

UK Insurance Act 2015 Comes Into Force

August 12, 2016

Insurance

The Insurance Act, which received Royal Assent and became law in the United Kingdom in February 2015, has now come into force: it applies to all insurance policies entered into on or after August 12, 2016, including renewals, and to all variations to existing policies made on or after that date.

As previously reported, the Act contains the most significant changes to UK insurance law for corporate policyholders for over a century and is intended to improve the coverage position of policyholders. This alert is a reminder of the main features of the Act and reactions to it to date.

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 Act assists policyholders by re-characterizing the policyholder's duty to disclose to the insurer all material facts known to it at the time of placing an insurance policy as a duty of "fair presentation of the risk" and providing further guidance about this duty. 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.

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:** The Act eliminates the previously existing remedy under UK law, which entitled the insurer to 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.

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 that are favourable to policyholders. Most importantly, an insurer may no longer rely on an unconnected breach of warranty to avoid paying a claim, as was previously possible; there must be now a nexus between the claim and the breach of warranty. In addition, 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.
- **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 limits an 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.

Reactions to the Insurance Act

Policyholders continue to expect that the Act will improve their legal position from August 2016, although there remain concerns, fuelled by the following suggestions/developments:

- The view that, in the prevailing soft market, insurers are more likely to try to use the remedies available to them under the Act for a policyholder’s breach of its duty of fair presentation: Those new remedies have been characterized as fairer and more proportionate than the old blanket remedy of avoidance *ab initio* (in the U.S., rescission), but over half of Airmic members in a November 2015 survey felt that some insurers were more likely to invoke these facially less draconian remedies to challenge claims under the new Act.
- The publicizing of ways in which insurers might be able to circumvent the effect of the new law: For example, insurers may re-cast warranties as conditions precedent, and thereby continue to deny coverage for a claim even if the breach of warranty does not actually contribute to the policyholder’s loss.
- Indications that the judiciary may interpret the much more prescriptive disclosure regime under the Act strictly and against the interests of policyholders: In a British Insurance Law Association mock trial, the UK Supreme Court judge, Lord Mance, who is the foremost insurance law specialist on the Supreme Court panel, found that a corporate policyholder had breached its duty to make a reasonable search for material information because, following the departure under a cloud of a key

employee, it had inadvertently failed to make enquiries of an external consultant who had had relatively limited contact with the company. This was an outcome that surprised many English lawyers and insurance market participants.

- The fact that, although the new legislation helps policyholders by providing a checklist from which to prepare a fair presentation, it also gives insurers a checklist to probe a presentation for deficiencies.

These concerns confirm that policyholders must remain vigilant as regards the impending changes and take the steps below.

Damages for Late Payment of Claims Available from May 2017

The UK Treasury removed from the draft Insurance Bill, before it reached Parliament, 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 as an uncontroversial Bill before the General Election in May 2015.

The Government re-introduced this provision as part of the draft Enterprise Bill, which started its life in the House of Lords in September 2015. On May 4, 2016 the Enterprise Act received the Royal Assent, and the policyholder right to damages for late payment of an insurance claim became law in the UK in substantially the same form as when it was introduced, with the exception of the addition of a one year time limit for bringing claims, following insurer pressure.

The relevant provisions will apply only to claims under policies, including renewals, that are entered into on or after May 4, 2017 and to variations of existing policies entered into on or after that date.

Comment

In light of the new legislation, policyholders should consider 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 searching for, assembling, and producing information in connection with an insurance placement, and the timing of these modifications to their procedures;
 - could propose policy amendments to insurers, such as:
 - a modification or clarification of the new presentation obligations—for example, seeking agreement from the insurer as to the extent of a reasonable search for information that would be required as part of an application for insurance or the format or extent of the presentation; and
 - the substitution of the insurers' remedy of proportionate reduction of claim by payment of increased premium in cases of innocent non-disclosure where the insurer would have charged a higher premium if it had known the full facts.
- Review carefully all changes in policy wordings proposed by insurers and 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.

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- 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 (such as interest or payment of collection costs) that may assist in case of late payment, in the absence of statutory assistance prior to May 2017.

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

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