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Navigating the Insurance Act 2015

An essential guide from Eversheds

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Introduction

The Insurance Act 2015 makes some fundamental changes to what businesses have to do to ensure that their insurance policies are effective and that their claims are paid in full.

The Act applies to all policies governed by the laws of England, Wales, Scotland and Northern Ireland and which are taken out, renewed or varied on or after 12 August 2016. However, as there are new rules about what businesses are required to do before their insurance policies are in place (or renewed or varied), **you need to start planning and act now.**

In particular you need to understand the new duty to make a fair presentation of the risk and what this means for you on a practical basis:

- there are new rules as to what material information needs to be disclosed to insurers, which can include information known by the business' senior management, its insurance broker and third parties such as outsourced service providers
- there is a new obligation to make a reasonable search for such material information
- it may be necessary to ensure that sufficient information is provided to put insurers on notice that they must make further enquiries for the purpose of revealing information they would want to know

There are also wholesale changes to the remedies available to insurers for breach and how warranties and other terms operate.

This document is a general introduction to the Act to help you understand the obligations that will be imposed upon you in the months leading up to 12 August 2016 and thereafter.

We are currently advising on all aspects of the new Act and can help you understand what the changes will mean for you.

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The Duty of Fair Presentation

What is changing?

There are new rules governing what information a business must disclose to its insurer before the insurance policy is taken out. This new requirement is called the Duty of Fair Presentation.

Why is it important?

Failure to comply with the Duty of Fair Presentation may give the insurer grounds to refuse to pay a claim, or reduce the amount they do pay.

What does this mean?

The new Duty of Fair Presentation is different to and more structured than the current duty to disclose all material information. Arguably, it increases the scope of the obligations that are imposed on a business in relation to pre-contractual disclosure.

To comply with the Duty of Fair Presentation, prior to the start of the policy the business must:

- *disclose "every material circumstance which [it] knows or ought to know"*
- *"failing that, [provide] disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purposes of revealing those material circumstances"*

What is a "material circumstance"?

The new test for what is a material circumstance is largely the same as the current test. Information will be material if it *"would influence the judgement of a prudent insurer in determining whether to take the risk and, if so, on what terms."*

What does a business insured know, or what ought it to know?

The test for what "material circumstances" the business is deemed to know, and must therefore disclose, is broader than the current test. The business insured is deemed to know the following:

- *what is known to the individuals who are part of the business' "senior management"*
- *what is known to the individuals responsible for the business' insurance (for example, the insurance manager and/or broker)*
- *what should reasonably have been revealed by a "reasonable search of information available to the Insured", including information which is "held within the insured's organisation or by any other person"*

Businesses should work with their brokers to ensure that presentations to insurers are as comprehensive as possible. It is clearly more advisable to endeavour to discover and disclose all material circumstances than to rely on the presentation putting insurers on notice that they need to ask further questions.

Because of this new rule, insurers are likely to ask more questions about business' presentations than they did previously, so businesses need to make sure they have sufficient time to answer them fully before the start of their policy.

Who are the insured's "senior management"?

The Act does not specify this, beyond stating that it means *"those individuals who play significant roles in the making of decisions"* about how the business' activities are to be managed or organised.

In order for you to understand the scope of the search for what your business knows, we recommend that you seek to agree with your insurer exactly who is your senior management.

What does this mean? *(continued)*

What is a "reasonable search"?

In order to discover and disclose "material circumstances", the business is obliged to conduct a *"reasonable search of the information available"* to it. This search is for *"information held within the insured's organisation or by any other person"*. This will include information held by the business' broker or by, for example, its outsourced IT provider.

The Act does not define what a '"reasonable search" is. We recommend that you seek to agree the scope of your "reasonable search" with your insurer. To do this, you will need to present to the insurer the scope of the search you propose and agree it with them. This may take some time, so you should start work on this as soon as possible.

How does the business disclose "sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purposes of revealing those material circumstances"?

If the business fails to disclose *"every material circumstance which [it] knows or ought to know"*, it can still satisfy the Duty of Fair Presentation if it discloses information, *"which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purposes of revealing those material circumstances."*

However, material information must not be "buried" in dense files of documents disclosed to insurers or in the "small print".

Provided the business complies with this, if the insurer does not then make enquiries to reveal the material circumstances, the insurer cannot later claim that the business failed to disclose them.

You should work with your brokers to ensure that presentations to insurers are as comprehensive as possible. It is clearly more advisable to endeavour to discover and disclose all material circumstances than to rely on the presentation putting insurers on notice that they need to ask further questions.

Because of this new rule, insurers are likely to ask more questions about your presentations than they did previously, so you need to make sure you have sufficient time to answer them fully before the start of your policy.

What else do businesses need to know about the Duty of Fair Presentation?

The Act says a business insured's "knowledge" includes *"matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining from confirming them or enquiring about them."* Therefore the business cannot "turn a blind eye" in its search, or fail to make enquiries in the knowledge that the answer will be damaging.

Remedies for breach of the Duty of Fair Presentation

What is changing?

The Act makes some important changes to the remedies that are available to an insurer in the event of breach by an insured business of their pre-contractual disclosure obligation (the Duty of Fair Presentation).

Why is it important?

Failure to comply with the Duty of Fair Presentation may give the insurer grounds to avoid the policy (i.e. treat it as if it never existed), refuse to pay a claim, reduce the amount they do pay, or vary the terms of the policy.

What does this mean?

The duty of "utmost good faith" is retained, but the sole remedy of avoidance for its breach is abolished, and is replaced with a range of proportionate remedies which are based on the severity of the breach and depend on:

- *whether the breach is deliberate or reckless*
- *if the breach is not deliberate or reckless, what the insurer would have done if the Duty of Fair Presentation had been complied with*

What if the breach is deliberate or reckless?

The position remains the same as under the current law, which is that the insurer is entitled to avoid the policy and can keep the premium.

Where a policy is avoided it is deemed to have never existed, so the business would have to repay any sums it has received from the insurer in respect of claims under the policy.

The insurer's ability to keep the premium is essentially a penalty that is imposed to deter such deliberate or reckless conduct.

A breach is deliberate where the business knows that it is in breach of the Duty of Fair Presentation; it will be reckless if it does not care whether it is in breach of the Duty of Fair Presentation.

What does this mean? *(continued)*

What if the breach is not deliberate or reckless?

There are a range of proportionate remedies available to the insurer.

There are broadly three options available to the insurer, based on what they would have done if there had been a fair presentation of the risk:

a) Avoidance

If the insurer would not have written the risk at all, then they may avoid the policy but must return the premium. This means that avoidance is still available as a remedy for the insurer even where the breach is "innocent" (or at the very least, not deliberate or reckless).

To be able to avoid the policy, the insurer would have to be able to demonstrate that if the insured business had made a fair presentation of the risk, they would not have been prepared to write the risk at all. This would have to be proved by evidence from the underwriter who was responsible for writing the risk.

b) Variation of the terms

If, in the absence of a breach of duty, the insurer would have written the risk but on different terms, the contract will be treated as if it had been written on those terms. This does not include terms relating to premium (see below for further information).

This means, for example, that the insurer may impose certain exclusions where they can establish that these would have been imposed if there had been a fair presentation of the risk. This could affect whether they pay the claim in question.

This remedy can also have an effect on losses which the insurer has already paid because it involves treating the contract as if it had been entered into on those different terms, therefore having retrospective effect.

This means that if the insurer proves that it would have contracted on different terms and those terms would have reduced or extinguished its liability for losses which pre-date the insurer's discovery of a breach of the duty, the insured business may have to reimburse the insurer for those losses.

c) Reduction of the claim

If the insurer would have written the risk but for a higher premium, the insurer is entitled to proportionately reduce the claim in the same proportion that the actual premium bears to the premium that the insurer would have charged if a fair presentation had been made.

This remedy may be used on a standalone basis or alongside the variation of terms discussed above.

Warranties and other terms

What is changing?

The Act introduces changes to the rules governing the status of particular terms in an insurance policy and the consequences of their breach.

Why is it important?

Failure to comply with the terms of a policy may give insurers grounds to refuse to pay a claim or reduce the amount they do pay.

What does this mean?

Warranties

Under the current law, a warranty is a term in a policy which, if breached, permanently discharges the insurer's liability to the business from the moment of the breach, even if the breach is later remedied.

The Act does not define whether a term is a "warranty". This remains a question of contractual construction, so that a warranty under the current law will also be a warranty under the Act.

What has changed is the substantive legal effect of a term being designated as a warranty. Under the Act, breach of a warranty will no longer permanently discharge the insurer's liability.

Instead, the Act will transform warranties into "suspensory conditions". This means that the insurer will not be liable to pay any claims while the insured business is in breach of warranty. However, if the business later remedies the breach then the insurer is liable for subsequent claims, unless they are attributable to something that happened before the breach was remedied.

The insurer is also liable for losses which occur or are attributable to something that happens before the breach of warranty.

How to remedy a breach of warranty

In view of the importance of these terms, you need to understand how you can "remedy" a breach of warranty to regain the benefit of your policy.

Where the warranty requires something to be done by a particular time – for example, installation of a sprinkler system by a particular date, and the sprinkler system is not installed by the required date, the breach will be remedied if the *"risk to which the warranty relates later becomes essentially the same as that originally contemplated by the parties"* – so if the sprinkler system is subsequently installed, that will remedy the breach.

For other warranties the breach is remedied if you cease to be in breach. For example, if the business warrants that it will always have a security guard at its premises, but in fact one day there is no security guard present, the breach will be remedied when there is a security guard once again present.

There may be situations where a breach cannot be remedied. For example, if the business has a policy covering a shipment of goods in which it warrants that the goods will be stored in refrigeration units at all times, and during transit the goods are not refrigerated causing them to become damaged, but are then later moved to refrigeration units, then it is unlikely that the insurer would be liable because the damage caused by the breach cannot be remedied.

What does this mean? *(continued)*

Terms not relevant to loss

The Act will prevent an insurer from relying on the business' breach of a term if that breach is entirely unconnected with actual loss suffered. For example, the insurer cannot rely on breach of a burglar alarm warranty where loss is caused by flood or fire.

This applies to any contractual term if compliance with that term would tend to reduce the risk of loss of a particular kind, or at a particular location or time - for example, where the business warrants that its sprinkler system will be inspected every six months, since that would reduce the risk of loss caused by fire.

This does not apply to terms which define the risk as a whole - for example, terms which define who is entitled to drive a vehicle, or a warranty that a ship will not enter a war zone. Breach of such terms will enable the insurer to deny a claim, regardless of their connection to the loss.

The determination of whether a term is one that either:

- reduces the risk of loss of a particular kind, or at a particular location or time, so that the insurer cannot rely on a breach that is unconnected with the actual loss suffered; or
- a term which defines the risk as a whole, so that the insurer's full rights are preserved in the event of a breach

is not straightforward and is likely to lead to disputes.

Abolition of "Basis Clauses"

Any representation made by the business in connection with a proposed insurance policy is currently capable of being converted into a warranty as to its truth/accuracy by means of a term in either the policy or the proposal. Such "basis clauses" will no longer be allowed.

This means that any term which states that the facts stated in the proposal form the basis of the contract will no longer be of any effect. The parties cannot contract out of this provision, which is good for insureds as it reduces the risk of inadvertent breach of warranty.

Contracting out

In business contracts the parties are free to contract out of any part of the Act, apart from those relating to basis clauses. In order to do this the insurer must overcome two hurdles:

- first, the insurer must take sufficient steps to draw the term to the business' attention before the contract is concluded
- second, the term must be drafted so that it is clear and unambiguous as to its effect. This means that the insurer has to explain the effect of the term

For example, there may be circumstances where an insurer seeks to preserve the protection provided by the current law in respect of breaches of particular terms, such as premium payment warranties.

Summary: Implications for businesses

Positive:

- the Act allows for the insured business to agree with its insurer a list of individuals whose knowledge for the purposes of the duty of fair presentation is to count
- similarly, the business could agree with the insurer the parameters of what will constitute a *"reasonable search of information available to the insured"* (for example, locations to search and individuals with whom they need to speak)
- if there is a breach of the duty to make a fair presentation of the risk which was not deliberate or reckless and would not have, in its absence, led the insurer to decline to write the cover on any terms, then the insurer will not be able to avoid the policy and will be limited to proportional remedies
- the insured business will no longer face insurers seeking to avoid cover founded on "basis clauses"
- the law that a breach of warranty results in the automatic discharge of the insurer's liability will be abolished – warranties will be transformed into suspensory conditions. If a breach of warranty is remedied before a loss is sustained, then the insurer will not be entitled to rely on it
- the insured business may also benefit from provisions of the Act concerning policy terms not relevant to the actual loss, if the business can show that non-compliance with the particular term could not have caused or increased the loss which actually occurred

Negative:

- the business will have to make disclosure of *"every material circumstance which [it] knows or ought to know"* (by conducting a reasonable search of the information available to it) or give the insurer sufficient information to put it on notice that it needs to make further enquiries
- the disclosure will have to be in a manner which would be *"reasonably clear and accessible to a prudent insurer"*. This rules out data dumping, even in circumstances where the business is disclosing information which puts the insurer on notice that it needs to make further enquiries
- risk presentations will need to be carefully drafted, with comprehensive executive summaries
- the issue of the insured business' knowledge must be clearly understood – in particular, who constitutes the "senior management" and "individuals who are responsible for the insured's insurance" (such as the broker)
- the provisions of the Act relating to remedies for breach of the duty of fair presentation need to be understood. Deliberate or reckless breach will allow the insurer to avoid the contract, refuse all claims and keep the premium

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