The Insurance Act 2015 – what it means for you as an insured.

The Insurance Act 2015 ("the Act") finally came into force on 12 August 2016. The Act represents the biggest change in English insurance law for over a century.

The Act came into force on 12 August 2016 and will apply to insurance and reinsurance contracts governed by the laws of England, Wales, Scotland and Northern Ireland which are entered into on or after 12 August 2016. It will also apply to variations made on or after 12 August 2016 to insurance contracts that were entered into at any time.

Duty of Disclosure & Fair Presentation of Risk

Under Section 3 of the Act there is a duty on an insured to make a “fair presentation of the risk” before the contract is entered into. The obligation to make a fair presentation of risk seeks to promote the disclosure of information relevant to an insurer’s assessment of risk as a co-operative exercise between insurers and insureds. The rationale behind this approach is simple; an insured will know the specific information relevant to how their business is run and an insurer will know which of that information is relevant to their assessment of risk.

To fulfil their obligation of making fair presentation of risk, an insured is required to disclose every material circumstance which they know or ought to know. This is effectively the same as the obligation under the old law.

However, under the provisions of the Act if an insured fails to meet the threshold above they can still meet their duty of fair presentation of risk through disclosure which gives an insurer sufficient information to put a prudent insurer on notice to make further enquiries. This requires an insurer to be more proactive at the underwriting stage to balance the insured’s task of trying to detail every piece of information that an insurer may consider is relevant to their assessment of risk.

The Act also prescribes not just what information to disclose but also how the information is to be disclosed. Disclosure must be made in a manner which makes the information reasonably clear and accessible to a prudent insurer.
If a presentation is substantial it must be adequately organised and accessible (for example by indexing) to enable a prospective insurer to appreciate the significant details of the risk. It is hoped that these provisions will discourage the practice of data dumping.

There is no requirement to disclose information if it falls into one of the exceptions under Section 3(5). This includes information which the insurer knows, ought to know or is presumed to know. This places a positive obligation on the insurer to seek information needed to underwrite the risk.

Knowledge

The level of knowledge required of an insured to give a fair presentation of risk is set out in Section 4 of the Act and can be summarised as follows:

An insured is not required to disclose matters which an insurer knows or ought to know.
Remedies for Non-Disclosure

The Act has amended the remedy available to the insurer to better reflect the consequences of non-disclosure of risk.

Under Section 8 of the Act, an insurer will still continue to have a remedy against the insured for breach of its obligation of fair presentation. However, an insurer is now required to demonstrate that but for the breach, it would not have entered into the contract of insurance at all or would have done so on different terms (for example charging a higher premium).

The type of remedy now depends on whether there has been a qualifying breach the nature of which will determine the remedy available. This turns on whether the breach was deliberate or reckless. If the breach was deliberate or reckless then the policy can be avoided and the premium does not need to be returned. If, however, it was not deliberate or reckless then the following applies:

- If an insurer can demonstrate that but for that breach of the obligation of fair representation an insurer would not have entered the contract of insurance, then an insurer can avoid the policy but the premium must be returned.

- If an insurer would have entered into the contract but would have charged a greater premium had it known all of the facts, then an insurer is entitled to reduce the amount paid out on a claim. This payment is scaled down proportionately to the premium increase. The Act includes a formula for working out the percentage for a proportionate reduction.

- If an insurer would have entered into the contract but on different terms, then an insurer may treat the policy as having included those...
different terms from the outset. This could result in the addition of warranties or exclusions which affect the recoverability of claims.

The obligation is on an insurer to prove whether a breach was deliberate or reckless.

**Warranties & Basis of Contracts Clauses**

Warranties are contractual terms which must be complied with. Under the current law a warranty must be complied with whether or not it is material or connected to the risk being insured.

Warranties can be express written terms of a policy or implied terms. A warranty may be a term by which an insured undertakes to act or not act in a set of circumstances or that some condition will be fulfilled or that an insured confirms or denies the existence of particular set of facts.

Under the current law, in the event of breach of warranty an insurer may avoid the policy even if the breached warranty was entirely unrelated to the type of loss occurring or even if the breach was subsequently remedied.

Under Section 10 of the Act, breaches of warranty do not automatically result in the policy being avoided. Instead, warranties become “suspensive conditions” which means that an insurer is not liable for losses during the time of the breach but once the breach is remedied an insurer will be liable again.

For example, a warranty may exist which states that an insured must ensure that a working sprinkler system is installed in a warehouse. For any period of time when the sprinkler system is not in working order, the policy will be suspended. The policy is not totally avoided and cover will resume once the sprinkler system is back in working order.

Furthermore, in order for an insurer to avoid liability, Section 11 of the Act requires a causal link between the breach of warranty and the loss. Therefore, the warranty must be connected to the loss. This can be through the loss being of a particular kind, at a particular location or at a particular time. An insurer will therefore not be able to rely on non-compliance with the warranty if an insured can demonstrate that the non-compliance could not have increased the risk of the loss.

The Act also abolishes “basis of contract” clauses. Basis of contract clauses were ones which convert all pre-contractual statements and representations into warranties. No particular form of words was required but these may take the form of statements such as “form the basis of the contract” or by reference in the policy itself to the proposal form or other statements being incorporated...
into the policy. Not only are these types of clauses abolished under the Act, their abolition is part of the Act which cannot be ‘contracted out’ of.

**Fraudulent Claims**

Section 12 of the Act codifies the law in respect of insurer’s rights in the event of a fraudulent claim. Under these provisions an insurer has no liability to pay out for a fraudulent claim. Under the Act an insurer can recover any sums paid out once the fraud is recovered.

The Act also provides a new remedy and allows an insurer to give notice that the contract is terminated retroactively from the time the fraudulent act occurred. If an insurer chooses this option and treats the contract as terminated then an insurer can refuse all liability for claims made after that date and will not need to return any premiums already paid by an insured.

There is also a new provision in relation to group policies which allows an insurer to cease cover for one beneficiary of the policy who has been fraudulent whilst maintaining cover for the other innocent beneficiaries. This means innocent group members are not unfairly prejudiced by a fraudulent individual.

**Contracting Out**

The Act is designed to be the default rules for all non-consumer business contracts. However, as the provisions may not be suitable for all, the Act allows parties to contract out of the default regime. The only part of the regime which cannot be contracted out of is the ban on basis of contract clause.

In order to contract out (and place more onerous terms on an insured) an insurer must meet the transparency requirements under the Act:

- an insurer must bring the change to an insured’s attention before the contract is entered into; and
- the clause must be “clear and unambiguous.”

In determining whether the transparency requirements have been met, the characteristics of an insured and the circumstances of the transaction will be taken into account and therefore different requirements may be necessary for a smaller insured than a large sophisticated one.
Conclusion and Practical Considerations

The Act is a major overhaul of UK’s insurance legislation and there are a number of practical points to take into consideration going forward.

Firstly, insureds would be prudent to consider thinking about their renewal process earlier than usual to ensure that they have time to

+ collect the information that insureds are required to disclose to insurers from the potentially wider cast of individuals who are considered to have knowledge under the Act;
+ collate this information into a suitable form which is reasonably clear and accessible
+ and sign off whatever extra information might be required by insurers

As the Act encourages insurers to be pro-active in assessing the risks they are underwriting, this may result in insurers starting to make more robust challenges and seeking clarification on an insured’s presentation or proposal. Preparing and submitting information early may help to avoid any last minute rush to respond to an insurer’s challenges.

In relation to the duty of fair presentation, it may be advantageous for insureds to consider the following in order to engage with all those deemed to have knowledge of the risk and capture of all the required information to be disclosed:

+ an internal review to identify and document the individuals and position which make up senior management. The renewal process should clearly document the involvement of these individuals;
+ raise awareness of the burdens the Act places on staff members and the board of an insured and the consequence of non-compliance;
+ an external review with brokers to get their view on what they consider relevant and proportionate for an organisation to disclose.

Finally, as the duty of fair presentation of risk includes the format of presentation insureds should consider what they can do practically to collate the information so that it can easily put together and presented. Insureds may also wish to seek guidance from their broker/insurer in respect of what information they are particularly concerned with and what they require to be highlighted.

15 August 2016