the insurer will depend on whether or not the breach of the duty of fair presentation was deliberate or reckless and what the insurer would have done had the duty not been breached.

While the removal of the sole remedy of avoidance is a positive step for policyholders, a number of issues arise out of the new regime of proportionate remedies. We hope this *Adviser* will give you some practical guidance on how to address some of these issues in advance of the Act taking effect on 12 August 2016.

1 The Act applies to both insurance and reinsurance contracts and, therefore, references in this *Adviser* to the provisions of the Act relating to an "insured" and "insurer" should be read to include "reinsured" and "reinsurer" respectively.

A REMINDER ABOUT THE NEW DUTY OF FAIR PRESENTATION

In our *Adviser – Issue 4*, we discussed the new duty of fair presentation and gave some practical guidance on steps you can take now as part of your preparations. By way of a reminder, once the Act comes into force, before entering into a business insurance contract[2] the insured must make a "fair presentation" of the risk to the insurer, which means it must:

1. (a) Disclose every material circumstance that it knows or ought to know, or (b) failing that, provide the insurer with sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purposes of revealing those material circumstances; and
2. Present the disclosure in a manner that would be "reasonably clear and accessible to a prudent insurer"; and
3. Not make a misrepresentation, so that "every material representation as to a matter of fact is substantially correct and every material representation as to a matter of expectation or belief is made in good faith".

If the duty of fair presentation is breached, "proportionate remedies" will apply.

PROPORTIONATE REMEDIES

Under the Act, if the insured's failure to make a fair presentation is deliberate or reckless, the insurer can still avoid the contract (in other words, it will be able to cancel the contract from day one and treat it as if it never existed) and will not have to return the premium. The Act defines a "reckless" breach as one where the insured did not care whether or not it was in breach of the duty to make a fair presentation of the risk.

However, if the failure to make a fair presentation was not deliberate or reckless (for example, if it was simply the result of a careless or innocent oversight, or due to defective reporting standards), then the insurer has the following range of remedies available to it, which are based on what the actual underwriter can show they would have done had a fair presentation been made:

i. If the insurer would not have entered into the contract on any terms, it can still avoid the contract but must return the premium.

ii. If the insurer would have entered into the contract but on different terms (other than relating to premium), the contract will be treated as if it included those terms from the outset.

iii. If the insurer would have entered into the contract but would have charged a higher premium, then, rather than pay additional premium, the insurer's remedy is to reduce proportionately the amount paid on a claim. This means the insurer need only pay "X%", where "X%" is calculated as follows:

$$X = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100$$

HOW WILL PROPORTIONATE REMEDIES WORK IN PRACTICE?

Take an example where an insured wishes to purchase a property policy to cover commercial premises that have a history of subsidence. Before inception, the insured fails to mention the prior history of subsidence to the insurer, but the failure to mention this is not deliberate or reckless. Had the insurer been aware of the prior history, it would have included an exclusion for loss or damage caused by subsidence. In the event of a claim, the policy would be treated as if that exclusion had been included from the outset. No claims caused by subsidence will be covered and any such claims that have already been paid by the insurer under the policy will have to be re-paid by the insured.

Alternatively, take a scenario where a firm of architects purchases a liability policy with a GBP10 million limit (including defence costs) and, prior to inception, innocently fails to disclose that it has started working on projects in the Middle East. When the insured presents a claim under the policy and the insurer becomes aware of the Middle East projects, the insurer argues that, had a fair presentation been made it would have doubled the premium. In these circumstances, the insurer need only pay 50% of the claim. The insurer's reduced liability will also apply in respect of any additional coverage afforded by the policy, such as cover for defence costs. In this example, if the insured had incurred GBP1 million of defence costs, it would only be able to recover GBP500,000 of these.

In this scenario, what determines the level of additional premium due (and therefore the proportionate reduction of the claim payment) is not the size of the claim but rather the insurer's attitude to the non-disclosed fact, in this case the fact that the insured was carrying out projects in the Middle East.

It is very important to note that where the insurer seeks to reduce a claim payment proportionately it cannot also charge the additional premium. The insurer can, however, combine proportionate remedies (2) and (3) above.

[2] A business insurance contract is any contract that is not a consumer contract. A consumer contract is an insurance contract taken out by an individual for purposes that are wholly or mainly unrelated to their business, trade, or profession.

That is, it could proportionately reduce a claim payment and also amend the terms and conditions of the policy, for example, by adding an exclusion.

PROPORTIONATE REMEDIES AND VARIATIONS OF POLICIES

Proportionate remedies also apply to variations of policies. For example, if a policy incepts on 1 July 2016 but is varied on 1 September 2016, if there is a breach of the duty of fair presentation in respect of the variation, the following remedies will apply:

i. If the failure to make a fair presentation was deliberate or reckless, the insurer may avoid the entire policy, with effect from the time the variation was made;

ii. If the failure to make a fair presentation was not deliberate or reckless, then:

   a. If the insurer would have agreed to the variation on different terms (not relating to premium), the variation will be treated as if it had been entered into on those different terms.

   b. If the insurer would not have agreed to the variation on any terms, it may treat the contract as if the variation was never made. Any extra premium paid for the variation must be returned and, if the total premium was reduced as a result of the variation, then the insurer may reduce proportionately the amount paid on claims arising out of events after the variation.

   c. If the insurer would have increased the premium/not have reduced the premium/reduced the premium by less than it did, then it may reduce proportionately the amount paid on claims arising out of events after the variation.

The diagram below illustrates how proportionate remedies could apply where, for example, an insured purchases a property policy covering four locations, which is then varied to cover an additional fifth location, and, prior to inception, the insured fails to disclose that the fifth location had been burgled twice in the previous year.

PROVING THE HYPOTHETICAL

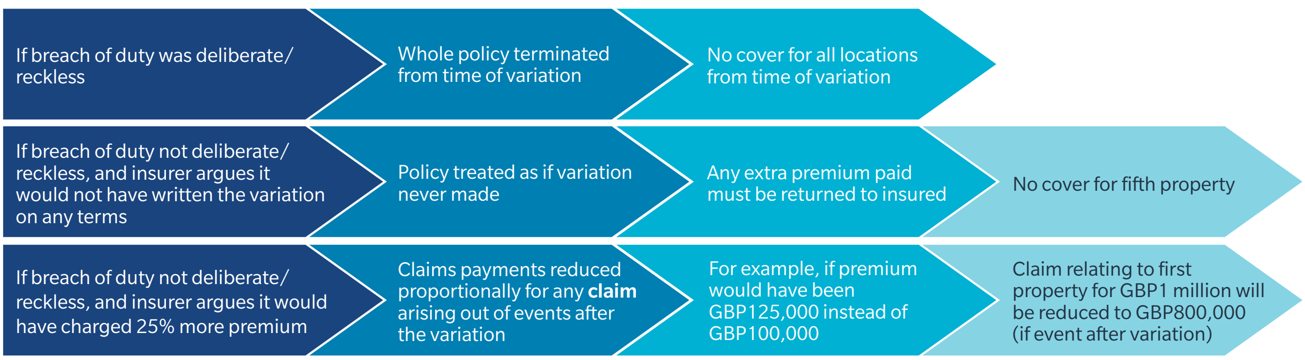
In order to rely on proportionate remedies, the burden will be on the insurer to show what it would have done had a fair presentation been made, and in this context it is what the "actual" underwriter would have done which needs to be proved. This may present some challenges for insurers, since what the "actual" underwriter would have done if given all the material information depends on a number of elements, such as the existing relationship (if any) between the insured and the insurer, the nature of the market (that is, whether it is a hard or soft market), and the insurer's capacity at the time. It remains to be seen how insurers will address this issue of proving what they would have done had a hypothetical fair presentation been made.

PRACTICAL ISSUES TO START CONSIDERING NOW

YOUR CURRENT POLICY PROVISIONS

One of the key issues to consider is the existing language in your policy that deals with the remedies that are available to insurers if there is a non-disclosure or misrepresentation. If your policy is silent on this, then insurers' remedies will be determined by the law that governs your policy. So if, for example, your policy is governed by the laws of England and Wales, Scotland, or Northern Ireland, then, if your policy incepts, renews, or is varied on or after 12 August 2016, the new regime of proportionate remedies will apply in the event of a breach of the duty of fair presentation.

Currently, because the sole remedy of avoidance is so harsh, it is sometimes possible to negotiate enhanced non-avoidance language into policies. This language seeks to limit the remedy of avoidance by restricting insurers' right to avoid, for example, only to situations where the non-disclosure or misrepresentation is fraudulent.



Alternatively, some policies include a range of remedies where there is non-disclosure of material information, for example, enabling the insured to pay additional premium in circumstances where a higher premium would have been charged. We recommend that you review your policy wording with your broker, to identify whether you already have any such enhanced non-avoidance language.

If you do have any preferential language that puts you in a better position than you would be under the Act, you may want to try to preserve it in your policies after the Act comes into force. For example, if you currently have the language which limits the insurer's remedy for non-disclosure only to situations where the non-disclosure is fraudulent, this puts you in a better position than you would be under the Act. This is because, under the Act, if there is a non-fraudulent failure to make a fair presentation, the insurer may still be able to argue that, had it known about the non-disclosed fact, it would have included an additional term or charged a higher premium. We therefore recommend that you consider with your broker what amendments need to be made to your existing policy language to ensure that you retain any language that puts you in a more advantageous position than under the Act, in particular, where you are seeking to limit the remedies available to insurers in the event of a breach of the duty of fair presentation.

DO YOU HAVE TO ACCEPT PROPORTIONATE REMEDIES?

As under the current law, the Act will not detract from your right to try to negotiate different policy terms and to put yourself in a better position than you would be under the Act. It will still be open to insureds to try to negotiate more beneficial terms with insurers.

Therefore, we recommend that you consider your policy with your broker to identify whether or not you currently have such enhanced non-avoidance language, its scope, and what remedies you want insurers to have where there is a breach of the duty of fair presentation. For example, do you want to try and limit insurers' remedies so that the only remedy available for breach of the duty of fair presentation is avoidance in the event of the breach being deliberate or reckless (thereby removing insurers' ability to apply an exclusion or reduce a claim payment)? Alternatively, would you rather have the ability to pay any additional premium that the insurer would have charged had a fair presentation been made, than face a proportionate reduction of claim payments? (Remember, however, it may not always be more beneficial to pay additional premium. For example, it could be more than the reduction in the claim payment.)

Once you have decided what remedies you want insurers to have, you will need to think about how far you want to go in pressing for this in the negotiations with insurers.

Remember, when negotiating cover with insurers, there are other important factors to take into account, such as the scope of cover, the availability of extensions, the level of the excess or deductible, and the nature of the exclusions. Identify which factors are of most importance to you.

Also, be prepared for possible insurer resistance to requests for enhanced language. Under the current law, it is sometimes possible to obtain enhanced non-avoidance language, as insurers recognise that the existing sole remedy of avoidance is very harsh. Once the Act comes into force, insurers may be less willing to provide it, given there will be a new regime of more balanced remedies.

POTENTIAL IMPACT ON CLAIMS HANDLING

From a practical perspective, proportionate remedies could impact how insurers handle disputed claims in a number of ways, For example:

- Going forward, as there will be a new range of remedies, and not just the "nuclear" option of avoidance, insurers may be more inclined to take non-disclosure points and to impose additional policy terms or reduce claim payments.

- Where more than one insurer takes a share of the same risk and multiple insurers provide cover, there is a possibility that, in the event of a disputed claim, each insurer will argue it would have taken a different course of action from the other, and so different insurers may argue for different remedies. For example, one insurer could argue that it would have added an exclusion, whereas another could argue that it would not have provided cover at all. One way to try to reduce the risk of this is, by way of enhanced language in your policy, to seek to limit the number of remedies available to all the insurers on the placement and try to agree a consistent approach from all the insurers as regards the remedies that can be applied.

- Where there are excess layers sitting above a primary policy, and insurers on the primary layer only pay a proportion of the limit, it could have an impact on whether the excess layer policies respond. For example, if there is a proportionate reduction of a claim payment on the primary policy, the first excess layer insurer could seek to argue that, because the limit of the primary policy has not been fully exhausted, the excess layer cover is not triggered.

- In practice, the impact of proportionate reduction of claim payments is no different to the situation that could arise today where, on a primary policy, the insured settles a claim with its primary insurers for less than 100% of the policy limit, so that the primary policy limit has not been fully exhausted.
  We recommend that you consider with your broker the language in your excess layer policies, so that you look to address the situation where a claim is substantial enough that the excess layer policies would be expected to respond, but, because only a partial payment on the primary policy has been made, there is a potential argument that the excess layer cover is not triggered.

- Proportionate reduction of claim payments could impact on the claims control of insurers on liability policies. For example, if an insurer is able to show that, had a fair presentation been made, there would have been a 50% increase in the premium, it will be entitled to reduce the claim payment by one-third. This will also reduce the defence costs recoverable under the policy by one-third, so you could have a situation where the insurer has selected the defence lawyers and retains the conduct and control of any negotiations and proceedings, and yet the insurer is only paying two-thirds of the defence costs. Accordingly, we recommend insureds consider with their broker any claims control provisions in their policies and what amendments are necessary, or consider including a costs-sharing provision to address such a situation.

- In the context of reinsurance there is a risk for reinsureds and captives where the remedies in, respectively, the insurance and reinsurance policies are not back to back. For example, consider the situation where there has been a breach of the duty of fair presentation because the insured has innocently failed to provide some material information to the insurers prior to inception, and where the non-disclosure was replicated when the reinsured purchased its reinsurance cover. If the insurance policy limits insurers' right to avoid only to situations where the failure to make a fair presentation is deliberate or reckless, but the reinsurance policy does not contain such a limitation and the full regime of proportionate remedies applies, the reinsured could find itself with limited or no reinsurance cover. This would be because the reinsured would not have a remedy in the event of the insured's innocent breach of duty and would be required to pay the underlying claim in full, but the reinsurers could apply one of the proportionate remedies and limit their liability to the reinsured. For example, if reinsurers could show that had they received a fair presentation they would have charged an additional premium, the reinsured would have paid the insurance claim in full but would face a proportionate reduction of its reinsurance claim.

KEY TAKEAWAYS – WHAT CAN YOU DO NOW TO PREPARE FOR THE NEW REGIME OF PROPORTIONATE REMEDIES?

It is a positive and welcome step for policyholders that the sole, harsh, and inflexible remedy of avoidance has been replaced with a more balanced regime of proportionate remedies. However, there is going to be uncertainty as to how the new regime will work in practice.

To prepare for the new regime, we recommend that insureds do the following:

- Work with your broker to consider the terms of your current policies to ascertain what, if any, enhanced non-avoidance language you already have and what amendments will be necessary to preserve such language and negotiate any required amendments with insurers.

- Think about whether you wish to try to limit the range of remedies available to insurers where there is a breach of the duty of fair presentation.

- Consider with your broker whether you want to try and agree with insurers that, in the event of a failure to make a fair presentation, you will pay the additional premium insurers would have charged, rather than taking a proportionate reduction of claims payments.

- Consider with your broker whether any amendments are necessary to excess layer policies to deal with the situation where the primary insurance policy limit is not exhausted due to the application of proportionate remedies by the primary layer insurers.

- If you are a captive and you purchase reinsurance, check that the reinsurers' remedies are consistent with the insurers' remedies.

- Ensure you have a robust process in place to address the duty of fair presentation prior to inception, to limit insurers' ability to argue there has been a breach of the duty.

We hope the above gives you some guidance on how the new regime of proportionate remedies will apply and what you can do now to address some of the issues that could arise. If you have any queries about the new regime of proportionate remedies, or the other provisions of the Act, please do not hesitate to get in contact with your usual Marsh contact.

THE DUTY OF DISCLOSURE AND FAIR PRESENTATION

We would specifically draw your attention to the attached "Duty of Disclosure and Fair Presentation" document. We ask that you read it carefully as, if your (re)insurance contract is governed by English law (i.e. the laws of England, Wales, Scotland or Northern Ireland), any failure to disclose material information to your insurer, or any misrepresentation, may adversely affect the validity of your contract. If your contract is not governed by English law we recommend that you obtain independent advice as to your obligations under the relevant law.

The attached guidance note does not purport to constitute legal advice but it does reflect the law. If having read the attached document you have any questions, please do not hesitate to discuss this with your usual Marsh contact. In any event, Marsh Ltd recommends full disclosure of all material facts and circumstances as best practice.

August 2016

THE DUTY OF DISCLOSURE AND FAIR PRESENTATION

If your insurance[1] policy is governed by the laws of England and Wales, Scotland or Northern Ireland[2] please read this guidance note carefully, as any failure to comply with the duty of fair presentation and disclose material information to your insurer may adversely affect the validity of your insurance policy. If you have any questions, please do not hesitate to contact your usual Marsh contact in the first instance.

If your insurance policy is not governed by the laws of England and Wales, Scotland, or Northern Ireland, we recommend that you obtain independent advice as to your obligations under the relevant law. If you are not sure about which law applies to your insurance policy, you should discuss this with your usual Marsh contact.

This guidance note does not purport to constitute legal advice but it does reflect the law. Your insurance policy may contain clauses which vary the strict legal position. If appropriate you should, in addition to speaking with your usual Marsh contact, consider taking your own independent legal advice.

Please tell us if the person in your organisation responsible for arranging insurance changes so that we may explain the duty of disclosure/fair presentation to that person.

REMEMBER – you are responsible for the accuracy and completeness of all the information you provide to us and to your insurer.

1. BUSINESS INSURANCE CONTRACTS[3]

1.1 YOUR OBLIGATIONS

If you are a business and your insurance policy is governed by English law, you must, at all times, act with utmost good faith towards your insurer. Before your policy is placed, at renewal, and when varying or extending the policy, you have a duty under the Insurance Act 2015 to make a "fair presentation" of the risk and you must disclose to your insurer all information, facts, and circumstances which are, or ought to be, known to you and which are material to the risk. In addition, if your policy contains a particular clause stating that any change in circumstances must be advised to your insurer, you will also have to disclose certain information during the policy period.

1 References to insurance/insured/insurer also apply to reinsurance/reinsured/reinsurer, save for consumer insurance references.

2 All references to English law include the laws of Wales, Scotland, and Northern Ireland.

3 A business insurance contract is any contract which is not a consumer contract. A consumer contract is an insurance contract taken out by an individual for purposes which are wholly or mainly unrelated to the individual's trade, business, or profession.

When providing information or completing a proposal form or otherwise confirming any information to your insurer, you should take care to ensure that the details provided are complete and accurate.

Even where a proposal form is used, you should note that your duty to make a fair presentation is not confined to answering the specific questions listed in the form and/or asked by us or your insurer and that all material circumstances should be disclosed to your insurer, regardless of whether or not your insurer has asked for the information.

THE INSURANCE ACT 2015 GIVES SOME GUIDANCE AS TO WHAT A "FAIR PRESENTATION" OF THE RISK MEANS:

- You must disclose every material circumstance which is known by (i) your senior management (the Act defines "senior management" as "those individuals who play significant roles in the making of decisions about how the insured's activities are to be managed or organised"); **and** (ii) those individuals responsible for arranging your insurance (which includes risk managers and any employee who assists in the collection of data, or who negotiates the terms of the insurance, such as your individual brokers).[4]
- You "ought to know" what should reasonably have been revealed by a "reasonable search" of information available to you. This means you must conduct a reasonable search for, and disclose, material information that is available to you. It is important to note that this includes not only information held within your organisation[5] but also outside it, including information held by your agents, and also held by persons and entities who are to be covered by the insurance.
- You must not make any misrepresentations to your insurer.
- You must provide the information to your insurer in a manner which would be "reasonably clear and accessible" to a prudent insurer. This is a new, standalone, duty.

1.2 WHAT IS "MATERIAL"?

Under English law, every circumstance is material if it would influence the judgement of a prudent insurer in fixing the premium and/or the terms of the insurance and/or determining whether to accept the risk. This refers to "any" prudent insurer, not just the insurer who has been offered the risk. A circumstance may be material even if disclosure would not necessarily lead to an increased premium or declinature of the risk.

In the context of business insurance policies, insurers are likely to regard matters such as, but not limited to, the examples detailed in Appendix 1 of this document as material. If you are unsure whether a fact or circumstance should be disclosed, or whether the duty to disclose information continues throughout the period of a particular policy, we recommend that you disclose the information anyway, as failure to do so may lead to your insurer reducing its claim payment, applying additional terms, or even avoiding the policy.

1.3 WHEN TO DISCLOSE

The duty to make a fair presentation applies throughout the negotiations preceding the placing of your policy until your insurer has agreed to accept the risk and has set the terms, price, and level of participation, and the contract has been finalised.

After the policy has been placed, the duty to make a fair presentation arises again if you wish to make changes to the policy so that your insurer takes additional risk or when there is an extension of the policy period. A policy condition may also require you to advise your insurer of a specific increase or alteration in risk which puts a duty on you to disclose certain information. The duty to make a fair presentation and disclose material facts and circumstances arises again during the renewal process.

1.4 FAILURE TO DISCLOSE

The consequences of failing to comply with the duty of fair presentation and failing to disclose a material fact or circumstance will depend on the precise terms of your insurance policy.

The Insurance Act 2015 sets out the remedies that your insurer will have if you fail to comply with the duty of fair presentation. Your insurer's remedy will depend on whether or not your failure was deliberate or reckless:

- If you *deliberately* or *recklessly* fail to comply with your duties, your insurer will be able to avoid the policy, that is, to treat it as if it had never existed, and may retain the premium.
- If your failure to comply with your duties was not deliberate or reckless, your insurer's remedy will depend on what the insurer can show it would have done had a fair presentation of the risk been made:

---

4 If you are an individual taking out a business insurance policy, for example if you are a sole trader or a trustee, you must disclose the material information that you know and that is known by the individuals responsible for arranging your insurance.

5 If you are an individual taking out a business insurance policy, this means that it will not only be information that is known or held by you that may have to be disclosed.

- If your insurer would not have entered into the contract on any terms, it can still avoid the contract but must return the premium;
- If your insurer would have entered into the contract but on different terms (not relating to premium), the contract may be treated as if it included those terms from the outset;
- If your insurer would have entered into the contract but would have charged a higher premium, the amount paid on a claim may be reduced proportionately.

Similar proportionate remedies are available to your insurer in the event of a breach of the duty of fair presentation in relation to a variation of your policy, and will depend on whether the breach was deliberate or reckless and what the insurer can show it would have done had the duty not been breached. This may result in the insurer treating the policy as if the variation was never made, reducing your claim payment, applying additional terms, or even avoiding the entire policy.

2. CONSUMER INSURANCE CONTRACTS

2.1 YOUR OBLIGATIONS

If you are a consumer insured (i.e. a person taking out insurance for purposes wholly or mainly unrelated to your business, trade, or profession), and the insurance policy is governed by English law, then you must:

- Take reasonable care to provide complete, accurate, and honest answers to the questions we and your insurers ask, and not to make a misrepresentation, when you take out, make changes to, and renew your policy.
- You should note that if on renewal of your policy you do not meet your insurer's request to confirm or change details you have previously given, this may amount to a misrepresentation.
- Please also tell us if there are any changes to the information set out in the Statement of Fact, Certificate of Insurance (if applicable), or on your Schedule.
- If any of the information provided by you changes after you purchase or renew your policy and during the period of your policy, please provide us with details.

2.2 FAILURE TO DISCLOSE

If any of the information provided by you is not complete and accurate:

- Your insurer may cancel your policy and treat it as if it never existed; or
- Your insurer may refuse to pay any claim, or
- Your insurer may not pay any claim in full, or
- Your insurer may revise the premium and/or change the compulsory excess, or
- The extent of the cover may be affected.

For motor insurance it is an offence under Road Traffic legislation to provide incomplete or inaccurate information to the questions asked in your application for the purpose of obtaining a certificate of motor insurance.

Insurers recommend you keep a record (including copies of letters) of all information provided to them or us for your future reference.

The above duties arise before the policy is placed, when it is varied or extended, and when it is renewed. The duties may also arise during the policy period if the policy contains a condition which requires you to advise your insurer of a specific increase or alteration in risk.

If you are not sure whether your insurer needs particular information, we recommend that you provide it to them anyway.

APPENDIX 1

NON-EXHAUSTIVE ILLUSTRATIVE EXAMPLES OF MATERIAL INFORMATION

Circumstances which may be considered material are:

- Special or unusual facts relating to the risk.
- Any particular concerns which led you to seek insurance cover for the risk.
- Anything which would generally be understood as being something that should be disclosed for the type of risk in question.

By way of example:

GENERAL INFORMATION ABOUT YOUR BUSINESS

- Business activity (or change to business activity), including processes, products, and geographic presence.
- New companies, markets, acquisitions, or disposals.
- Additional premises/insurable items.
- Changes to premises.
- Higher than ordinary degree of risk or liability (specific to your business or industry).
- Business financial status.
- Loss history/experience, including paid and outstanding claims and potential claims/circumstances/incidents/losses that were not reported as claims (whether insured or not).
- Details of criminal charges and convictions of your organisation, its directors or employees; regulatory investigations or enforcement/health and safety investigations and prosecutions.
- Any insurers' previous declinatures, refusals to renew, imposed terms/restrictions in cover, mid-term cancellations, etc.

MATERIAL DAMAGE POLICIES

- Changes in construction and/or purpose.
- New/amended processes.
- Changes to fire protections.
- Increased storage of hazardous materials/attractive stock.
- Any attempted break-in or arson attack.
- Use of temporary/third party premises.

LIABILITY POLICIES

- Changes to business activities (including disclosing historic activities that have ceased).
- The creation or acquisition of new companies for which cover is required.
- Products exported to, or work in, overseas territories (particularly the USA or Canada).
- Work in or on hazardous locations such as offshore installations.
- Health and safety investigations/prosecutions.

MOTOR FLEET POLICIES

- Driving convictions.
- Corporate investigations/prosecutions.
- Undisclosed accidents.
- Changes to vehicle performance.
- Change of use of vehicle.

BUSINESS PERSONAL ACCIDENT AND TRAVEL POLICIES

- Changes to business activities.
- Material differences in the travel pattern (different geographies, number of journeys, etc.).

REMEMBER – THIS LIST PROVIDES EXAMPLES ONLY. IF IN DOUBT – DISCLOSE.

For more information about the duty of disclosure and fair presentation, visit marsh.com, or contact your local Marsh representative.

MARSH

June 2016

ADVISER

THE ENTERPRISE ACT 2016 — NEW RIGHT FOR POLICYHOLDERS TO CLAIM DAMAGES FOR LATE PAYMENT OF INSURANCE CLAIMS

Passed on 4 May 2016, the Enterprise Act 2016 (the "Act"), now gives policyholders a potential right to claim damages in the event of late payment of claims. The provisions will come into effect on **4 May 2017** and will apply to every (re)insurance policy placed or renewed on or after that date, if it is subject to the laws of England and Wales, Scotland, or Northern Ireland. The provisions making the changes will be an amendment to the Insurance Act 2015.

CURRENT LAW

Under current law[1], damages for late payment of claims are not recoverable from insurers. An insured can only recover what it is owed under the policy and cannot recover from insurers any additional losses it has suffered due to delay in payment by them.

NEW ACT

Under the Act, it will be an implied term of every contract of insurance that if the insured makes a claim under the policy, the insurer must pay any sums due within a reasonable time. Breach of this implied term may give rise to a claim against the insurer for damages.

The Act provides that a "reasonable time" includes a reasonable time to investigate and assess the claim. What is a "reasonable time" will depend on the relevant circumstances; however, the Act provides examples of matters which may need to be taken into account, including:

- The type of insurance.
- The size and complexity of the claim.
- Compliance with relevant statutory or regulatory rules or guidance.
- Factors outside the insurer's control.

The Act also provides that if an insurer can show there were reasonable grounds for disputing the claim (whether in relation to liability or quantum), the insurer will not be in breach of the implied term merely by failing to pay the claim while that dispute is continuing.

CONTRACTING OUT

The Act does contain provisions to allow parties to a non-consumer policy to contract out of the implied term, provided the insurer meets the "transparency requirements" in the Insurance Act 2015. However, such contracting out will not be valid where there has been a deliberate or reckless breach of the implied term by the insurer, and insurers will not be permitted to contract out in respect of consumer insurance policies.

TIME LIMITATION

It is very important for insureds to be aware that, under the Act, claims against insurers for breach of the implied term must be brought no later than one year from the date on which the insurer has paid all the sums due in respect of the claim. After the expiry of that one-year period, any claim for damages against the insurer will be time-barred.

1 Except in Scotland.

COMMENT

In some circumstances, damages for late payment of claims may offer an important remedy for insureds and may provide an incentive for insurers to process and pay claims promptly. The Act is certainly a useful weapon in the insured's armoury, and will give insureds and their brokers an additional negotiating point with insurers. However, there are significant hurdles to a successful claim for late payment. In order to recover damages for late payment, an insured would have to show that:

- The insured had a valid claim under the policy; and
- The insurer failed to pay within a reasonable time; and
- The insured had suffered loss, which was caused by the insurer's breach of the implied term; and
- The loss suffered by the insured was foreseeable (that is, the loss suffered was the type of loss that would have been contemplated by the insurer and the insured at the date the insurance contract was entered into, had thought been given to the issue).

Furthermore, the insured will not be able to recover any loss that could have been avoided by taking reasonable steps.

As such, the Act does not give insureds carte blanche to claim or recover damages from insurers in all cases. The Act contains a number of defences for insurers, and the courts would no doubt take into account the fact that claims – particularly complex ones – can often justifiably take considerable time to investigate.

While the Act is a very positive step forward for insureds and should encourage insurers to increase the efficiency of their claims-handling processes, we do not see it as opening the gates to a flood of successful litigation against insurers.

If you have any questions about this subject, please do not hesitate to contact your usual Marsh representative.

MARSH

June 2016

ADVISER

THE INSURANCE ACT 2015 – WARRANTIES AND OTHER TERMS

When the Insurance Act 2015 (the "Act") comes into force on 12 August 2016, it will make some key changes to the law relating to warranties and other terms in insurance contracts. The changes will apply to all insurance and reinsurance contracts that incept or are renewed on or after 12 August 2016, and to variations of existing policies on or after that date, if the contract is subject to the laws of England and Wales, Scotland, or Northern Ireland, regardless of where the policy is placed and where the policyholder is situated.

KEY CHANGES

- Insurers will not be able to rely on breach of a warranty or similar "risk mitigation term" to reject a claim, if the breach is not connected to the actual loss that has occurred.
- Automatic and permanent termination of cover will no longer be the insurer's sole remedy for breach of warranty; instead, cover will be suspended while the insured is in breach of warranty.
- "Basis of contract" clauses will be completely abolished, and insurers will not be able to contract out of this.

This Adviser comprises three parts. Part 1 is a reminder of how insurance terms are classified; Part 2 sets out the changes to be brought in by the Act; and Part 3 sets out some issues for you to consider to ensure you are prepared to take full advantage of (and are not to be disadvantaged by insurers' responses to) the changes.

PART 1: CLASSIFICATION OF POLICY TERMS (THE CURRENT POSITION)

How an insurance contract term is classified is important, as it determines the insurer's remedy if the term is breached. Understanding how insurers' remedies for breach will change as a result of the Act, and what you can do to limit insurers' remedies, will be invaluable when looking to maximise the effectiveness of your policy.

Terms in insurance contracts can be split into three categories; warranties, conditions precedent, and bare conditions.

WARRANTIES – WHAT ARE THEY, HOW ARE THEY CREATED, AND UNDER CURRENT LAW WHAT HAPPENS IN THE EVENT OF NON-COMPLIANCE?

A warranty is a policy term that requires exact compliance; any departure from its requirements constitutes a breach.

Warranties can be created in various ways:

- **Express term**: A warranty can be created by expressly labelling it as such.
- **Construction**: A warranty can be implied into a policy where, for example, compliance with the term goes to the root of the insurance contract and where the term is material to the risk.
- **Basis of contract clauses**: A "basis of contract clause" is often found in proposal forms stating that the facts set out in the proposal form are the "basis of the policy" and are to be construed as being incorporated into it. This type of clause has the effect of conferring the status of a warranty on all of the pre-contractual representations made by the prospective policyholder.

Under current law, if a policyholder breaches a warranty, the insurer is permanently and automatically off-risk from the date of the breach, even if the breach is irrelevant to the loss that has occurred, and even if the breach is subsequently remedied. This is clearly a very harsh remedy and, as will be discussed below, is one of the key things that the Act seeks to address.

CONDITIONS PRECEDENT – WHAT ARE THEY, HOW ARE THEY CREATED, AND WHAT HAPPENS IN THE EVENT OF NON-COMPLIANCE?

Conditions precedent can be divided into the following categories:

- **Conditions precedent to the insurer coming on risk**: This type of condition precedent is imposed at the pre-contractual stage and provides that the insurer will not come on risk until certain conditions have been satisfied. For example, a payment of premium condition or a requirement that the insured provides a survey of the insured subject matter.
- **Conditions precedent to the insurer's liability to pay a claim**: This type of condition precedent is usually connected to the claims process. While the consequences of breach will depend on the precise words used, a breach will usually entitle the insurer to decline a particular claim, but will not impact the cover going forward. For example, if a policy contains a condition precedent that a claim be notified within a specific time period from the insured becoming aware of it, failure to comply will mean there is no cover for a late-notified claim, *even if* the insurer has not suffered any prejudice as a result of the late notice. However, the policy remains valid for future claims.

Conditions precedent can be created in a number of ways:

- **Express term**: The policy may expressly classify certain terms as being conditions precedent to an insurer's risk or to an insurer's liability for a claim.
- **If the consequences of breach of the condition are spelled out, it can indicate that the clause is a condition precedent** (for example, a clause stating that a claim under the policy will not be payable unless a particular condition has been complied with). Even though the condition is not expressly labelled as, or stated to be a "condition precedent", the wording of the clause requires the condition to be treated as such, by spelling out the consequences of breach.
- **Sweep-up clause**: A sweep-up clause (sometimes known as an "observance" clause) provides that all conditions in the policy are conditions precedent and that failure to comply with them prejudices the policyholder's cover in the event of a claim.

BARE CONDITIONS – WHAT ARE THEY, HOW ARE THEY CREATED, AND WHAT HAPPENS IN THE EVENT OF NON-COMPLIANCE?

A bare condition is a policy condition that is concerned with the policyholder's conduct during the currency of the policy (for example, a requirement that the policyholder renders all reasonable assistance to and co-operates with the insurer in the event of a claim). Breach of such a term will entitle the insurer to damages if it can show it has suffered prejudice as a result of the breach.

PART 2: WHAT CHANGES WILL THE ACT BRING ABOUT?

The changes to the law on warranties and other terms are contained in Sections 9 to 11 of the Act and are discussed in reverse order below. These changes are positive steps forward for policyholders, as they address some of the harshness of the current law, in terms of insurers' remedies for breach of warranty, and insurers' current ability to rely on irrelevant breaches of policy terms to avoid paying claims.

SECTION 11: "RISK MITIGATION TERMS"

Section 11 of the Act aims to prevent insurers from relying on breaches of policy terms that are unconnected to the actual loss the policyholder has suffered, as grounds upon which to decline or limit liability for paying the claim. It is very important to note that Section 11 applies to all policy terms (including warranties *and* conditions precedent) that would tend to reduce the risk of (a) a particular type of loss, or (b) loss at a particular time, or (c) loss at a particular place. These are called "risk mitigation terms".

As a result of this change in the law, insurers will no longer be able to rely on a policyholder's breach of a risk mitigation term to avoid paying a claim, if the policyholder can show that the breach of the term *"could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred" (s11(3) Insurance Act 2015)*. For example, if an insured property was damaged by flooding, it is unlikely that the insurer would be able to rely on a breach of a policy term which required sprinklers to be operational. On the other hand, the insurer would probably still be able to rely on this breach if the property was damaged by fire and the sprinklers had not been kept operational. Note that the burden will be on the policyholder to prove that the breach could not have increased the risk of the loss that occurred.

However, one major limitation for policyholders to bear in mind is that this new protection does not apply to policy terms that "define the risk as a whole". If the term that has been breached is one that "defines the risk as a whole", then depending on the precise drafting of the term and even after the Act comes into force, insurers may still be able to rely on a breach of the term as grounds for repudiating or limiting liability for the claim.

Although the changes being brought in by section 11 of the Act are good news for policyholders, the Act does give rise to some areas of uncertainty.

Which policy terms fall within the scope of Section 11? It will not always be easy to identify which policy terms are "risk mitigation terms" (and are, therefore, protected by Section 11) and which are terms that "define the risk as a whole" (and are, therefore, not protected). As examples of terms that could be regarded as defining the risk as a whole, the Law Commission cited terms that[1]:

- Define the geographical area in which a loss must occur, if the insurer is to be liable to indemnify the insured; or
- Require that a property or vehicle is not to be used commercially; or
- Define the age, identity, qualifications, or experience of a driver of a vehicle.

Although the Law Commission has provided these examples, whether a term is or is not one that "defines the risk as a whole" will ultimately be left to the courts to determine. Furthermore:

- **How far does Section 11 apply to exclusions?** Although the Law Commission's Explanatory Notes[2] suggest that Section 11 will apply to exclusions, it is not clear whether the courts would construe an exclusion clause as being a term with which the policyholder must "comply" for the purposes of Section 11(1). It could also be argued that an exclusion is a term which defines the risk as a whole (thereby falling outside the scope of Section 11), as it places limits on the scope of cover provided by a policy.

SECTION 10: CHANGES TO THE LAW ON INSURER'S REMEDIES FOR BREACH OF WARRANTY

One of the biggest changes that will be brought in by the Act is that, if a warranty is breached, automatic and permanent termination of cover will no longer be the insurer's sole remedy for breach of warranty. Instead, if a warranty is breached, cover will simply be **suspended** from the time of the breach until the breach has been remedied (provided the breach can be remedied). Once the insured has remedied the breach, the insurer will be liable for subsequent losses – *unless* the loss is attributable to something that happened during the period that cover was suspended.

WHEN IS A BREACH OF WARRANTY REMEDIED?

The following examples may assist in identifying when a breach of warranty has been remedied:

- **Time-specific warranties**: If a warranty requires something to be done (or not done) by an ascertainable time, a breach is remedied when the risk to which the warranty relates becomes essentially the same as that originally contemplated by the parties to the insurance contract. For example, if a property policy contains a warranty requiring a burglar alarm to be installed by 1 April and the policyholder does not install it until 15 April, the breach is remedied on 15 April; at that point, the risk becomes the same as that originally contemplated by the parties. In this scenario, cover will have been suspended between 1 and 15 April.

  This means the insurer will be on risk for losses that occur between inception and 1 April; will not be liable for any losses that occur between 1 and 15 April (unless the insured can show that the breach could not have increased the risk of the loss that actually occurred in the circumstances in which it did occur – a point to which we return below); and the insurer will be liable for losses that occur after that 15 April, *provided* they are not attributable to something that happened in the period 1 to 15 April.

- **Other warranties**: In any other case, the breach of warranty is remedied when the insured ceases to be in breach of warranty. For example, if a warranty requires a vessel to sail with a 20-strong crew and the policyholder sets sail with a crew of only 18, the breach is remedied as soon as the insured picks up two additional crew members. At that point, the insured ceases to be in breach of warranty.

However, it is very important to bear in mind that there will be breaches of warranty that can never be remedied; for example, a warranty relating to a duty of confidentiality cannot be remedied once confidentiality has been compromised. As a result, the insurer's liability would remain suspended for the remainder of the policy period, meaning that the policyholder has no cover from the date of breach.

For this reason, it is best for policyholders to resist, where possible, having warranties in their policies that are not capable of remedy. For example, policyholders should resist any term that provides that a certain state of affairs is "warranted at inception" as, in such circumstances, if there is non-compliance with the term at inception, this cannot be remedied, as there is only one policy inception date.

1 Law Comm No. 353 (dated July 2014) at #18.33; Explanatory Notes at #95.

2 At #95

IF A RISK MITIGATION TERM IS BREACHED AND A LOSS OCCURS BEFORE THE BREACH IS REMEDIED, IS THERE COVER OR NOT?

Finally, it is important to understand the link between sections 10 and 11 of the Act. A situation could arise where a warranty has been breached, meaning that the insurer's liability is suspended from the date of breach, and a loss that is unconnected to the breach occurs during the period when cover is suspended. In these circumstances, the starting point is that there is **no** cover for any loss that occurs during the period of suspension of cover, regardless of whether the breach has any causal connection with the loss (see Section 10). This is because the insurer's liability is suspended from the point at which the warranty has been breached. **However**, if the warranty is a risk mitigation term (rather than a term which defines the risk as a whole) and, if the policyholder can show that the breach could not have increased the risk of the loss that occurred in the circumstances in which it occurred then, because of Section 11 of the Act, the insurer will **not** be able to rely on the breach of warranty to escape liability. It is, therefore, possible that, while the starting point is that there is no cover for the unconnected loss, if the policyholder can rely upon Section 11, then cover may be available, even though the loss took place during the period in which the insurer's liability was suspended.

SECTION 9: ABOLITION OF "BASIS OF CONTRACT" CLAUSES

Section 9 of the Act will completely abolish "basis of contract" clauses, which is a significant step forward for policyholders. This means that, after the Act comes into force, insurers will no longer be able to convert representations made by the insured in pre-contractual documentation into warranties by means of a term in the policy or in the proposal form. However, it is important to note that this change in the law will only apply to policies that incept or are renewed on or after 12 August 2016, and to variations of existing policies on or after that date. In other words, if a policy that has been placed before 12 August 2016 contains a "basis of contract" clause, the Act will not automatically render that basis clause as being of no effect.

CONTRACTING OUT OF THE ACT

Apart from the abolition of basis of contact clauses, it will be open to policyholders and insurers to contract out of the Act. Policyholders can, therefore, seek to put themselves in a better position than they would be in under the Act, and insurers may try to exclude the positive changes brought in by it. However, if an insurer does seek to include such a "*disadvantageous term*" in a policy (that is, one that would put the policyholder in a worse position than it would be under the Act), then, in order for the disadvantageous term to be effective, the insurer must meet the following *"transparency requirements"* set out at section 17 of the Act:

- The insurer must take sufficient steps to draw the disadvantageous term to the insured's (or its broker's) attention <u>before</u> the policy is entered into; and
- The term must be clear and unambiguous as to its <u>effect</u>.

Therefore, as regards the second requirement, it would not be sufficient for a term simply to state that, for example, "*Section 10 of the Insurance Act 2015 is excluded in its entirety*". To comply with the Act's transparency requirements, the disadvantageous term would need to spell out the actual effect of Section 10 being excluded. A compliant term might, therefore, read: "*Section 10 of the Insurance Act 2015 is excluded in its entirety. As a result, if the insured fails to comply exactly with any warranty in the policy, the insurer is discharged irrevocably from liability from the date of the breach of warranty. Accordingly, the insured cannot avail itself of the defence that it remedied the breach of warranty before any loss occurred.*"

PART 3: PRACTICAL POINTS FOR POLICYHOLDERS TO CONSIDER

INSURERS' RESPONSES TO THE ACT

Some insurers have already made public statements that, in advance of August 2016, they will comply with "the spirit" of the Act. Although this sounds positive, policyholders should treat such statements with caution. Unless the policy wording does actually reflect the new law, there is ambiguity and uncertainty as to the meaning and practical effect of such generalised statements.

Other insurers are seeking to use their own clauses to bring in certain provisions of the Act. Again, caution should be exercised and policyholders should review carefully any clause(s) that an insurer seeks to use which purports to introduce certain aspects of the Act in advance of August 2016. The insurer's clauses may not be identical to the Act, and may even be disadvantageous to the policyholder.

Policyholders should also watch out for insurers trying to contract out of certain aspects of the Act. For example, the Lloyd's Market Association (LMA) has issued a number of clauses which aim to contract out of parts of the Act, including clauses which seek to:

- Revert to the sole remedy of avoidance for breach of the duty of fair presentation.
- Preserve the current remedy of automatic and permanent termination of cover for breach of warranty.
- Exclude the effect of Section 11, to enable insurers to rely on a breach of a risk mitigation term that is unconnected to the actual loss suffered.

These clauses are not in the interests of policyholders and, where possible, should be resisted.

THE TERMS AND CONDITIONS OF POLICY WORDINGS

So as to take full advantage of what the Act has to offer it is crucial that policyholders are familiar with their policy wordings, for example, to ensure that if a warranty is included policyholders are aware of its existence and how any breach can be remedied, so that insurers' liability is restored following a breach. In addition, policyholders will need to watch out for insurers seeking to:

- Convert warranties into **conditions precedent**, in an attempt to circumvent the effect of Section 10. (This is because, while under Section 10 a breach of a warranty can be remedied, a breach of a condition precedent cannot. Therefore, where the condition precedent is breached, the insurer may be able to argue that it has no liability).
- Include **exclusions**, to avoid the uncertainty as to what is and is not a risk mitigation term or one that defines the risk as a whole.
- Include conditions precedent to liability that certain matters are true and accurate, to get around the Act's abolition of basis clauses.
- Contract out of certain aspects of the Act, for example, by using the LMA clauses, which, in some cases, effectively retain the harshness of the existing law.
- Include clauses to bring in certain provisions of the Act in advance of August 2016, which are drafted in terms that are not identical to the Act and are less advantageous for policyholders (as referred to above).

HOW WILL THE ACT AFFECT YOUR POLICY WORDING?

It will also be important for policyholders to ensure they are familiar with the categorisation of policy terms and how certain policy terms are drafted, for example, whether the policy contains any terms that are categorised as (or could be deemed to be) warranties or conditions precedent, which, if not complied with, could prejudice coverage in the event of a claim. Remember – if a policy contains a warranty, even once the Act comes into force, the policyholder will still be required to comply – strictly – with its provisions; **it is only the remedy for breach** that the Act will change.

Other practical issues for policyholders to consider arising out of policy warranties include:

- Keep a record of all warranties and record compliance with them;
- Avoid, where possible, the inclusion of warranties that cannot be remedied following a breach; and
- If a breach of warranty occurs, record the date the breach was remedied, as this is the date when the insurer's liability is restored.

Remember: Even once the Act comes into force, if a **condition precedent** is breached, it may mean that the insurer has no liability to pay a claim or is even off risk permanently. Under the Act, it is only breaches of warranty that can be remedied. Policyholders should, therefore, be aware of any policy conditions that are stated to be, or could be construed as, conditions precedent to the insurer's liability.

Policyholders should ensure that their key operational personnel are also aware of the existence of any warranties or conditions precedent and that they understand what steps need to be taken to ensure compliance with them, and the potential impact on coverage in the event of non-compliance.

The Act brings benefits to policyholders under Section 11, by preventing insurers, in certain circumstances, from relying on a breach of a policy term that is unconnected to the actual loss suffered as grounds upon which to decline a claim. Policyholders should try to identify and agree with insurers those policy terms that are, on the one hand, risk mitigation terms, and those that are, on the other hand, terms that define the risk as a whole, so they have some clarity as to the terms to which Section 11 can apply.

BE AWARE OF WHAT THE ACT IS NOT CHANGING

Even once the Act is in force, it will still be possible for insurers to include conditions precedent and warranties in policies, and insurers will still not have to label them as such.

Also, even once the Act is in force, policyholders will still have to comply with the requirements of all policy conditions and warranties. Remember, it is only the insurer's remedies for breaches of risk mitigation terms and warranties that the Act will change.

For example, if a policy contains a condition precedent about notification of claims or losses within a certain timeframe this must still be strictly complied with, and failure to do so could prejudice the policyholder's ability to recover under the policy.

Policyholders should, therefore, use the time before 12 August 2016 to improve their notification provisions to ensure the following:

- The notification provision is only triggered by the knowledge of certain class(es) of individual within the insured (for example, the knowledge of the risk manager) and not the insured generally.
- There is a reasonable period in which to notify (as opposed to a short specified time limit). There is a clear threshold for a notification clause to be triggered, such as claims likely to be for more than a certain monetary amount.

Finally, it will still be possible to include condition precedent "sweep-up" clauses in policies. For the reasons discussed above, such clauses should be avoided.

We hope the above gives you some guidance on how the Act will have an impact on some of the terms and conditions within your policy wordings and what you can do now to address some of the issues that could arise. If you have any queries about any of the issues discussed in this Adviser or the other provisions of the Act, please do not hesitate to get in contact with your usual Marsh contact.

uk.marsh.com/insuranceact

INSURANCE ACT WEBCASTS

Visit uk.marsh.com/insuranceact to access our webcast replays and presentation slides.

THE DUTY OF FAIR PRESENTATION

PROPORTIONATE REMEDIES

WARRANTIES AND OTHER TERMS

Visit uk.marsh.com/insuranceact, a one-stop-shop to all of our guidance on the Insurance Act 2015.

For further information, please contact your local Marsh office or visit our website at uk.marsh.com

GRAPHICS NO. 16-0575 (Containing 15-0221, 15-0678, 15-1020, 16-0075, 16-0333, 16-0583, and 16-0431).

INSURANCE BROKERS CII CHARTERED