COVINGTON

New UK Insurance Act Passed

March 9, 2015

Insurance

Introduction

On February 12, 2015, the Insurance Act received Royal Assent and became law in the United Kingdom. It contains the most significant changes to UK insurance law for corporate policyholders for over a century, which will come into force in August 2016.

The House of Lords Bill that gave rise to the Act followed various reports by the UK Law Commission on potential amendments to the law and consultations with representatives of interested parties. The Bill had been classified as an uncontroversial Law Commission Bill, with a view to ensuring passage of the legislation before the UK General Election in May 2015 with the support of both main political parties. As a result of this classification, two measures potentially favorable to policyholders that were perceived by the UK Government as controversial were dropped from the initial draft Bill, though one was eventually reinstated.

The Contents of the Insurance Act

The provisions of most interest to policyholders are as follows:

- **Duty of Fair Presentation of Risk at Time of Placing Insurance:** The UK has long imposed a duty on the policyholder to disclose to the insurer all material facts known to it at the time of placing an insurance policy. The Act recharacterizes this as a duty of "fair presentation of the risk." The policyholder remains obliged either (1) to disclose every material circumstance that it knows or ought to know, or (2) to provide sufficient information to put a prudent insurer on notice that it needs to investigate the risks further. The policyholder is also subject to a duty not to make any misrepresentation in an application for insurance. However, the Act seeks to regulate the form of the policyholder's disclosure and, in particular, to discourage "data dumps" by policyholders purchasing insurance. It does so by requiring that the disclosures be made in a reasonably clear and accessible manner. The Act also deals in some detail with the knowledge to be ascribed to policyholder, broker and insurer in the context of the placing of insurance, following on from concerns expressed by large corporate policyholders in particular concerning the scope of the knowledge that should be attributed to them at the placing stage. The Act provides, for example, that a policyholder is deemed to know what should reasonably have been revealed by a "reasonable search" of information available to the policyholder.

- **"Proportionate" Remedy for Breach of Duty of Fair Presentation:** Under prior UK law, the insurer could rescind (in UK legal terms, "avoid") an insurance policy for *all* non-disclosures, even when the policyholder could show that the insurer still would have underwritten the policy had the disclosure been made. The Act eliminates that rescission remedy. Instead, the Act sets forth a system of "proportionate" remedies. The insurer may still rescind the policy if the policyholder's breach of the duty of fair presentation was deliberate or reckless, or if it can prove that it would have refused

to write the policy if it had been aware of the breach. If, however, the insurer would have written the policy on different terms, the policy remains valid, but those different terms are deemed part of the policy. If the insurer would have written the policy at a higher premium, it can reduce the amount of the claim that it pays to the policyholder in proportion to the difference in premium.

- **Abolition of Basis of Contract Clauses:** Prior UK law allowed insurers to use the so-called "Basis of Contract" clauses, which gave insurers the right to deny coverage if the insured failed to comply with a condition to coverage, regardless of the materiality of the term and its relevance to a policyholder's claim. The Act abolishes the Basis of Contract rule and prohibits any term within an insurance contract that has the effect of converting a representation into a warranty.

- **Changes to Consequences of Breach of Warranty:** The Act amends the law relating to breaches of a warranty given to an insurer in two ways. First, an insurer is no longer automatically fully discharged from liability by a policyholder's breach of warranty. A breach of warranty suspends the insurer's coverage obligations, but those obligations can be reinstated if the policyholder remedies the breach. Possibly more importantly, under the Act an insurer may no longer rely on an unconnected breach of warranty to avoid paying a claim; under the Act, there must be a nexus between the claim and the breach of warranty. This latter measure was dropped from the Law Commission's Bill prior to its introduction into the House of Lords as too "controversial", but it was reinstated by the Lords.

- **Contracting Out:** The Act allows the parties to agree in a contract of insurance that the Act's provisions do not apply. However, the Act requires the party favored by the contracting out provision (in practice the insurer) to take steps to draw any consequentially disadvantageous term to the other party's (i.e., the policyholder's) attention before the contract is entered into, failing which the term has no effect.

In addition to these proposed key amendments, the Act makes the following changes:

- **Limit of Insurer's Rights in Case of Fraudulent Claims:** the Act clarifies the rules against payment of fraudulent claims by providing that an insurer may not rely on a fraudulent claim to avoid liability to pay genuine losses that occurred before the fraud, although it may seek to treat the contract as having been terminated at the time of the fraud. The Act also protects individual insured parties under a group insurance contract from the fraud of another insured party.

- **Introduction of the Third Parties (Rights against Insurers) Act 2010:** A recent UK insurance enactment (which has not yet gone into effect) allows a third party claimant to bring proceedings directly against an insurer as soon as the policyholder defendant is subject to an insolvency event, rather than having to wait for the liability of the policyholder to be established first, as was the case previously. That law is principally aimed at benefiting individuals with occupational claims against employers or other responsible parties that have become insolvent. The Act amends the prior enactment to deal with some perceived shortcomings and to enable it to be brought into force.

Damages For Late Payment of Claims: A Lost Opportunity

The Treasury removed from the draft Bill before its introduction to the House of Lords a provision that created an implied term in all insurance contracts that an insurer must pay any

sums due within a reasonable time, for fear that opposition to that provision might prevent the Bill from being passed before the next General Election.

The Government has indicated that it will seek to introduce this provision in due course. In the meantime, the Government asserts that policyholders' interests are protected by the regulator, the Financial Conduct Authority, which (1) is conducting a thematic review of the payment of commercial claims by insurers and (2) is said to be prepared to take action against any insurer that "has a systematic problem with late payment."

Comment

Although the proposed reforms are said to be intended to improve the position of the corporate policyholder under UK insurance law, it remains to be seen how successful each of the new provisions will be in achieving this objective. The imminent introduction of the fair presentation provisions in particular will require many policyholders to carry out far-reaching reviews of their insurance placement procedures.

In preparation for the new legislation, which will apply to policies concluded after 12 August 2016, policyholders purchasing insurance in the London Market or with UK choice of law provisions should consider taking steps that include the following:

- Review in consultation with their brokers and with input from their legal advisers the extent to which:
  - they need to modify their procedures for assembling and producing placing information and/or
  - they should propose to insurers any modification or clarification of the forthcoming presentation obligations - for example, concerning the extent of a reasonable search for information as part of an application for insurance or the format or extent of the presentation.
  - they should try to agree with insurers that all or some of the provisions of the new Act are deemed to apply to new business or renewals before the Act is brought into force in August 2016.
- Be vigilant for efforts by insurers to rely on contracting-out language that could remove all or part of the advantages of the new legislation. Such efforts can be expected even before the legislation takes effect.
- Also be vigilant for insurers seeking to increase premium to compensate for a perceived reduction in their options to take action where there has been non-disclosure.
- Consider negotiating contractual provisions that may assist in case of late payment, in the absence of statutory assistance.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Insurance team:

Richard Mattick	+44 20 7067 2023	rmattick@cov.com
John Buchanan	+1 202 662 5366	jbuchanan@cov.com
Benedict Lenhart	+1 202 662 5114	blenhart@cov.com
David Goodwin	+1 415 591 7074	dgoodwin@cov.com