BEALE&CO

INSURANCE TRENDS 2023:

THRIVING THROUGH ADVERSITY, LOOKING TO THE FUTURE

International Construction and Insurance Law Specialists

INTRODUCTION

Welcome to our insurance trends report for 2023. In what feels like a tumultuous time for many, we have identified a number of recurring trends that will affect the insurance claims market across all lines of business.

Reflecting on our 2022 report it is apparent that the extent of the predicted recovery has still to be realised. Not only does it seem that the world's climate is becoming more extreme and unpredictable, but also that geopolitical events and the UK economy have followed suit. With inflation stubbornly high, rising interest rates, and increased tensions around the world, there are some concerns that global financial stability is at risk.

At times like these, making accurate predictions is a challenging task. Having said that, the insurance market is robust, and the key to its continued success is its ability to evolve quickly in response to unexpected events and emerging trends. In this report, our industry experts across our specialist lines of business share their thoughts on the emerging trends and those we anticipate in the near future.

The key pervasive trends we cover in this year's report are:

1. ESG - how effectively businesses (insurers included) outwardly address ESG requirements will impact those businesses from a reputational viewpoint. There has been a tangible increase in climate change litigation and a growing body of activist shareholders and employees willing to challenge their companies' records on issues such as climate-related metrics, equality and diversity and board level attitudes to a company's social environment.

2. INCREASED REGULATION - regulators across the globe are sharpening their knives and preparing to crack down across the professions and across several lines of business. Whether the focus is on environmental concerns, building safety, cyber security, education, or financial institutions, there is an attempt by regulators to move beyond corporate responsibility and look to impose responsibility on individuals for their own actions.

3. BUILDING SAFETY ACT 2022 - this Act looks set to cause ripples across many sectors. Clearly those involved in the construction industry are poised for claims arising out of the various provisions of the Act but those in other professions such as solicitors, surveyors and even directors and officers will be under increased scrutiny following its enactment, with sections targeting individuals for breaches of the Act coming into force in October 2023.

4. CLAIMS INFLATION - the world is in the throes of the highest rates of inflation for many decades. The increased cost of living and the elevated interest rates mean that all lines of insurance will continue to feel the ill-effects of claims inflation.

5. TECHNOLOGY - the impact of technology on the insurance market is set to continue, particularly through the increased use of Artificial Intelligence ("AI") through media such as ChatGPT. This will impact cyber security and data protection and will touch all lines of business.

6. GEOPOLITICS - one trend that is not explicitly mentioned much in our report (although it is implicitly referred to), but which any report on 2023 trends would be incomplete without, is geopolitics. The tensions between nation states naturally affect all lines of business. As the war in Ukraine reaches its second year and amidst heightened tensions between China and Taiwan, insurers will be looking closely at issues such as supply chains. Insurers are also acutely aware of the need to carry out careful sanctions checks and to seek advice before writing business in certain territories or even paying out claims.

The effects of these commercial, legal, and regulatory developments, some of which will be with us for many years to come, will have a significant impact on almost all aspects of the insurance market. With the stability the market has enjoyed in the past now more of a fond memory, it is vital for insurers, brokers and MGAs to be forward looking and to invest in digitisation and innovation in order to mitigate risk and maintain growth. We hope this report will provide helpful insight into the insurance claims environment and leave you equipped to remain resilient and to be better prepare for the future.

Again, I would like to thank all of the talented lawyers who contributed to this year's report. Your time and expertise are invaluable to the continued success of this series.

Sheena Sood

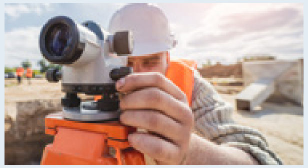
Sheena Sood,
Senior Partner

EXECUTIVE SUMMARY

Here's a summary of our key insurance trends and predictions across the sectors for the next 12 months. Click on a market area below to read our full analysis.

CONSTRUCTION 5

- Construction output and order books remained relatively strong into 2023 despite increased costs of materials and labour.
- Ongoing issues with fire safety - new claims are expected to be made following the Grenfell final report expected early 2024.
- The construction industry has come under intense scrutiny due to emerging environmental matters and we expect an increase in climate-related claims against consultants and contractors.
- Similar rise in claims on PFI projects as they complete and are handed back to the public sector.
- Use of 3D printing and new technology forecast to increase significantly within sector.
- Potential for PI rates to remain flat (or to decrease for the first time in the last four years) later this year.

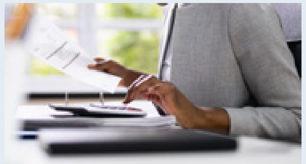


SURVEYORS 10

- The market for surveyors' PI Insurance is showing some signs of improvement.
- The depressed housing market is likely to heighten risk of claims against valuers.
- Fire safety-related exposures, for surveyors and managing agents, are a growing concern.
- Cladding remains the most uncertain and controversial area.
- Looking ahead, increasing development and adoption of Automated Valuation Models, and of its potential benefits and risks to the valuation process, will be keenly followed by insurers.

SOLICITORS 13

- The tough market for PI Insurance is likely to improve with rates predicted to decrease.
- The floodgates have not yet been opened for data breach claims.
- More recent cases have further explored the interpretation and application of aggregation clauses in other professional indemnity wordings.
- Controversy over SRA review of both law firms' culture and the role of in-house solicitors.
- The regulatory burden upon law firms shows no signs of diminishing.
- Firms will need to demonstrate that they have taken the new Building Safety Act on board in their risk management strategies if they are to persuade insurers that they are a good PII risk at renewal.
- The proposed implementation of the Fixed Recoverable Costs Regime in October 2023.



ACCOUNTANTS & AUDITORS 17

- The threat of significant negligence claims is still hanging over the industry.
- A weak economy will continue to lead to more potential fraud.
- Increased insolvencies (both personal and corporate) lead to more claims against advisors and insolvency practitioners.
- FRC transition to ARGA is ongoing and firms need to prepare.
- Impact of latest tech advancements on accounting and auditing are real and profound.

INSURANCE BROKERS 20

- Although the last 12 months saw benign claims conditions for brokers the hard market does present risks for the future.
- Economic strains leading to rising cost of resolving insurance claims and rapid claims inflation.
- A continued frenzy of broker consolidation to increase market share or open up new distribution channels together with the increased risk of claims as a result.
- Regulatory burden on insurance brokers to continue to grow.

DIRECTORS & OFFICERS 22

- Given rising insolvencies, we expect claims against directors to increase.
- Underwriters are braced for ESG-related claims against directors from activist shareholders and employees.
- Directors need to be aware of the latest technology developments and the potential risks of AI, cyber and data theft litigation.
- The D&O insurance market is expected to continue to grow with several new entrants into the market.

EXECUTIVE SUMMARY

Here's a summary of our key insurance trends and predictions across the sectors for the next 12 months. Click on a market area below to read our full analysis.

EDUCATION 26

- An increase in claims arising from alleged mishandling of investigations into sexual misconduct and failure to follow guidance in this area.
- Debate over whether the government will introduce a statutory duty of care for Universities to their most vulnerable students and the potential for a surge in mental health claims.
- Upward trend in SEND Tribunal claims steepening.
- Claims alleging failure to provide adequate student support during COVID continue against schools and universities.
- Developments in status of students as consumers.
- Possible claims as a result of industrial action by lecturers leading to delays in grades being handed down and the consequent impact on employment.

ENVIRONMENTAL 29

- Environmental insurance is a boom area as climate change litigation continues its rise.
- A more proactive approach is being taken by regulators to ensure compliance with environmental regulations.
- Harsher penalties and enforcement from the Environment Agency and other regulators.
- Latest development in environmental 'nuisance' claims could impact property development.

INDEPENDENT FINANCIAL ADVISORS 32

- Significant developments in relation to the restructuring of the British Steel Pension Scheme over the past year will remain a key focus in relation to risks to IFAs in the year ahead.
- The FCA has had a busy year and various projects will have ramifications for IFAs and their insurers over the next twelve months.
- Firms must take steps to implement actions required by the new Consumer Duty for new and existing products or services by 31 July 2023.
- The FCA is driving improved access for individuals to financial advice and retirement strategies.
- Finding affordable PII cover is likely to continue to represent a challenge for firms.

CYBER 35

- The evolution in technology and advancements in cyber-criminal activity is being met head on with an increase in savvy underwriting.
- The next 12 months are likely to see regulators looking to enforce a minimum level of cyber insurance and risk management across their members.
- Continuing new entrants to the cyber insurance market will help lower the premium increases experienced in recent years.
- Insurers can expect increased claims under cyber insurance policies with ransomware again expected to feature most prominently.

ENVIRONMENTAL, SOCIAL & GOVERNANCE 39

- A softening ESG insurance market with increased capacity and a decrease in rates as competition has increased.
- Increased regulatory scrutiny and risks on ESG matters.
- Derivative ESG actions in the US and Australia are now potentially coming to the UK.
- The potential for claims under professional indemnity policies against a range of professionals arising from the alleged failure to properly deal with ESG-related matters.

FINANCIAL INSTITUTIONS 42

- FI insurance market is hard and the cost of insurance for FIs is high and increasing.
- ESG focus comes with substantial risks for FIs.
- The potential widening of the Quincecare duty.
- Increased scrutiny on money laundering, crypto and tax evasion.
- Cyber risk still amongst the biggest risks facing FIs.
- Consumer protection will be keenly enforced by the FCA.
- The fallout from banking crisis earlier this year remains uncertain, although wide-ranging litigation is probable.

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CONSTRUCTION

Towards the end of 2022, there were indications that capacity in the UK construction PI market was starting to stabilise. The first half of 2023 has also seen some evidence that there may be a subtle shift in underwriters' risk appetite. There is also some prospect that rates may remain flat (or start to decrease for the first time in the last 3-4 years) later this year.

2023 has also seen some evidence that there may be a subtle shift in underwriters' risk appetite

The spike in claim notifications that many predicted arising from the COVID-19 pandemic and the current economic climate has not yet materialised, but many anticipate this could occur later in 2023 and/or into 2024.

In terms of construction sector trends, we predict this will be dominated by ongoing fire safety concerns, emerging environmental issues, Artificial Intelligence (AI), technology and the current financial climate. We also may see a variety of legal issues arising when further infrastructure assets are handed back as more Private Finance Initiatives (PFI) contracts come to an end.

FIRE SAFETY

CLAIMS

Unsurprisingly, fire safety has retained its place in the spotlight in the 2023 construction landscape as the government looks to drive remediation works on "high risk" buildings.

We expect there to be a flurry of activity regarding existing cladding claims (as limitation becomes more of a focus for claimants who are coming under increasing government pressure to hold perceived guilty parties to account – see below). New claims are expected following publication of the Grenfell Inquiry Phase 2 final report which is due in early 2024. Further claims are expected to emerge from ongoing remediation works.

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The extent to which these claims touch insurers will depend largely on the scope of the fire safety / External Wall Systems (EWS) exclusion wording which applies and what insurance cover is afforded to those carrying out cladding remediation works. On this latter issue, the IUA's September 2022 Building Safety Fund Cladding and Fire Safety Limited Exclusion and Aggregation Clause wordings were a helpful result of collaboration between the Department of Levelling Up, Housing and Communities (DLUHC) and the UK insurance market.

We expect to see an increase in the "second wave" of claims (i.e. those concerning structural and other non-fire safety issues) that have started to materialise as a result of fire safety remediation works commencing. Such claims may not be caught by existing fire safety / EWS exclusion clauses.

There have been two decisions of the Technology and Construction Court (TCC) that have addressed most of the main legal arguments that many predicted surrounding fire safety claims. The main issue that remains to be dealt with where there remains little judicial commentary concerns apportionment of any liability as between contractors and the design team. The introduction of PAS 9980:2022 (essentially a method for EWS assessment), and the support it has gathered from the government, leads us to conclude that matters of quantum and the legal issues surrounding what constitutes a reasonable and proportionate remedial scheme will be the main battleground for legal development in the TCC over the next 12-18 months.

GOVERNMENT INTERVENTION

Government intervention continues to be a key theme in 2023. The government initiating legal proceedings against a freeholder for failing to remediate unsafe cladding sets the scene for further litigation from the DLUHC.

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Fifty developers have signed the Developer's Pledge to remediate critical life-threatening fire safety defects in buildings over 11 metres in height which they developed or refurbished in the last 30 years. As part of this commitment, developers have agreed to reimburse funding received from the government remediation programmes. In conjunction with the Building Safety Levy, the construction industry is directly paying an estimated £5 billion to address existing fire safety defects.

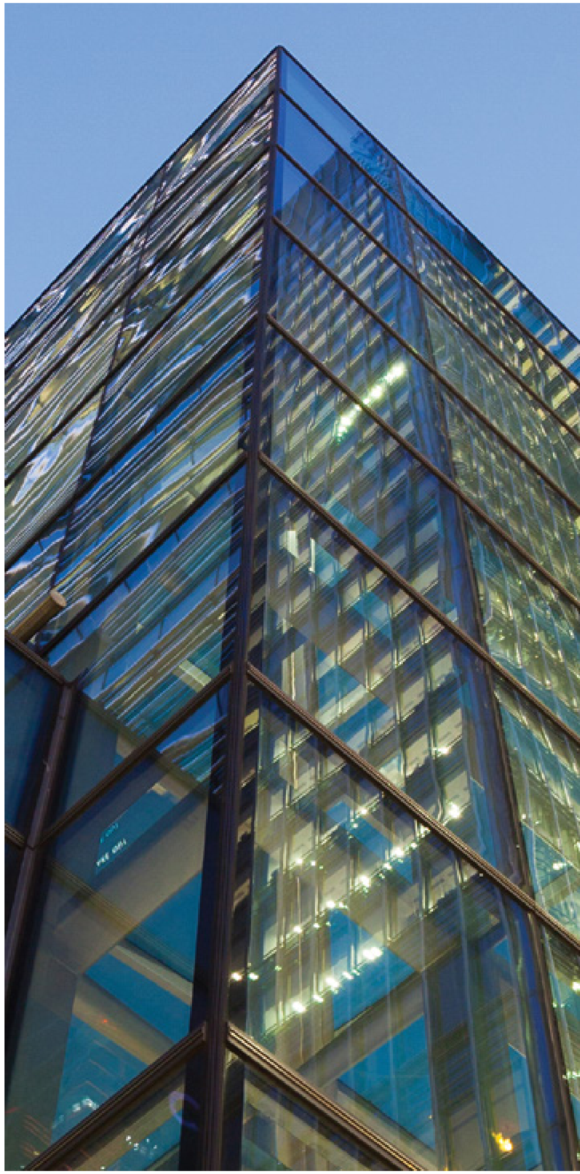
Under the government's Responsible Actors Scheme (RAS), draft regulations have been proposed to impose planning and building control prohibitions on non-signatories. The government has also threatened to publicise those who decline to sign the pledge. We therefore expect developers to comply with their pledge commitments to avoid sanction. Significant sums of money are being reserved by developers to enable them to comply with their pledge commitments. The consequences of the RAS are likely to be an increase in claim activity (see above) and the initial diversion of capital to pay for remediation works. This may, in turn, affect future development levels and delay existing projects.

The Housing Secretary has also written directly to Kingspan, as well as to investors in Kingspan, Arconic, and Saint-Goban in a bid to hold the insulation manufacturers financially accountable for their role in the "cladding crisis". The letter to Kingspan seeking financial contributions to nationwide remedial schemes was sent at a time the company reported significant profits. If the approach to Kingspan is successful in recovering money for remediation, then we can expect further approaches to other manufacturers who may have contributed to fire safety issues.

THE BUILDING SAFETY ACT 2022 (BSA)

The immediate claims ramifications of the BSA that we are seeing are claimants (i) seeking to amend existing Particulars of Claim to introduce new causes of action under the Defective Premises Act 1972 (DPA) (that are now within time for limitation purposes given the introduction of a retrospective limitation period of 30 years) and (ii) seeking to add additional defendants to proceedings via a combination of applications under CPR19 and for Building Liability Orders (BLOs).

The overriding purpose of the introduction of BLOs was to address the concern of special purpose vehicles dissolving to avoid liability. However, the early signs are that BLOs will be sought on a much wider basis against related group companies, even where the original contracting entity remains active. Given the inherent legal principle that such action will seek to erode (i.e. that piercing the corporate veil is only permissible for impropriety linked to attempts to conceal or avoid liability), we expect there to be several test



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Part 3 of the BSA is intended to come into force by 28 October 2023. This will introduce defined levels of accountability for specific duty holders via secondary legislation. The current draft of that secondary legislation is the Building (Appointment of Persons, Industry Competence and Dutyholders) (England) Regulations [2021]. Both the insurance and construction sectors have expressed significant concerns regarding elements of these draft regulations given practical issues relating to workable divisions of responsibility / control amongst the wider project team and possible coverage issues which could arise because of imposing strict liability. A consultation on the draft regulations has closed and the government's response is awaited with interest.

SLOW UPTAKE OF AI AND TECHNOLOGY

In some instances the construction industry has suffered from the slow uptake of AI and technology. This could be due to several factors including limited financial resources, a shortage of workers with the necessary technological capabilities coupled with an incomplete understanding of the potential benefits. Consequently, the construction sector typically suffers from a lack of incentive to invest in and harness AI technologies.

The uptake of technology remains largely focused on the project management aspect of construction, with digital platforms such as BIM offering support across various workstreams as well as facilitating remote access to sites. Recent improvements and increased AI-orientation is likely to result in drones becoming more commonplace in the industry. With the ability to provide real-time aerial imagery, 3D LiDAR scans, BIM capabilities and safety monitoring, technologically refined drones have the potential to play a vital role in construction with the ability to monitor sites and conduct site surveys remotely.

Greener technologies will have a greater presence in the industry with the drive to prioritise sustainability and the government's net zero target. The use of 3D printing is forecast to increase significantly within construction as the industry looks to adopt greener construction practices. The ability of 3D printing to create more sustainable materials that improve the energy efficiency in greener buildings places the technology at the forefront of the tech revolution within construction. Moreover, augmented reality (AR) can improve building accuracy and detect errors at an early stage, which limits the extent of wasted costs and materials on projects. Similarly, virtual reality (VR) enables architects and engineers to consider potential issues or logistical errors prior to commencement of the project, which could revolutionise how projects are designed.

Additionally, technological advancements have created opportunities in the form of new processes, for example, the recycling of concrete. In construction, innovation has initiated the reevaluation of long-standing, traditional procedures with the long-term aim of re-aligning them with sustainable practices. The choice of materials used initially and the processes to obtain and repurpose those materials is a consideration that we expect will play a bigger role in the future.

Overall, the construction industry can expect to benefit from a range of innovative technologies which facilitate collaboration, increase safety and accuracy whilst limiting waste and delay on projects.

ENVIRONMENTAL ISSUES

BIODIVERSITY NET GAIN (BNG)

The Environment Act 2021 introduced a new requirement that with a few limited exceptions, all new developments in England will be required to achieve a BNG of at least 10%, guaranteed for 30 years.

BNG is an approach to development, and/or land management, that leaves nature in a measurably better state than beforehand. This will apply from November 2023 for developments in the Town & County Planning Act 1990 and from 2025 for Nationally Significant Infrastructure Projects (NSIPs). BNG will be measured using the biodiversity metrics developed by Natural England called (biodiversity metric 3.1).

There are already some projects which have achieved a BNG but, given the requirements of the Environment Act 2021, considerations around achieving a BNG are going to be important for those designing and building developments and NSIPs.

NET ZERO

The UK government has committed to reaching a net zero greenhouse gas emissions target by 2050 as part of its participation in the Paris Agreement to reduce global warming.

The construction industry has come under intense scrutiny recently given the statistics revealing the amount of carbon emissions that can be accredited to the built environment and infrastructure (over 50% of the total annual carbon emissions in the UK).

The introduction of (i) NEC X29 (the climate change clause) last July, which will make a failure to comply with Climate Change Requirements (CCRs) a breach of contract and a defect that the contractor is required to rectify under the contract, and (ii) PAS 2080:2023, to specifically address the management of carbon in infrastructure, is just the start and a sign of things to come.

INFRASTRUCTURE

The government has acknowledged the infrastructure challenges currently faced by the UK in its Mission Zero Review and suggested the development of cross-sectoral infrastructure to be a midterm solution in the process of decarbonising the UK.

As set out in the Mission Zero Review, the key drivers to achieve net zero were identified as being: the construction of renewable energy sources and the construction of infrastructure to facilitate the distribution of the green economy. Whilst efforts towards producing renewable energy have begun, infrastructure enabling a cross-sectoral renewable future have not yet crystallised. Further networks to support hydrogen, CO_2 and electricity distributions will be erected in a bid to revolutionise legacy infrastructure and to synergise new projects for future processes.

Nevertheless, the urgency to continue construction of renewable energy sources, nuclear, hydrogen and other low carbon emitting energy sources remains a strong focus of current infrastructure projects.

CLAIMS

In relation to X29 clauses, and other bespoke contractual climate-related obligations, we expect an increase in claims as their use continues to gain popularity in contracts. The extent to which insurers may be affected will depend on contractual liability wordings and any corresponding exclusions.

Sub-contractors are also being held to the same standard as their employers in

relation to net zero obligations, as it is becoming increasingly common for sub-contractors to be required to warrant compliance with the same environmental standards as the main contractor, and/or to report on their green credentials. Therefore, it is expected that sub-contractors will be brought into future climate change-related proceedings; similar to the claims we are currently seeing in the fire safety sphere.

Sub-contractors will usually warrant their compliance with any such climate obligations with a warranty or guarantee.

From an insurer perspective any such liability arising from liabilities and/or warranties may, of course, be excluded from cover.

In relation to new infrastructure, and in the context of climate change, claims are also likely to arise from the design and construction of buildings where professionals have failed to consider adverse weather events which may now be considered as foreseeable in the UK. Floods and heatwaves will need to be factored into any future design.

THE CURRENT ECONOMIC CLIMATE

Inflation, labour costs and interest rates have all risen significantly. The rise in the costs of construction materials has been pronounced with a 37% increase since 2020 according to the Building Cost Information Service Materials Cost Index - largely due to supply-chain disruption and rising energy costs.

This increase has impacted both live projects and existing claims. Live projects continue to be put on hold as a result and, more importantly, where consultants have obligations of designing to budget there are increased risks of claims being brought in relation to any overruns. As for existing claims, we have seen an increase in applications being made to amend and update Schedules of Loss and Scott Schedules. Any increase to the quantum of claims is concerning for insurers and creates reserving and actuarial issues.

We expect the economic downturn to continue to drive an increase in insolvencies for firms in the construction sector (currently at a 13 year high with this trend set to continue in the medium term). Any increase in the volume of insolvencies creates a risk to insurers of a rise in claims being made against them pursuant to the Third Parties (Rights against Insurers) Act 2010. For those insolvent companies which are part of a wider group of companies, the commentary above regarding BLOs should be noted and understood.

Additionally, labour shortages may result in an inexperienced or less skilled staff which increases the risk of accidents, project delays or errors.

PFI CONTRACTS

During the remainder of 2023 and moving into 2024, more PFI contracts will end, covering assets worth millions of pounds. On expiry, in most cases the ownership of the asset will be transferred to the public sector, which will be responsible for ensuring the continued running of the facility.

Against this background we expect to see possible issues continuing to arise with the hand-back of the PFI asset, with claims then being pursued against the contractors and designers of the facility.

Claims may also start to arise before hand-back of the PFI asset as a result of the Infrastructure and Projects Authority's (IPA) health check. The IPA offers all PFI projects within seven years of expiry an initial expiry health check, with further reviews at three and five years. The health check involves a review of key project documentation and a structured interview process with the contracting authority. The review process uses a diagnostic tool to help assess and benchmark the project's readiness for expiry. The output from health checks is a short report which identifies the key issues and action recommendations for an authority. This process may give rise to various claims from the local authority and the project company, which we expect to be passed down the chain as necessary to the facilities manager or the original design-and-build contractors.

It is likely that issues in the maintenance of the PFI asset will fall to the facilities management contractors. Accordingly, these contractors could be carrying out their own audits ahead of those carried out by the local authorities to assess the quality of the current asset.

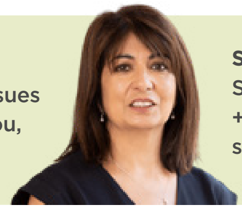
However, we are also seeing a number of claims brought by project companies against contractors in relation to the assets not being built as specified in the design and build contract or the agreement between the procurer and project company. Such claims are then being passed to the original designers appointed by the contractors.

A common trend with these claims is that of alleged defects being judged by current design standards rather than those in place at the time of specification and installation.

CONCLUSION

Despite challenging conditions, construction output and order books remained relatively strong throughout 2022 and into 2023. However, several factors continue to have a significant impact on projects and the industry more generally, led by (but by no means limited to) the ongoing issues with fire safety, increased costs of materials and labour and the increased focus on emerging environmental matters. Insurers should be aware of these trends when assessing their risk appetite in the future, as these factors are set to continue throughout 2023 and into 2024 and may lead to further notifications and claims.

To discuss how any of these issues might affect you, please contact



Sheena Sood
Senior Partner
+44 (0)20 7469 0402
s.sood@beale-law.com

Ian Masser
Partner
+44 (0)20 7469 0439
i.masser@beale-law.com

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SURVEYORS

The somewhat bleak outlook for the surveyor PII market forecast in last year's edition is showing some signs of improvement. Both 2022 and 2023 saw some new additions to the RICS panel of Listed Insurers and some familiar names returning. Brokers have been reporting that it is starting to become easier to place cover as premiums begin to stabilise and improve.

However, despite the UK housing market showing reasonable resilience in the first half of 2023, repossessions are on the increase and significant numbers of borrowers, already contending with a cost of living crisis, will soon exit short, fixed-term mortgages for much higher rates. With the increasing likelihood of lenders looking to realise their security over the next two years, and the associated risk of claims against valuers, valuation remains a key risk for insurers.

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Fire safety-related exposures, for surveyors and managing agents, are likewise a concern as progress is made towards reviving the market for properties in multi-storey buildings with cladding. While insurers are still prevented from excluding fire safety claims in respect of properties of four storeys or less, the RICS hopes to achieve more comprehensive fire safety cover within its 2024 minimum policy wording.

Looking ahead, increasing development and adoption of Automated Valuation Models (AVMs), and of its potential benefits and risks to the valuation process, will be keenly followed by insurers following publication by the RICS of its paper 'Automated Valuation Models (AVMs): Implications for the Profession and their Clients'.

RESIDENTIAL VALUATION CLAIMS

Insurers of valuers for residential mortgage purposes await to see whether the energy crisis, current rates of inflation and the recent surge in interest rates will translate into a slew of claims or whether more responsible lending practices, instituted following the 2007-2008 global financial crisis, and encouraged by the lending rules introduced in 2014 by the FCA's Mortgage Market Review of 2012 ('MMR'), have gone far enough to avert widescale repossessions.

Mortgage self-certification has long gone, one hundred percent mortgages (without a guarantor) are exceptional and borrowers seeking interest-only mortgages have had to demonstrate a viable strategy for capital repayment which is not dependent on house price growth. In particular, those lending rules specified a stress interest rate for testing borrower affordability and imposed caps on the amount of lending banks and building societies could provide above 4.5 times salary. The Bank of England scrapped the interest rate stress test in August 2022 as a result of concern that affordability rules had become too onerous for borrowers, particularly those unable to rely on parental assistance. Fast forward by a year and the base rate has rocketed from 1.75% to 5.25% (at the time of writing) with core inflation in 2023 at a 30-year high, putting borrower resilience – and the last decade's lending practices – firmly to the test. Secured lending in the UK has long ceased to be a free-for-all and, whilst an increase in lenders resorting to their security seems inevitable, there is cause for optimism that it will not be so dramatic this time around.

Building and fire safety in relation to multi-occupied residential buildings remain key areas of concern at this time.

Over the last decade, both valuers and lenders have become more keenly aware of the need for valuations to be underpinned by proper comparable evidence and a sound methodology (with lenders frequently requiring valuers to revisit reports where they have failed to show their working). Where claims are made, valuers should be better positioned to defend them.

The impact of the COVID-19 pandemic and current economic circumstances are likely to result in an increase in certain types of claims. Lockdown restrictions appear to be behind an increase in claims concerning RICS Home Surveys and dilapidation reports, and behind a marked increase in UK divorce rates which gives rise to an increased risk of claims against those providing valuations as expert witnesses in matrimonial disputes.

Firms providing reports to charities disposing of property assets (pursuant to the Charities Act 2011 and Charities Act 2022) may increasingly find their advice and valuations under scrutiny as plummeting charitable donations inevitably cause charities to review their finances. Similarly, the recent, significant reduction in residential property transactions, following soon after the stagnation of the market during the pandemic, is plainly putting some firms under serious financial pressure and may well see a plethora of coverage disputes where it appears firms may have downplayed concerns at renewal to avoid premium hikes.

BUILDING AND FIRE SAFETY

Building and fire safety in relation to multi-occupied residential buildings remain key areas of concern at this time. With the Fire Safety (England) Regulations 2022 coming into force earlier this year, new safety obligations are now imposed on 'Responsible Persons' – a definition encompassing managing agents where they have control over common areas – to ensure residents are provided with fire safety instructions.

In the case of high-rise properties the obligations include the provision of detailed property information to the local Fire & Rescue Service about the building's layout and design and construction of its external wall system, along with the undertaking of monthly checks on lifts and other firefighting equipment. In respect of relevant properties, managing agents will need to identify if they are deemed by their management contract to have control over common parts and, where they are, to confirm that systems are in place to ensure compliance.

Since our previous update, the Home Office has published its Fire Safety Act Commencement Prioritisation guidance to be used by 'Responsible Persons' in relation to their duties under the Fire Safety Act 2021 ('FSA') which, through its prioritisation tool, arranges buildings into five priority tiers and determines what action is required depending on the risks posed. Whilst neither the guidance nor use of the tool is mandatory, it is likely courts will take account of the guidance in determining whether a Responsible Person has complied with their duties under the FSA.

CLADDING

In relation to mortgage valuations of buildings with cladding, last autumn saw the introduction of the government-backed insurance scheme intended to unblock the market for leaseholders. This was in response to difficulties encountered by professionals in obtaining PII for undertaking fire risk appraisals on external wall systems in order to complete EWS1 forms where required by a valuer or lender.

The purpose of the EWS1 form is to determine whether remedial works affecting the value of a property are likely to be required to the cladding. The initiative should expedite the completion of EWS1 forms where required and stimulate market activity in relation to affected properties. Each policy will cover a single EWS1 survey, on a specific building, with varying limits of indemnity of up to £10 million for buildings above 30m in height.

In addition to the insurance scheme, late last year the RICS consulted on proposals to introduce a new professional standard, the 'Valuation of properties in multi-storey, multi-occupancy residential buildings with cladding (1st edition)' in order to provide consistency during the valuation process – and hence assurance for lenders looking to resume lending against relevant properties. The new standard applies where remediation work to cladding for fire safety purposes is required, a route to funding remediation is clear and lenders have indicated willingness to lend. The new standard, which came into effect in England only from 1 December 2022, details what information valuers should consider as part of the valuation process (including whether remedial works to the external walls and attachments have been identified and whether the costs are known, whether the building is eligible for one of the remediation funding schemes, and whether dates for commencement and completion of remediation schemes have been scheduled) it also provides several 'indicative scenarios' accompanied by valuation approach considerations. Given the complexity and potential challenge to valuers in arriving at valuations in respect of relevant properties as the market revives, the new standard strongly advises valuers to consider their potential liability, to ensure they have appropriate levels of PII for the specific valuation work undertaken and to agree terms around liability capping and third-party reliance. PII providers will require particularly strong assurances that valuation processes in this uncertain area are robust.

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AUTOMATED VALUATION MODELS

Finally, since our 2022 edition was published, the RICS has released its 'Automated Valuation Models (AVMs): Implications for the Profession and their Clients' providing a "*snapshot of the current landscape of AVM adoption across all assets types*". AVMs are generally most effective in the case of similar, frequently traded assets, and therefore for residential property, where there is good data availability for lending, but the use of automation in a hybrid role in valuing commercial real estate is increasing, whether as an input to the valuation process (for example, scoring and identification of comparable evidence) or as a second opinion. The increasing adoption of AVMs and, in turn, the reduced reliance on manual valuations has the potential for improved consistency and speed of valuation at reduced cost and the obvious benefit of removing human error (and wrongful manipulation of data) from the valuation process. However, the availability of high quality data underpinning AVMs is of course critical to the effectiveness of automated processes, as is the input of valuers and property professionals in model development. Stakeholders consulted have highlighted a range of risks, from inherent data selection bias (where an AVM is driven by a partial view of the market, relying on proprietary data sources) to a potential lack of adequate management and supervision of AVM outputs produced by less-qualified personnel. Whilst embracing automation will undoubtedly bring benefits to the valuation process, PII providers will need a clear understanding of where the new risks lie.

To discuss how any of these issues might affect you, please contact

Martin Jensen
Partner
+44 (0)20 7469 0505
m.jensen@beale-law.com

Joanna Lewis
Partner
+44 (0)20 7469 0444
j.lewis@beale-law.com

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SOLICITORS

The professional indemnity insurance market for the legal profession has experienced extremely tough market conditions over the past few years; it has not been uncommon for premiums to have increased by over 100% in some cases, with many firms being unable to secure commercially viable terms at all. A declining appetite to insure legal professionals, coupled with very limited new entrants to the market to keep prices keen, has served to ramp up premium cost as demand has far outstripped supply.

According to research published by Hazlewoods in Q1 of 2023, at least 46 law firms closed in the 15 months preceding October 2022 due to the rising costs of PI insurance. The report showed that on average, the premium for PI insurance was at almost 5% of law firms' turnover, with firms that carry out a significant amount of conveyancing work (i.e., more than 25% of their revenue) paying as much as 20% of their turnover for PI insurance.

As predicted in our 2022 review, this last year has seen the continued merger of law firms. Between November 2021 and November 2022 116 firms closed as a result of a merger, accounting for 20% of all closures.

However, despite these tough conditions, there are positive signs. Whilst rate decreases remain rare, rate increases seem to be slowing and reports suggest a levelling out of the market, with rates

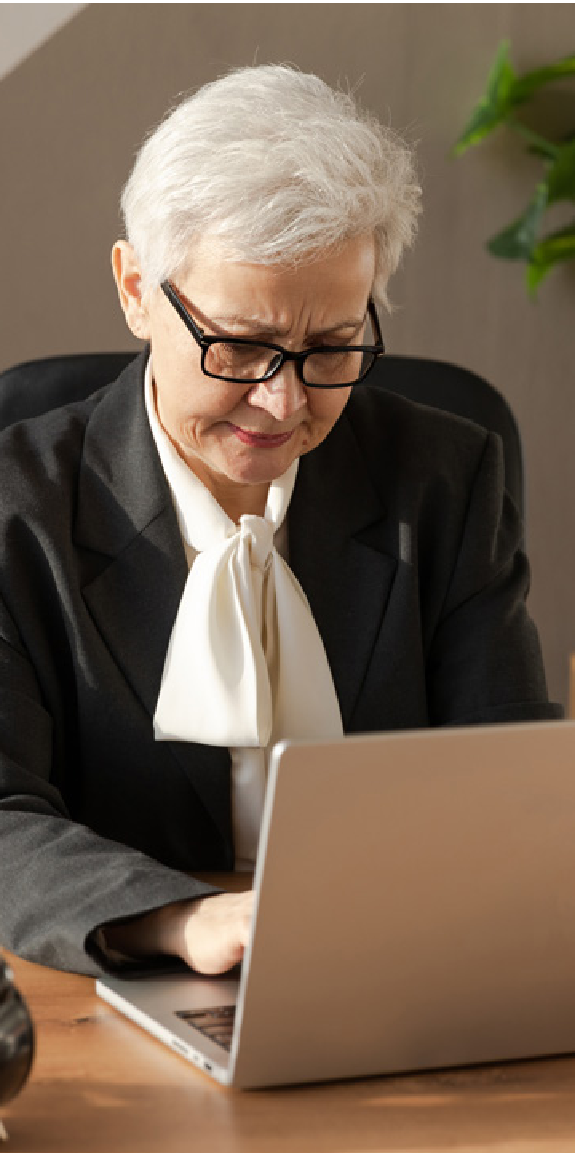
...at least 46 law firms closed in the 15 months preceding October 2022 due to the rising costs of PI insurance

predicted to start to decrease over the short term. There are signs of new entrants and an increasing appetite from the market to write solicitors PI business.

Perhaps one reason for the shift in conditions is that we have not seen the wave of COVID-related claims which was widely expected. As we highlighted in the 2022 Insurance Trends report, we anticipated an increase in claims in the following areas: cyber scams, private client and litigation. Whilst notifications are being made, the predicted wave of claims has not yet materialised. Overall, according to the UK litigation data platform, Solomonic, the volume of claims against professional service firms fell by around 25% in 2022. There were over one third fewer claims against solicitors and barristers between 1 October and 31 December 2022, compared with the same period in 2020.

There are signs of new entrants and an increasing appetite from the market to write solicitors PI business.

Additionally, it was feared that the floodgates would open for data breach claims. However, this has not yet materialised. Recent cases have shown that it is only data breaches with a serious impact on an individual which will be worth litigating, and that care is needed in the costs incurred and in choosing the court. Claimants and their advisers should carefully consider what kind and level of damages should be pleaded and the most appropriate forum to bring the action; data breach cases no longer seem to be the 'cash cow' claims farmers once envisaged.



KEY TRENDS

AGGREGATION

As referenced in our 2022 review, the Court of Appeal in the case of *Baines & Anor v Dixon Coles & Gill (A firm) & Ors* clarified the limited scope of aggregation under the SRA's Minimum Terms and Conditions for PII, by confirming a narrow interpretation of the aggregating wording 'related matters or transactions'.

Other cases have further explored the interpretation and application of aggregation clauses in other professional indemnity wordings. In *Spire Healthcare Ltd v Royal & Sun Alliance Insurance*, the Court of Appeal reiterated that aggregation clauses are to be construed in a balanced fashion, taking a neutral approach; and that where the aggregation clause contained standard wording it was appropriate to construe the wording consistently with other cases.

The Court of Appeal also reiterated that aggregation clauses referring to occurrences 'attributable to one source or original cause' intend for the widest possible effect and that there is no distinction between wordings referring to an 'original cause', 'originating cause' and 'source'.

Later cases in 2022 continued to emphasise the fundamental importance of considering the policy wording carefully against the particular facts of the case in determining whether claims aggregate.

Whilst it is always tempting to interpret aggregation provisions in the way most beneficial to one's own interests on the facts of the particular case, it is clear that courts will do everything possible to strike a balance between the parties. That exercise will frequently involve not just an analysis of legal equality, but also an evaluation of the parties' respective financial positions. As other cases have highlighted over recent years, insurers are looked upon as having very deep pockets, and that appears to put them on the wrong side of judicial sympathy when up against less financially secure opponents.

FIRM CULTURE

In February 2022, the SRA published its Workplace Culture Thematic Review which sets out the SRA's expectations for workplace culture within law firms. The focus is on supporting employees' wellbeing in the workplace by setting standards that apply to law firms and those responsible for a law firm's culture and the systems in place to uphold it. The SRA considers that this is essential for the delivery of competent and ethical legal services, and it is therefore a core part of its ongoing risk management strategy.

> *Since its review, the SRA have launched a new consultation on rule changes concerning health and wellbeing at work.*

Since its review, the SRA has launched a new consultation on rule changes concerning health and wellbeing at work. These proposals aim to ensure that regulated workplaces treat colleagues with dignity and respect and, if that does not happen, the SRA proposes to put in place additional regulatory powers to deal with firms and individuals in order to protect clients and the public. In its review the SRA considered how firms can create a positive culture in the workplace "*where employees feel supported, risks are managed, and clients are protected*" and it has provided examples of policies and working practices which can achieve this. The recommended strategies and actions include creating a wellbeing strategy, focussing on recognition and reward, engaging with colleagues, defining a firm's culture, and creating a safe environment to raise issues and concerns.

These latest proposals from the SRA have been received with mixed reviews. Whilst few would deny that a positive workplace culture is needed in any effective organisation, the regulation of a culture is far more problematic. The review also highlights the tension between client focus and employee wellbeing; regulation to date has focused almost exclusively on the interests of clients but some would argue that a focus on employee wellbeing cuts across that and, in some circumstances, client service could suffer. There is undoubtedly more to follow on this topic, and we will be following it closely.

IN-HOUSE SOLICITORS

On 14 March 2023 the SRA published its latest thematic review on in-house solicitors. In summary, the review concludes that, whilst facing challenges, the in-house sector is bearing up well and poses a relatively low ethical risk. However, leaders in the in-house community have since published a response which welcomes the SRA's focus on the sector but sets out extreme concerns with the findings and conclusions reached. They consider that the review "*understates the severity of the risks present in the in-house environment and misinterprets or is inadequate in its conclusions as to their cause*". This is because there are often influences on in-house teams to achieve particular objectives or to push legal interpretations to their limits so as to facilitate the business of the wider company. These influences are less prevalent in private practice. The in-house community's response to the SRA calls for it to: (i) acknowledge and prioritise the seriousness of the risks and challenges in the in-house environment; and (ii) provide practical and regulatory support to address those risks. The reviews and the consultation represent a significant shift in thinking with regard to workplace culture in the legal sector.

REGULATION - FINANCIAL PENALTIES

The SRA has recently confirmed the details of changes for how they levy financial penalties to law firms and solicitors. The reforms will come in later this year and will see the introduction of a fixed-penalty regime for lower-level misconduct, future fines for firms and individuals linked directly to bandings based on percentages of income/turnover, and a pilot on the use of personal impact statements for cases involving sexual misconduct, discrimination, or any form of harassment. The purpose of the changes is to help cases be resolved more quickly, saving time, costs and stress for those involved. In response to a number of well publicised cases the new fining bands will also enable different levels of fine to be issued to a low-earning junior solicitor compared with those levied on a senior equity partner for similar offences. This follows new legislation brought into effect in 2022, which increased the amount of fine that the SRA can directly issue to 'traditional' law firms from £2,000 to £25,000.

Meanwhile, the Legal Services Board is also conducting its own review into ongoing competence and standards, examining whether the current approaches taken by regulators are effective in protecting consumers and the public interest. There is ongoing focus on the SQE, the new examination through which people enter the profession, and whether the training and testing is sufficiently rigorous as to maintain standards of competence and ethics. Its findings are awaited, but it is likely that more reforms will be rolled out at some point this year.

The regulatory burden upon law firms certainly shows no signs of diminishing.

BUILDING SAFETY ACT 2022

The Building Safety Act 2022 gained Royal Assent on 28 April 2022. The Act provides for the safety standards of buildings and people in buildings. The intention of the Act is to give

homeowners more rights and powers, as well as providing protection for leaseholders from the costs associated with remedying a building's historic defects.

The introduction of the Act has created uncertainty for construction professionals regarding who will be accountable for ensuring compliance.

On the legal side, conveyancing solicitors should be aware of the Act and consider how they will comply with the additional requirements that the Act places upon them. Particular attention will need to be paid to Part 2 requirements of lenders and the additional checks that solicitors will need to carry out. In amongst various obligations (all of which will doubtless make their way into the UK Finance Mortgage Lenders' Handbook) there are a host of new certificates that buildings falling within the ambit of the legislation will need to carry, so the job of the conveyancer will become even more tricky than it is now.

This is currently a very hot topic among insurers, so firms will need to demonstrate that they have taken the new Act on board in their risk management thinking if they are to persuade insurers that they are a good PII risk at renewal.

FIXED RECOVERABLE COSTS

The implementation date for the government's proposed changes to the Fixed Recoverable Costs ("FRC") is expected to be in October 2023. The government intends to extend FRC to all other civil cases in the Fast Track up to the value of £25,000, expand the Fast Track to include simpler 'intermediate' cases valued between £25,000–£100,000 in damages, introduce a new process and FRC for Noise Induced Hearing Loss claims; and introduce costs budgeting in "heavy" Judicial Review cases. There will also be four bands applicable to intermediate cases and FRC will be calculated in relation to which band the claim falls into. The intention is that those claims that have been allocated as intermediate cases will be subject to an expedited procedure. The government intends to implement an uplift of 35% of FRC where a Part 36 offer to settle is made by one side, but not beaten by the other at trial.

It seems likely that these latest changes will substantially affect the cases to which they apply, and lawyers' work on them, however it remains to be seen to what extent these reforms to FRC will affect claims concerning professionals and their insurers. The changes do not seem well suited to the complexities of many professional negligence claims and the significant reputational issues to which they frequently give rise. It may well be that many such claims are simply valued too highly to be included in the expanded Fast Track, with its limit of £100,000. The position may be less certain if there is a question over the "complexity" of the claim, especially because, in our experience, courts are keen to downplay complexity in claims in order to conserve judicial resources by moving cases out of the High Court where possible. In any event, these reforms to FRC seem unlikely to be the final word on costs in civil litigation. Once these changes have bedded in, we would not be surprised to see further proposals for costs reform from the government, which may well affect professionals and their insurers further.

> *...the insurance market's general wariness of the Building Safety Act will doubtless keep rates keen for those firms with a conveyancing practice*

CONCLUSION

The claims environment for legal professionals currently seems to be more benign than many (including this firm) predicted last year. The expected wave of recessionary claims has yet to materialise and the softening market looks likely to generate increased competition among insurers looking to enter this market at the right time in the cycle. Whilst that will be good news to many firms at renewal time, the insurance market's general wariness of the Building Safety Act will doubtless keep rates keen for those firms with a conveyancing practice, as that seems to be the issue of most concern going into the October renewals.

To discuss how any of these issues might affect you, please contact

Martin Jensen
Partner
+44 (0)20 7469 0505
m.jensen@beale-law.com

Joe Bryant
Partner
+44 (0)7786 679 602
j.bryant@beale-law.com

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ACCOUNTANTS AND AUDITORS

Last year was a significant year for the accounting and audit industry. An expert on UK local government financial accounting and capital financing said that 2022 was the year for ‘confronting chaos in audit and accounting’. The production of the draft Minimum Standard for Audit Committees, which was issued for consultation in November 2022, was one step taken to try and achieve this goal. Environmental, Social and Governance (ESG) was also a key focus in 2022 along with the Financial Reporting Council’s research into Modern Slavery Reporting Practices, the Corporate Reporting Review Team’s Thematic Review of TCFD disclosures and climate in financial statements, as well as the FRC Lab’s report on disclosing net zero commitments.

HOW IS 2023 LOOKING?

2023 continues to be another critical year for the industry. Pandemic-induced changes to working practices have resulted in a renewed push for reform of the overall profession. Ongoing economic uncertainty, driven by inflationary pressure also continues to put pressure on companies’ financial stability. Considerable increases in interest rates, along with a static economy, has led to growing fears that this year will see a further wave of corporate collapses as well as personal insolvencies. These concerns have been compounded by the cost-of-living crisis.

Pandemic-induced changes to working practices have resulted in a renewed push for reform of the overall profession.

Although recently settled, the alleged negligence claim for £1.3 billion from the Carillion creditors against KPMG has been a large focus of the industry for the past couple of years. The claim related to audits of Carillion’s accounts between 2014 and 2016. Carillion’s creditors alleged that KPMG were negligent when acting as auditors, claiming that Carillion had incurred significant losses, and paid out £210 million in dividends in reliance on its audits. Whilst the terms of the settlement remain confidential the nature of the claim highlights the risks faced by auditors.

KEY TRENDS

INCREASED INSOLVENCY

Latest government figures suggest that the number of companies registered insolvent in 2022 rose by 32% compared with 2021. Historically, economic downturns (e.g. the global financial crisis) have caused an increase in claims against the profession. Stakeholders often look for someone to criticise and blame for a company’s lack of financial stability, resulting in an increase in claims (whether well founded or speculative) against accountants and auditors. Audits are likely to become increasingly scrutinised where stakeholders spot previously identifiable concerns which would have minimised or prevented loss.

Indeed one of the first steps that an insolvency practitioner will take upon their appointment is to consider whether claims can be made against a company's professional advisors and we saw a notable increase in such claims in the period from 2008-2010. In addition, insolvency practitioners now have access to a significantly more mature litigation funding market and may find it easier to fund claims against professional advisors than was the case previously.

This rise in insolvencies has meant that insolvency practitioners have been exceptionally busy and are likely to get even more so. Insolvency professionals are often faced with challenging circumstances, frequently having to make swift decisions based on limited information and balancing the competing interests of stakeholders. There is always a potential risk that a mistake will be made which may ultimately lead to a claim. The sheer increase in insolvencies is likely to lead to a corresponding risk of an increase in claims against insolvency practitioners.

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History tells us that economic pressures lead to an increase in fraud – and often auditors are blamed for failing to detect such fraud. When a company is on the verge of insolvency its directors must have regard to the interests of creditors of the company, as well as those of the shareholders. This shift in mindset can often get directors into legal difficulty.

REGULATORY CHANGES

On the regulatory front, preparations for the Financial Reporting Council's (FRC) transition to the Audit Regulation and Governance Authority ("ARGA") will continue in 2023. The transition will give the regulator greater enforcement powers, along with a better ability to tackle audit reform. The transition looks set to take place later than originally planned, with the switch now not anticipated until April 2024.

The aim of the transition is to restore the public's trust in the way in which the UK's largest companies are run. ARGA's overarching objective will be to "*protect and promote the interests of investors, other users of corporate reporting and the wider public interest*." ARGA is also intended to have the power to set minimum enforceable standards for audit committees in relation to both the appointment and oversight of auditors.

In the meantime, the FRC is trying to push ahead with certain changes which it can implement with the powers it has. The goal of these changes is to try and ensure the auditing standards remain fit-for-purpose in light of changing work environments caused by COVID.

In addition, the FRC has announced new areas of supervisory focus for 2023. Particular attention is being paid to fraud risks, climate-related risks, and risk identification and assessment. In selecting corporate reports and audits for review, the FRC will prioritise sectors that are under particular pressure.

TECHNOLOGICAL ADVANCEMENTS

Accounting and audit practices have been changing over time as technology continues to develop and older ways of doing things are superseded. Increased use of technology is looking set to continue into 2023 and beyond with benefits for accountants, as this will eliminate the need for manual data entry, instead allowing for a focus on data analysis. It is, however, auditors who may arguably benefit most from increased use of automation technology, which will reduce the time spent on documentation location and retrieval and assist in verifying the accuracy of a transaction.

Increased use of automation technology may also help accountants improve service to their clients by providing more predictive analysis figures.

Too heavy a reliance on technology can, however, itself cause potential issues. After all, the reliability of the output depends on the quality of the input.

SUMMARY

It is always difficult to identify emerging trends, especially in the ever-evolving field of accounting and auditing. However, a volatile geopolitical and economic backdrop suggests that the next 12 months will be another critical period for the accountancy and audit regulatory industry. The ongoing difficulties faced by businesses are likely to lead to increased insolvencies and a knock-on effect in terms of claims against insolvency practitioners. Finally, ever developing and changing regulatory requirements will need, as ever, to be kept in the forefront of professionals' minds so as to minimise claims exposure.

To discuss how any of these issues might affect you, please contact

Joe Eizenberg
Partner
+44 (0)117 428 9303
j.eizenberg@beale-law.com

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INSURANCE BROKERS

Twelve months ago, we predicted a wave of claims against insurance brokers arising out of failed COVID-related business interruption (BI) claims. However, although we have seen a number of attempted claims over the past twelve months, the predicted wave has yet to materialise, perhaps because more insurers are being compelled to pay the underlying BI claims than was originally predicted. It also seems as if claimant lawyers have realised the significant evidential and causation hurdles which need to be overcome to pursue a broker successfully in relation to COVID losses, so hopefully this issue can now be largely confined to the past.

In fact, the past year has seen relatively benign claims conditions for insurance brokers, with fewer, bigger claims replacing the attritional losses that were the hallmark of the soft market.

> *...the past year has seen relatively benign claims conditions for insurance brokers, with fewer, bigger claims replacing the attritional losses that were the hallmark of the soft market.*

MARKET VOLATILITY

However, the hard market does present risks for the future. With insurers being far more discerning in their risk selection, it is not just premia that are changing rapidly across the board. Capacity in the market has ebbed and flowed massively over the past few years, with much less stability in terms of active carriers than might have been the case five years ago or more. Those insurers that are willing to quote may often restrict the scope or value of their cover on a case by case basis, with others refusing to quote at all if they perceive anything more than a minimal claims risk.

We have seen more changes to market wordings in the past few years than in the previous twenty. In such a rapidly evolving market, it is hard for the broking profession to keep up. We are starting to see claims arising from a broker's alleged failure to advise its client on the limitations in cover that had been imposed by the renewing insurer, and others relating to the broker's failure to inform its client of the existence of alternative markets that might have generated more competitive quotes. Other claimants have alleged inadequate presentation of premium cost and commissions earned. The trend is clear; in times when we are still largely working from home and where 'over the shoulder' supervision is still the exception rather than the norm, a lack of thorough analysis coupled with ineffective communication will continue to be a cause of complaints and claims. Technical understanding, transparency and clarity in both internal and external communications will help to prevent situations escalating, and brokers with effective training regimes will be able to prevent these often low level 'gripes' turning into something more serious.

CLAIMS INFLATION

Another trend which we are starting to see arises from the ongoing cost of living crisis in the UK and inflationary pressures globally. Alongside economic factors (e.g. costs of goods and services), extraneous factors such as the prevalence of environmental disasters and fraud are also having a material impact on the rising cost of resolving insurance claims. This phase of rapid

claims inflation risks policyholders being underinsured in the event of their needing to call on their cover, and brokers will always find themselves in the firing line if the client ends up receiving less than they were expecting. The RICS recommends that assets are valued for insurance purposes every three years; in the current climate we would suggest this may not be often enough, and we would instead recommend that brokers remind their clients of the need to obtain an up to date asset valuation on each renewal for so long as the current inflationary conditions prevail.

We also recommend that brokers review their stock wording in their quotes reminding clients that costs are increasing significantly and to check their cover meticulously to ensure that it is sufficient for their needs. Something that points specifically to the current period of inflation might be viewed more sympathetically by a court than whatever generic wording might have appeared in quotes over the past twenty years. Ultimately, whilst it is not the broker's duty to advise upon the correct level of cover for every client, a failure to advise the client to keep their asset valuations up to date (or to point out anything that might be glaringly in need of an update) will open them up to undoubted criticism. As always, we recommend that brokers document the advice that is given.

BROKER CONSOLIDATION AND ENHANCED SERVICES

Moving on, the last 12 months have seen a continued frenzy of activity on the M&A front, with broker consolidation continuing to appeal to those who see it as a way to increase market share or open up new distribution channels. Integrating two or more organisations is fraught with risk, both from a cultural and a systems perspective; there will always be scope for employee dissatisfaction and wellbeing issues, and systems conflicts can open up paths for cyber criminals to exploit. Very careful management is needed to bring organisations together in a way which minimises these risks and also mitigates the potential for conflicts arising.

Broker mergers are also a way into offering new and innovative services in an attempt to retain and attract clients in an increasingly competitive space. We are starting to see an explosion in such services, ranging from 'risk management' services (which have been offered for some time by most but which now encompass not only insurance risk but also HSE assessments, fire safety assessments and finance audits), through to legal advice hotlines, risk analytics advice and employee wellbeing consultancy. These services are great additions to the 'traditional' broking model, but care needs to be exercised in ensuring that the advice being given doesn't go too far. Advice on employee benefits could easily stray into the realms of requiring FCA authorisation, as could some advice proffered under a legal advice hotline. Brokers would be wise to check that their own E&O cover will extend to the advice given under these new services; one can only imagine the embarrassment of a broker having a PII claim declined in these circumstances.

REGULATORY

Finally, no update would be complete without mentioning the regulatory burden to which insurance brokers are subjected. This has grown again in recent months, with the introduction of the FCA's new Product Governance rules. These are aimed at regulating the potential abuse of 'loyal' customers who renew year on year and may miss out on the 'incentives' that are offered to tempt new customers. However, the rules require brokers and insurers to submit information about the profits and commissions they are earning across many sectors, which is bound to be scrutinised by the FCA in an attempt to regulate the peaks and troughs of the market cycle and keep prices keen. The rules also reiterate the need for insurance professionals to be entirely clear and transparent in their communications with consumers, which is an apt place to finish this update; while so much continues to evolve in this market, the essence of the claims risk remains the same.

To discuss how any of these issues might affect you, please contact

Joe Bryant
Partner
+44 (0)7786 679 602
j.bryant@beale-law.com

DIRECTORS AND OFFICERS

In last year's insurance trends report we commented that the predicted wave of insolvencies in 2021 had been much milder than was anticipated, although continuing economic uncertainty (exacerbated by the phasing out of COVID-19 support and the invasion of Ukraine by Russia) meant there was no guarantee of the continuation of that trend in 2022. Little did we know then about the full range of factors that were to buffet the economy for the rest of 2022 and into 2023. Concerns that financial difficulties and insolvencies faced by companies would lead to an increase in the number and size of claims against directors, have only increased.

Claims inflation (particularly relating to legal costs) is a significant driver of the increased severity of claims. In the US (which often foreshadows developments around the world) insurers are now seeing claimant and defendant lawyers charging rates of USD$2,000 per hour which clearly puts additional pressure on the limits of indemnity available, and the pricing of excess layers. These factors combine with a trend towards a greater inclination to hold directors personally responsible for a wide range of different factors and risks. In addition, a number of high-profile and sometimes novel claims will likely serve to encourage others to follow.

INSOLVENCIES LIKELY TO INCREASE

Insolvencies in the UK continue to increase. In Q1 of 2023 there were 5,747 company insolvencies in England and Wales (an increase of 18% on the same period in 2022). The figure in March 2023 (the last time the figures were published) was up 32% on February and up 11% on March 2022. The trend is clear, and it is anticipated that increased interest rates and high inflation will only accelerate the direction of travel. With increasing numbers of insolvencies comes an inevitably greater risk of claims against directors, as creditors and shareholders alike closely scrutinise what has gone wrong. The Insolvency Service will continue to use their new powers to investigate dissolved companies, including in relation to any COVID-19 financial support received.

To add to this concerning economic picture is the decision of the Supreme Court in *BTI 2014 LLC v Sequana [2022]*, a decision described by Lady Arden (one of the judges who heard the case) as "*momentous*". On the positive side for directors, the Supreme Court rejected the claimant's case that directors owed a duty to take into account the interests of a company's creditors when a company merely faced a "*real risk*" of insolvency. Further, the 'creditor duty' is not a duty owed to creditors but part of a director's duties owed to the company.

The Insolvency Service will continue to use their new powers to investigate dissolved companies, including in relation to any COVID-19 financial support received.

Although this was a seminal case the various judgments of the Supreme Court left open at least as many questions as were answered. Directors will be under a duty to take into account creditors' interests from the point at which the company is insolvent or bordering on

insolvency, or where administration or liquidation is probable. However, once the duty has arisen it will be for directors to weigh the interests of creditors and shareholders in the balance, with limited guidance from the Supreme Court as to how that exercise should be conducted in practice. In addition, creditors' interests will only entirely supersede the interests of the shareholders at the point when administration or liquidation becomes inevitable, albeit this was not something the Supreme Court was required to resolve on this occasion.

It is inevitable that this case will lead to further claims testing the boundaries of the 'creditor duty', which remain highly uncertain in theory as well as in practice.

UNDERWRITERS BRACED FOR ESG-RELATED CLAIMS

Businesses will have to continue to place an emphasis on environmental, social, and governance (ESG) issues as they seek to align themselves with the expectations of society (and regulators) as well as capitalise on commercial opportunities arising from the increasing relevance of ESG factors to commercial decisions such as investments. Section 172 of the Companies Act 2006 has long required directors to consider environmental factors, and the long-term health of a company, in executing their duties to act in the best interests of shareholders.

What is changing is highlighted by the high-profile climate litigation by ClientEarth against directors of Shell (in which ClientEarth holds a minority shareholding of only 27 shares) for allegedly prioritising short-term profits whilst failing to ensure Shell was equipped to deal with the pledges made in the Paris Agreement to move away from reliance on fossil fuels. The novelty of the litigation (which, if the Court gives permission for the claim to proceed, will become the first action of its kind in Europe) arises not merely from the fact that the claimant is a non-governmental organisation with shares, but because it seeks declarations of breach, and orders that the directors adopt a different approach, as well as compensation.

As a shareholder derivative action, the claim faces the very substantial hurdle of first obtaining permission to proceed with the claim. This was demonstrated by the fact that Mr Justice Trower dismissed the action in the first place on the basis that the allegations were vague and against principles which require directors to determine the weight to attach to factors they consider, and amounted to an "unnecessary and inappropriate elaboration of the statutory duty of care." The Judge also made comments in relation to the small value of

Businesses will have to continue to place an emphasis on environmental, social, and governance (ESG) issues as they seek to align themselves with the expectations of society

ClientEarth's shareholding and there was a clear inference that ClientEarth's "real interest is not in how best to promote the success of Shell for the benefit of its members as a whole" (as required by section 172 of the Companies Act 2006). This was despite ClientEarth having obtained the support of various other substantial Shell shareholders including UK pension funds.

On 24 July the High Court confirmed its earlier decision preventing ClientEarth continuing its derivative action. ClientEarth has indicated its intention to appeal that decision with senior lawyer, Paul Benson, stating: *"we are disappointed that the Judge has declined to reconsider his decision. The hearing was the first step towards appeal, which we will now pursue. The Court has accepted that climate change poses significant and foreseeable risks to Shell. We firmly stand behind our claim that the Board is currently neglecting to address those risks adequately, to the detriment of its shareholders."*

Regardless of the claim's merits and whether it is permitted to proceed or not, the intense focus on Shell's activities could, in any event, prompt some of the changes sought by means of litigation.

It will be interesting to see if other organisations seek to adopt similar tactics to those of ClientEarth in the coming year. Certainly underwriters are braced for a substantial increase in ESG-related claims as well as potential enforcement action by regulators such as the FCA which is currently heavily focused on ESG matters in a number of different sectors (as reflected elsewhere in this report).

Whilst the "E" in ESG typically takes centre-stage in any analysis of this area, we believe that the most pervasive risks lie in the "S", which covers issues such as diversity and inclusion, social value and harassment (amongst others).

There remain claims against Directors and Officers arising from the #MeToo movement in the US, and US and UK regulators are increasingly looking to companies' disclosures relating to their diversity and inclusion policies. Shareholders at Wells Fargo recently filed a class action against members of the board for allegedly failing to deal properly with diversity, equality and inclusivity problems, alleging that various scandals at Wells Fargo have harmed the bank's reputation and had an impact on its profits. We consider it likely that there will be a rise in these types of actions brought against boards either by activist shareholders or employees for failure to carry out diverse and inclusive practices.

There are also claims emerging in relation to 'pink washing' or 'rainbow washing', where businesses merely purport to promote LGBTQ+ equality. We have already seen actions brought in Australia and Israel on these grounds and it seems only a matter of time before such claims are advanced in the UK.

...we believe that the most pervasive risks lie in issues such as diversity and inclusion, social value and harassment (amongst others).

HIGH-PROFILE LITIGATION

The *ClientEarth v Shell* litigation is far from the only well-publicised claim of concern to directors and their insurers. The collapse of the Chinese real estate giant Evergrande, the distribution and receipt of the $1.9tn COVID-19 relief package, the Facebook data privacy scandal and the two Boeing 737 MAX crashes have all prompted high-profile claims against directors and officers of the relevant entities. More recently, claims have been filed against directors following the collapse of Silicon Valley Bank in March 2023 and the failure shortly thereafter of Credit Suisse after a series of recent scandals. These draw attention to the possibility of pursuing such claims and there are increasing numbers of commercial firms seeking to take advantage of opportunities that inevitably arise following such major events.

CONCERNS OVER POTENTIAL RISKS OF AI

Artificial intelligence (AI) and machine learning (ML) are rapidly developing technologies that are having a major impact on businesses of all types and sizes. The ongoing deluge of publicity relating to the current and potential capability of software such as ChatGPT has only served to highlight the almost limitless potential uses of AI, particularly as the software becomes increasingly sophisticated. However, there are concerns over the risks of using AI and whilst its adoption continues apace directors will need to keep themselves fully informed as to the ever-changing nature of the risks and what steps can and should be taken to minimise and mitigate against them.

The importance of cybersecurity and data protection continues to grow, with currently major potential for losses resulting from human error, or the involvement of 'bad actors'. Times of economic volatility, rapid technological progress and geopolitical instability are all known to create conditions in which cyber attacks and data thefts will grow, so combine them all together and there have perhaps rarely been more fertile conditions for those seeking to take advantage of any weaknesses in companies' cyber security and data protection systems. To these factors must be added the increasing normalisation of remote and hybrid working.

These are also areas where high-profile losses can be potentially ruinous. T-Mobile has estimated that a recent data breach may have exposed 37 million accounts and JD Sports has been hit by cyberattacks which leaked 10 million customers' data. A major ransomware cyber-attack on the Guardian media firm in December 2020 resulted in the theft of sensitive staff personal data and impacted parts of the firm's operations for several weeks.

Directors will need to take appropriate steps to ensure their companies are adequately protected in respect of these risks.

CHANGES TO THE BSA TO INCREASE INSURERS' COSTS?

As is covered in detail in other sections of this report, the Building Safety Act ("BSA") received Royal Assent on 28 April 2022 and is due to be fully in force in October 2023. The BSA places a number of new responsibilities on building owners, seeking to ensure that higher-risk buildings are safe. Section 161 of the Act extends responsibilities to individuals at director and management level for breach of certain obligations within the Act itself, and section 40 creates similar personal liability for certain breaches of the Building Act 1984. These provisions have potentially far-reaching consequences for directors, who may face fines or even imprisonment if found guilty.

It also increases risk for insurers who might face additional claims relating to fire safety outside the scope of those previously seen. D&O policies will invariably cover investigation costs for criminal prosecutions and therefore the extended scope of the BSA is likely to increase insurers' costs as a result.

D&O INSURANCE MARKET EXPECTED TO GROW

Amidst the global instability and an increased risk exposure, the global D&O insurance market was worth an estimated $100 billion in 2022 and is predicted to continue to grow further in light of the prevailing economic winds in 2023 and the consequently increased risks of claims against directors and officers. After a severe hardening of the D&O market from 2019 to 2022, outside investment into the market (including from lower cost bases such as Bermuda) and a number of new entrants into the market, particularly from specialist Managing General Agents ("MGAs") is causing the market to soften significantly, just as there is an increase in frequency and severity of claims for insurers to contend with.

As ever, the key to avoiding such claims (and successfully defending any claims that arise) is for directors to stay fully informed and to actively seek expert financial, legal and technical advice whenever appropriate.

To discuss how any of these issues might affect you, please contact

Ross Baker
Partner
+44 (0)20 7469 0509
r.baker@beale-law.com

Nathan Penny-Larter
Partner
+44 (0)20 7469 0498
n.penny-larter@beale-law.com

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EDUCATION

The Office of the Independent Adjudicator for Higher Education has issued guidance on a number of issues ranging from how universities should deal with staff to student sexual misconduct. In 2022 after that guidance was released, Beale & Co predicted an increase in claims arising from alleged mishandling of investigations into sexual misconduct and failure to follow this guidance. While the guidance was a positive move, many universities have been slow to respond and the handling of these complaints still remains a hot topic at the close of the 2022/23 academic year.

The 2022/23 academic year also saw the publication of HHJ Ralton's decision in the tragic case of *Abrahart v University of Bristol*. In that case, the University of Bristol was ordered to pay damages to the parents of a vulnerable student after it was found that the university had failed to make allowances for the student's significant anxiety, which led to her death by suicide.

Following this decision, in November 2022, twenty-five bereaved families brought a petition before parliament demanding a statutory duty of care for students in higher education. The government responded to this application in January 2023 commenting *"Higher Education providers do have a general duty of care to deliver educational and pastoral services to the standard of an ordinarily competent institution and, in carrying out these services, they are expected to act reasonably to protect the health, safety and welfare of their students. This can be summed up as providers owing a duty of care to not cause harm to their students through the university's own actions."* However, this response has been deemed by most commentators to be inadequate. The Father of Natasha Abrahart, Robert Abrahart, is reported to have commented *"If the government agrees with us that students deserve the protection of a legal duty of care then it should introduce a bill in parliament rather than making bland statements."*

Looking ahead into the 2023/24 academic year, it appears likely that more pressure will be placed on the government to introduce a statutory duty. With a topic this important, it is difficult to see how it can continue to be brushed under the carpet. Obviously, if such a statutory duty is introduced it will become far easier for students, or bereaved family members, to seek recourse through the courts where significant injury or death has arisen as result of a failure to comply.

> *...in the Q2 2022/23 academic year, SEND (Special Education Needs and Disability) Tribunals reached a notable new high of 5,600 cases*

Elsewhere, statistics released by the website Gov.UK, show that in Q2 of the 2022/23 academic year, SEND (Special Education Needs and Disability) Tribunals reached a notable new high of 5,600 cases. It was thought that the report released in March 2022 by the Local Government Agency which concluded that the 2015 SEND reforms had failed to prevent huge rises in legal disputes and tribunal hearings, may have encouraged the government to make significant changes to the SEND systems. However, it remains to be seen whether the government will institute any reforms to the SEND Tribunal in order to try and reduce the increase in claims or whether such action risks being seen as potentially penalising SEND students.

CLAIMS TRENDS

RISE IN MENTAL HEALTH CLAIMS

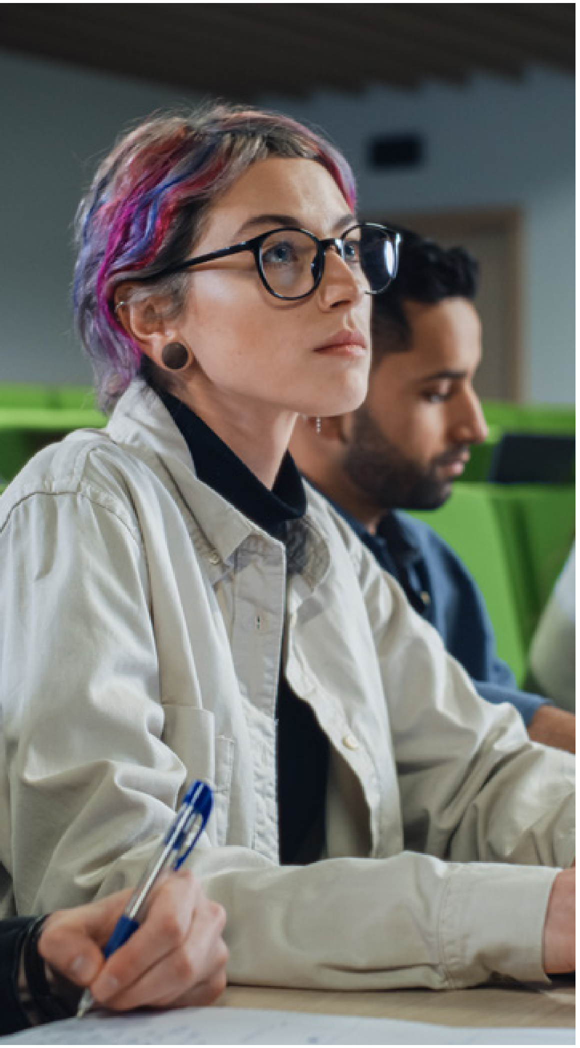
Following the decision in *Abrahart v University of Bristol* ("Abrahart"), it is anticipated that universities will see a rising number of claims relating to alleged failures to ensure the safety and wellbeing of its students. Both the Abrahart and also *Raquel Rosario Sanchez v University of Bristol* cases, found that there was no statute or precedent which establishes the existence of a duty of care owed by a university to a student. As such, currently cases relying solely on an alleged breach of a perceived duty are far more difficult to pursue. Whilst the case of Abrahart was successful, this was only on the grounds that the University of Bristol had failed to make sufficient allowances for the student's anxiety (which was found to be a disability) and, as such, the disability discrimination claim pursued under the Equality Act succeeded.

...universities have to remain alert to the duties owed to students pursuant to the Equality Act.

As already discussed, there has been recent lobbying for a new statutory duty to be imposed on universities. The government appears to be reluctant to do this, perhaps because it considers it would open the floodgates to claims. Nevertheless, what the case of Abrahart does show is that universities have to remain alert to the duties owed to students pursuant to the Equality Act.

IMPACT OF COVID AND STRIKE ACTION ON TEACHING

Three years on from the pandemic, claims continue to be pursued for inadequate teaching. The rise in claims of this nature is fuelled by class actions such as "Student Claim Group" which is pursuing 'breach of contract' claims alleging that universities failed to provide adequate teaching and support throughout the pandemic, and in turn are seeking compensation/the refunding of tuition fees. The argument most commonly deployed is questioning how universities could charge the same (£9,250) for online learning, when there are seemingly many reduced costs. However, it is unlikely that PI policies would respond to claims of this nature



(where usually a refund in tuition fees is sought as compensation).

This firm has also seen claims pursued against Independent Schools as a consequence of alleged failures to provide sufficient support, or adequate remote learning.

2022/2023 has also seen extensive strike action by railway workers, nurses, doctors and also teaching staff. The increase in the use of strikes by the University and College Union throughout 2023 has the potential to lead to an increase in compensation claims made against universities. Huge disruption has been caused to teaching due to the spread-out nature of the dates. This has been supplemented by 'marking strikes' which have just been announced and which could delay students obtaining their grades and being able to seek or enter into relevant employment. We could well see claims being pursued which seek alleged loss of earnings as a result of any delays to grades being handed down.

INTELLECTUAL PROPERTY AND STUDENTS AS CONSUMERS

The Patents Court confirmed in *Oxford University Innovation Ltd v Oxford Nanoimaging Ltd [2022]* that undergraduate and postgraduate students normally constitute consumers, allowing them the protections outlined in consumer legislation including the Unfair Terms in Consumer Contracts Regulations 1999. In this case, the judge considered the university's IP policy and deemed it to be fair and in good faith. The defendant, a university spin-out was therefore ordered to pay the claimant £700,000 in unpaid patent royalties for a super-resolution imaging device developed whilst the defendant's director was a student at the university. This case is the first in the UK courts to test whether undergraduate students constitute 'consumers'. This is a key question in student IP cases because having 'consumer' status affords individuals various consumer protections. The judge's affirmation may lead to further disputes between universities and student inventors, so it would be sensible for universities to review their IP policies, to ensure they would not be considered unfair under the case law tests discussed in this judgment.

SEND CLAIMS TO RISE

As mentioned earlier, claims brought in the SEND Tribunal continue to increase. The rise has been driven mainly as a result of alleged failures by schools to secure an Education Health Care ("EHC") assessment. Many of the tribunal claims brought against independent schools, which this firm has seen, arise out of alleged failures by the school to recognise a child has additional needs, to assist the parents in obtaining an EHC plan and/or to make reasonable adjustments in accordance with an EHC plan.

Although independent schools are not legally obliged to identify a special education need in the same way as local authority/state schools are*, independent schools must still comply with their statutory obligations under the Equality Act 2010. As such, independent schools have statutory duties to avoid disability discrimination and make reasonable adjustments. Where such duties are not complied with, schools are likely to face disability discrimination claims.

To discuss how any of these issues might affect you, please contact

Nathan Penny-Larter
Partner
+44 (0)20 7469 0498
n.penny-larter@beale-law.com

* Pursuant to the Children and Families Act 2014 and the Special Educational Needs and Disability Code of Practice 2015.

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ENVIRONMENTAL

Concerns about the environment have certainly risen to the fore in recent years. Since Brexit, the UK has implemented various measures to ensure that the existing environmental law remains in force, albeit at present environmental legislation remains a combination of domestic law, EU law and international law. The government has sought to set its own environmental goals and targets over the last few years, such as a commitment to ensuring that the UK reduces greenhouse gas emissions by 100% or 1990 levels by 2050. It is hoped that the broader environmental goals will be achieved through legislation and focusing on four primary targets of air quality, biodiversity, waste management and water quality.

During the last 12 months we have seen three primary trends. Firstly, climate change litigation. Climate change litigation has more than doubled globally in the past seven years, according to a report by London School of Economics and this increase is likely to continue, and the complexity of such litigation is also likely to increase. However, while the focus has previously been on oil and related type companies, the focus is now expanding to other sectors such as financial, agriculture, transport and construction. The increase in global litigation mirrors the increase of litigation in the English courts, with recent cases such as *Okpabi v Royal Dutch Shell Plc and Shell Petroleum Development Company of Nigeria* also illustrating that claims may be pursued in the UK in respect of foreign subsidiaries.

...while the focus has previously been on oil and related type companies, the focus is now expanding to other sectors such as financial, agriculture, transport and construction.

There has been an increase in environmental groups and other interested parties using the courts to hold governments and businesses accountable for their contribution towards climate change.

The trends in respect of climate and environmental litigation include an emerging focus on the commercial sector and the consideration of claims in relation to environmental, social and governance (ESG) issues. The clamour to address the effects of climate change is likely to increase as more and more cases both on a national and international level reach the courts and the recent number of important and often landmark decisions are set to continue, with the overriding perspective being that of seeking ways to compensate individuals suffering the effects of climate change and promoting change in behaviours to reduce climate change.

We have seen increased litigation to hold the government to account. The highlight being the ClientEarth/Friends of the Earth judicial review proceedings against the government in connection with its decarbonisation policies. The claimants pursued a claim that the government was in breach of the Climate Change Act and the Equality Act. In a seminal ruling the High Court found that the net zero strategy does not meet the government's obligations under

the Climate Change Act. As a result of the court ruling, the government issued a series of packages on the 30 March 2023, dubbed "green day" which are intended to tackle UK emissions and put in place a "carbon budget" delivery plan.

With regard to enforcement, a more proactive approach is being taken by regulators to ensure compliance with environmental regulations. Penalties are becoming harsher, with increased powers being granted to the Environment Agency along with enforcement by the new Office for Environmental Protection addressing breaches in environmental law. An additional trend has been the focus on what is known as the 'Circle Economy' with government and businesses looking for ways to promote sustainable production (as well as consumption) and to reduce waste generally.

THE FUTURE

The government has proposed a regime of environmental outcome reports to replace the current system of environmental impact assessments. These provisions are contained in the government's Levelling Up and Regeneration Bill. The intention is that it will work in tandem with regulations and government guidance which have yet to be published. It may be that we have to wait until 2024 to see the new Regulations for EOR to be enforced, alongside a transition period which is expected to be between six months to two years.

Recent trends in Environmental Agency (EA) prosecutions have brought to the fore (once more) concerns about the extent of water pollution in the UK.

Recent trends in Environmental Agency (EA) prosecutions have brought to the fore (once more) concerns about the extent of water pollution in the UK. We have previously referenced the record fine of £90 million being handed down to Southern Water in July 2021. Perhaps surprisingly though this has to be set against the stark fact that the number of Environmental Agency prosecutions in 2022 were significantly reduced, irrespective of the effects of the COVID pandemic.

However new penalties are set to be enforced, with existing penalties being harsher. Particular focus has been shone on variable monetary penalties. These can be imposed by the Environment Agency rather than the courts. At present the limit on such penalties is £250,000, but the Environment Secretary in October 2022 announced proposals to increase the limit to £250 million per individual breach. The driving force behind this announcement was the public debate around the accountability of the water companies for breaches of environmental legislation.

The knock-on effect of this increase in statutory powers could see significant prosecutions by the EA without the requirement of pursuing the Court process. In addition to monetary penalties, the EA has also said that it is set to increase its focus on enforcement undertakings by allowing an offender to propose a voluntary offer to the EA to make amends for pollution by putting the effects of its offence right, by easing the impact on third parties. The EA has confirmed that it will accept enforcement undertakings in more cases, although it will continue to prosecute in appropriate cases.

The consultation for variable monetary penalties to increase the limit from £250,000 to £250 million closed on 15 May and if this proposal is accepted, there is likely to be a significant increase in prosecutions brought in respect of environmental breaches. Additionally, the change in the prosecution process will have important implications for environmental claims and the insurance response.

The drive towards sustainability has also increased the focus on "greenwashing" (misleading environmental claims by organizations intended to promote an environmental impact that doesn't exist). For example, in October 2022 the Financial Conduct Authority (FCA) proposed a new set of measures in order to reduce greenwashing in respect of products that make sustainability claims. The proposed rules represent a clear message from the FCA that sustainability advertising and statements will be subject to closer scrutiny and that those companies engaging in greenwashing will face increasingly severe penalties. This may well develop into a fertile breeding ground for claims.

NEW HORIZONS

There has been an increase in investor review of climate and ESG issues and this is likely to result in investor-led claims for damages in relation to listed companies. The mandatory reporting requirements for large businesses to disclose their climate-related risks and opportunities will mean that claimants will be able to conduct a more rigorous analysis of how these companies are performing, and also be able to quantify the loss experienced by carbon related failures by these companies.

NUISANCE

Nuisance has always been an area of concern for environmental claims and we have recently seen a leading decision concerning the Neo Bankside which sits adjacent to the Tate Modern building in London. Complaints concerned the use of viewing platforms by visitors to the Tate and the extent to which they constituted a nuisance to the homeowners. At first instance the claimants were not successful with any of their complaints in respect of the Tate causing a nuisance. However, they were given permission to appeal to the Court of Appeal in respect of their common law nuisance claims. They were unsuccessful in the Court of Appeal, but the matter was then referred to the Supreme Court in 2021 with judgment being issued in February of this year. The Supreme Court found in favour of the claimants, and it was held that the judge had applied the wrong test to the use of the viewing platform. The correct test was not whether or not the use was unreasonable but in fact whether or not it was common and ordinary.

The case contains an interesting overview of nuisance generally, and is of interest to developers and property owners, as in simple terms, it confirms that flats in the middle of London can now object to being overlooked by the general public, which of course poses a potential threat to urban land use and developments. Interestingly, the case also reviews the common principles of nuisance which refer to there being no liability if the defendant is doing no more than making common and ordinary use of land in the context of the character or locality of the area. This case suggests that arguments raised based on public benefit will not defeat such a claim but may justify a different remedy for such damages, which will be of interest to insurers of companies that are pursued by large numbers of complainants in group litigation claims.

CLIENTEARTH'S CLAIM AGAINST SHELL'S DIRECTORS

Shell had previously announced in its 2020 energy transition strategy its aim to become a net zero emissions energy business by 2050 and in 2021 announced a target to reduce absolute emissions by 50% by 2030. Despite these targets and strategies, ClientEarth alleges that Shell's actions have been insufficient, and the claim alleges that Shell's directors have breached legal duties under the Companies Act 2006. The detail of this matter is covered in the D&O trends section, but if this claim is successful (notwithstanding the fact it still has significant hurdles to overcome), as mentioned earlier, derivative litigation is set to become an important tool for shareholders seeking to deter directors from failing to manage climate risk properly. This, of course, also poses a risk to insurers.

> *For many years we have seen commentary about the dawn of environmental insurance and now it looks as if "morning has broken"*

Along with cyber, it may be fair to say that environmental insurance offers one of the best areas for growth and it is increasingly evident that it will impact on other areas such as D&O, product liability, and construction. For many years we have seen commentary about the dawn of environmental insurance and now it looks as if "morning has broken" and the environmental market is set for significant growth.

To discuss how any of these issues might affect you, please contact

Michael Salau
Partner
+44 (0)20 7469 0448
m.salau@beale-law.com

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INDEPENDENT FINANCIAL ADVISERS

In the 2022 Insurance Trends report, we identified that the main risk to UK IFAs at that time was from the ongoing investigation by the Financial Conduct Authority ("FCA") into the restructuring of the British Steel Pension Scheme ("BSPS"), in the course of which many IFAs advised clients to transfer out of their defined benefit schemes and into personal pensions. There have been significant developments in relation to the BSPS over the past year and that will remain a key focus in relation to risks to IFAs for at least the foreseeable future. Indeed, the FCA has had a busy year and various projects that are ongoing or in the pipeline will have ramifications for IFAs and their insurers over the next twelve months. Unsurprisingly FCA initiatives dominate this year's report.

There have been significant developments in relation to the BSPS over the past year and that will remain a key focus in relation to risks to IFAs for at least the foreseeable future.

BRITISH STEEL PENSION SCHEME

On 28 November 2022, following a consultation, the FCA set out the final rules of an opt-out consumer redress scheme (the "Scheme") aimed at compensating those who relied on inappropriate advice to transfer out of the BSPS. The Scheme applies to individuals who were given advice to transfer out of the BSPS between 26 May 2016 (when the DWP launched a consultation on the BSPS) and 29 March 2018 (when the BSPS was closed to transfers). The timing of the Scheme's introduction reflects the FCA's concern about some claims already having become time-barred and a risk of vast numbers of further potential claims suffering the same fate (it is thought that to date only 10% of BSPS members who were advised to transfer-out have in fact pursued claims) and upon its implementation the Scheme operates to 'stop the clock' on the applicable limitation periods.

The Scheme involves a tight timetable, commencing with firms being required by 28 March 2023 to identify those clients who were advised to transfer out of BSPS during the relevant period, before having until 28 September 2023 to review the suitability of the advice given. In instances where firms conclude that advice to transfer was not suitable, they are required to calculate the appropriate redress using a calculator developed by the FCA. Cash lump sum offers are required to be made by 28 December 2023, or alternatively offers to make payments into pensions must be made by 28 February 2024. Firms are also required to provide frequent progress reports in relation to the Scheme to the FCA, and to their clients.

The FCA originally estimated that around 1,100 consumers who received advice in the relevant period will receive £49 million in total, so an average payment per claimant of around £45,000. Of the total sum, firms and their insurers are expected to pay £33.6 million with the remainder being paid by the Financial Services Compensation Scheme in respect of firms who are no longer trading (the FCA further estimates that

90% of firms in the Scheme – and trading at its outset – will be able to complete the Scheme without becoming insolvent). Accompanying the Scheme's announcement late last year, the FCA issued a 'Dear CEO' letter on 28 November 2022 setting out its expectations of PII providers, including being able to provide firms with a prompt 'indication of cover' in respect of potential in-scope claims so as to enable firms to assess their financial resources to meet claims, and providing a summary of reasons where claims are not expected to be covered.

However, in last year's report, we observed that many policies exclude claims arising in relation to defined benefit transfers – or often apply low aggregate limits and substantial excesses. The FCA has since consulted with those insurers active in the PII market for defined benefit transfers and similarly concluded that Scheme claims could now in fact be widely excluded from cover, noting also that policy excesses are typically £25,000 per claim: more than half of the FCA's predicted average claim value under the Scheme. Even where policies do not expressly exclude claims under the Scheme, there will doubtless be a plethora of coverage disputes during the summer months on issues such as scope of notification and

aggregation. In these circumstances, the Scheme may result in more advisory firms going under than the FCA had originally forecast.

It also remains to be seen the extent to which consumers will be prepared to accept the conclusions of the very firms they are seeking to hold to account. Where firms have marked their own advice as correct under the Scheme, consumers will be entitled to request that the Financial Ombudsman Service ("FOS") assess a firm's application of the Scheme rules. One can foresee that the FOS may well be inundated.

CONSUMER DUTY

Away from British Steel but staying with the influence of the FCA, the new Consumer Duty ('the Duty') must be implemented by firms for new and existing products or services by 31 July 2023 (for closed products or services the deadline is 31 July 2024).

The Duty represents what the FCA has termed a "paradigm shift" in its expectations of firms, aimed at enabling consumers to make informed, effective decisions, to act in their interests and pursue their financial objectives in an increasingly complex environment and testing economic climate. Directed towards preventing financial services firms from causing harm "including presenting information in a way that exploits consumers' behavioural biases, selling products or services that are not fit for purpose, or providing poor customer support" the Duty is underpinned by the new Consumer Principle, under which firms will be required to act to deliver good outcomes for retail customers, and three overarching rules: to act in good faith, to avoid foreseeable harm and to enable and support retail customers to pursue their financial objectives.

There is concern about the readiness of firms to comply with the Duty by the implementation deadline, and a lack of certainty as to what firms need to do to comply; the shift in focus onto outcomes means that the way in which those outcomes are to be achieved is not prescribed, and there is inherent uncertainty about the way in which the new standards will be assessed, not least by the FOS which already tends to be consumer-friendly.

On the positive side perhaps, the FCA decided not to introduce a private right of action for any breach of the Duty, although this may be only a temporary stay of execution, as the FCA considered that firms should not be burdened with implementing the Duty whilst at the same time having the immediate threat hanging over them of direct claims by consumers. Nevertheless, the FCA will closely review and monitor the implementation of the Duty and its effects, with the potential for a private right of action to be introduced at some point in the future. The FCA's approach tends to suggest that it would otherwise expect the introduction of the Duty to give rise to claims, and the delay in implementing any private right of action should help firms to mitigate against the potential for such claims.

As part of its strategy to improve outcomes for consumers, in December the FCA introduced additional rules to ensure that principal firms are adequately overseeing the conduct of their appointed representatives (ARs). This follows research indicating that principals and ARs account for more than 60% of the total value of recent claims to the Financial Services Compensation Scheme ("FSCS") and the rules should reduce instances of mis-selling.

ACCESSIBILITY OF FINANCIAL ADVICE

At the same time as implementing the new Consumer Duty, the FCA is currently seeking to improve access to financial advice at proportionate cost for large numbers of individuals who may be damaging their financial position by not investing cash reserves and allowing soaring inflation to diminish the value of savings (this follows its recent Financial Lives survey finding that 4.2 million people in the UK hold more than £10,000 in cash and are open to investing some of it). Proposals include limiting the possible investments that advisers can recommend to this cohort of clients, i.e. to a set of mainstream investments within stocks and shares ISAs and excluding high-risk products, as well as reducing the qualification requirements for firms to provide this advice, to reflect the correspondingly reduced complexity and risk.

RETIREMENT STRATEGIES

In addition, the FCA is now also carrying out a thematic review on the advice consumers are receiving in relation to retirement strategies. This follows the introduction of new pension freedoms in 2015, with concerns having already been expressed in some reports that clients' freedom has resulted in customers drawing down too much and too early (whether in accordance with advice or otherwise) such that their funds for the future will not be sufficient. The equity release market is another present focus of the FCA, with the FCA business plan published on 7 April 2022 stating that it intends to consider the market again to ensure that it is working in the best interests of consumers. This followed a 2020 review that found shortcomings in the advice being given, in particular noting failures to take individual consumers' circumstances sufficiently into account when giving advice.

There are obviously close connections between the FCA's current reviews and the inception of the Consumer Duty, with the FCA itself stating that the results of its review into advice regarding pension drawdowns will provide an early indicator as to the extent of compliance with the Duty. Whilst it is difficult to be critical of the aims of the FCA in any of the above regards, it is difficult to reach any conclusion other than that the introduction of the Duty, coupled with the themes of its other ongoing projects, will ultimately lead to increasing numbers of claims/FOS complaints. With the FOS award limit rising again by a further £40,000 this April to £415,000 for new complaints relating to post-1 April 2019 conduct (a fairly startling rise from the £150,000 limit for complaints referred to the FOS before 1 April 2019), more claims being determined by the FOS is likely to reduce the predictability of outcomes for firms and their insurers.

CONCLUSION

In all of the above respects, and more generally, it is impossible to escape the relevance of the state of the economy, in particular the cost of living crisis, high inflation and interest rates, and uncertainty around house prices. IFAs report that requests for reviews of finances have increased markedly in terms of number and frequency, and clients will inevitably be revisiting advice they previously received in rather different financial circumstances to those that existed at the time. In the short term at least, finding affordable PII cover is likely to continue to represent a challenge for firms.

To discuss how any of these issues might affect you, please contact

Joe Eizenberg
Partner
+44 (0)117 428 9303
j.eizenberg@beale-law.com

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CYBER

The geopolitical environment, the COVID pandemic and restructured working environments have in turn bred the insurgence of new technology; evolving and adapting at a staggering rate. Consequently, cyber attacks have risen exponentially over the last few years. The UK's Cyber Security Breaches Survey 2022 reported that over a 12-month period, 39% of UK businesses had identified a cyberattack. Companies are not the only victims. There is also risk to countries' infrastructure, such as education, transport and energy, with the potential to cause significant damage, both financially and reputationally.

Consequently, and rather unsurprisingly, in the last few years there has been a significant increase in claims under cyber policies from such attacks. Having said that, however, 2022 did see a downturn in the number of claims. This is likely to be due to a combination of the hard market and an emphasis on minimum controls becoming a necessary pre-requisite to obtaining cyber cover (which makes business harder to breach as a result of cyber attacks); and perhaps also due to the Russian invasion of Ukraine and the imposition of sanctions as a result.

During 2022 UK insurance providers, along with their global counterparts, reacted to this by raising premia, revising areas of coverage and increasing the size of deductibles. The increase in cyber claims also piqued the interest of competitor insurance companies, all eager to cash in on the emergence of new clients. Therefore 2022 began to see a lot of new entrants into the UK cyber market with policy options for insureds increasing as a result.

The cyber claims business is therefore booming, with little evidence of slowing down. The global market is expected to grow 20% annually and reach $23 billion in underwriting premia by 2025, according to the Swiss Re Institute.

Considering these developments, the following are areas we believe will be trending in the cyber claims market for the remainder of 2023 and beyond.

STRATEGIC UNDERWRITING

The evolution in technology and advancements in cyber criminal activity are being met head on with an increase in savvy underwriting. 2022 saw innovative underwriting techniques being implemented carefully to examine and evaluate the presented risks

The evolution in technology and advancements in cyber criminal activity is being met head on with an increase in savvy underwriting.

and understand them in more detail. Scanning technologies were used to identify cybersecurity weak spots in companies' infrastructure.

This rigorous approach to underwriting is expected to continue for the rest of this year. Insurers are expected to move away from traditional proposal form-led presentations and progress to more robust, detailed and sophisticated forms of assessing risk, such as the employment of Artificial Intelligence and the continuation of third-party scanning technologies. They will also make recommendations for improvement where vulnerabilities are detected which could affect coverage or endorsements to existing policies.

Insurers are increasingly looking at an organisation's third-party arrangements. This requires not just visibility around the supply chain, but also evidence that the organisation has considered the known risks of its supply chain, such as managing these risks through supply contracts with limits of liability, assurances regarding cyber security and securing rights of audit.

Insureds are also expected to demonstrate they operate within a risk aware culture and have minimum controls in place as a pre-requisite for cyber cover. A report by PwC noted that whilst 85% of respondents claim to have loss estimation methodology in place, the majority use simplistic exposure and factor-based methods, which have in the past shown to underestimate the risk.

Insureds are also expected to demonstrate they operate within a risk aware culture and have minimum controls in place as a pre-requisite for cyber cover.

Antivirus software and firewalls will no longer be sufficient to secure coverage. This year, insurers are demanding superlative internal cyber security controls from their insureds. According to Servca, these include Multi-Factor Authentication, use of VPNs in remote access and Endpoint Detection & Response along with mandatory Privileged Access Management and ongoing vulnerability scanning and detection.

In addition to greater dialogue between clients and their brokers/agents as to the enhanced level of scrutiny involved, it would be wise for organisations to partner with third-party assessors to investigate vulnerabilities in their networks and act on those red flags before their cyber insurance proposal is made so that they get the appropriate level of cover.

Through such strict underwriting protocols, the expectation for 2023 is that insurers will be clearer on affirmative and non-affirmative cyber cover in policies as well as providing specific wording in relation to any exclusions applied. Higher deductibles and tailored exclusion endorsements relevant to any new and predicted threats are likely, as well as more stringent limits and sub-limits.

ENHANCED CYBER REGULATION

In the near future we are also likely to see regulators from various sectors migrating away from the traditional free-hand approach and looking to enforce a minimum level of cyber insurance and risk management across their members.

In October 2021, the SRA amended its Minimum Terms and Conditions for Solicitor's Professional Indemnity cover to require insurers to make it visible that cyber exposures are not covered by professional indemnity policies, thus demonstrating how there is a real exposure that needs to be addressed in practical terms. Regulators' increased interest in cyber security and enforcement activities is demonstrated in the recent Australian case *ASIC v RI Advice [2022] FCA 496*. It is also envisaged that serious discussions will take place as to whether stand-alone cyber protection should be made compulsory for its members.

This may well be mirrored by other regulators and we are starting to see some developments in this regard.

The UK Ransomware Enquiry was launched by the Joint Committee on the National Security Strategy in October 2022 ("the Enquiry") in conjunction with the UK National Cyber Security Centre. The Enquiry is seeking to investigate the extent of the rise in ransomware attacks, the impact they are having on businesses and what proactive steps industries can take to prevent repetition. The findings have not yet been released, but some predictions of the outcomes include: i) new regulations and/or legislation to improve the security of products and services; ii) sanctions for businesses who fail to have appropriate security measures in place; and iii) cooperation between law enforcement, government bodies and the private sector to prevent attack.

Further, Lloyd's announced in August 2022 that, from 31 March 2023, all standalone cyber policies must include, at the inception or on renewal of each policy, a suitable exclusion clause excluding liability for losses arising from any state-backed cyber attack with certain minimum requirements. Such robust wording provides parties with clarity of cover, so that risks can be properly priced and the risk of coverage disputes, reduced.

It is also envisaged that serious discussions will develop as to whether stand-alone cyber protection should be made compulsory for its members.

Another consideration is the role of governments in assisting with many of the large aggregate losses sustained through cyber attacks, which the private insurance market may not be able to cover alone. A well structured public-private partnership could alleviate some of the pressure being felt by the market and ensure its sustainability in covering catastrophic and systemic cyber risks, and this could be an avenue the insurance industry is keen to pursue in the near future.

MARKET COMPETITION AND RATE

... increased competition will play its part in lowering the premium increase that has been seen over recent years.

STABILISATION

As mentioned above, 2022 saw a lot of new entrants to the cyber insurance market, with managing general agents (MGAs) establishing themselves among the traditional insurers. This level of competition allows for a variety of options for the insured when first seeking cyber coverage or when considering alternatives at renewal. This is expected to continue into the remainder of 2023 with existing insurers adding larger line sizes and entering the primary insurance space.

In turn, increased competition will play its part in potentially lowering the premium increase that has been seen over recent years. This factor, along with improved loss ratios, more sophisticated underwriting and improved risk management by insureds, will mean that the premium rates will most likely begin to stabilise by the end of 2023.

FORMS OF CYBER ATTACK

Despite expectation, neither ransomware nor social engineering fraud were responsible for the most cyber insurance claims in 2022. Instead, funds transfer fraud took the top spot and accounted for 36% of cyber insurance claims in 2022 (as reported by Corvus' Risk Insights Index).

Despite this dubious accolade, funds transfer fraud is not predicted to be the most dominant risk over the next few years. With significant threats such as Ryuk, BitLocker, Royal, WastedLocker and 'Ransomware-as-a-Service', attackers have become better at getting past cybersecurity checks.

Therefore, ransomware (despite there being some discussion in the US on excluding ransomware payments) is still expected to take pole position for cyber claims again in 2023.

THIRD- PARTY CLAIMS

A knock-on effect of cyber claims in the future is the rise in third-party claims. The majority of indemnity payments under cyber policies have been for first party losses, these include: legal costs; public relations costs; costs related to the loss of or damage to data; content-related claims related to data etc. However, insurers can expect an increase in claims made under cyber insurance policies for third-party coverage. This includes fines and penalties imposed by regulators and compensation to third parties for failure to protect their data.

CONCLUSION

In short, cyber attacks, through their sophisticated evolution, look set to rise - so much so that it is predicted by various sources that by 2025, 60% of businesses will prioritise cyber security as a business need. The insurance industry, associated regulators and the government are already taking steps to competently meet the threat and demand, head on.

To discuss how any of these issues might affect you, please contact

James Hutchinson
Partner
+44 (0)20 7469 0402
j.hutchinson@beale-law.com

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ENVIRONMENTAL, SOCIAL & GOVERNANCE

Environmental, Social and Governance ("ESG") issues are increasingly at the forefront of Insurers' and theirs Insureds' minds.

WHAT IS ESG?

ESG traditionally refers to a framework used to identify risks and issues against which an organisation's impact on the environment, society and how transparency and accountability in its governance can be measured or rated for investment purposes.

Originally termed "GES", because governance was seen as the most important pillar and key to having policies in place to manage environmental and social risks, the origins of ESG can be traced back to work done by (or for) the United Nations in the early 2000s. This work is reflected in the 17 United Nations Sustainable Development Goals that were subsequently developed and the United Nations PRI (Principles for Responsible Investing), which details a range of over 40 issues which may fall under the three pillars of ESG.

There is no single universally accepted definition of "ESG" and it means different things to different people and organisations; sustainability, Corporate Social Responsibility ("CSR") and corporate responsibility, for example, are all used interchangeably but may not have the same meaning to all. This means that making an organisation "ESG-ready" or "ESG-compliant" is fraught with risk and uncertainty and it requires a bespoke approach, to some extent, for each organisation dependant on that organisation's size, sector and operations.

ESG will impact all sectors and industries to some extent.

WHAT IS THE CURRENT LANDSCAPE?

After a lengthy hard insurance market, there has been some softening over the last year in some sectors, with increased capacity entering the market for certain lines of business, particularly D&O. This has led to a decrease in rates as competition has increased.

The scrutiny on ESG is likely to give rise to insurers looking carefully at proposal forms and the due diligence they carry out to assess their Insureds' response to ESG. As can be seen from the wider impact of ESG as a general theme in other parts of this document, ESG will impact all sectors and industries to some extent.

However, from a claims perspective, it is likely to affect D&O and Financial Institutions ("FI") primarily but also the professional indemnity policies of firms advising companies on issues such as climate related financial disclosures. There will therefore be pressures on accountants, auditors and potentially so-called ESG ratings providers who carry out these functions.

There is a tension, with which insurers are grappling, between a hesitancy to stop writing business in particular sectors (and for underwriters to consider individual proposals on their merits and facts) and the undoubted heightened risk which comes with the public's growing awareness of ESG-related issues.

INCREASED REGULATORY SCRUTINY

Governments and regulators both in the UK and around the world are increasingly focussed on personal, rather than corporate, liability (such as that of Directors and Officers) in relation to many issues, including ESG-related matters. As matters stand, the main focus of the regulators is the financial sector (which falls under the authority of the Financial Conduct Authority ("the FCA")), however, other sectors also need to be aware of the risks in this regard.

There are a number of regulatory risks which insurers and their insureds need to bear in mind which include, but are not limited to, the following.

Greenwashing is a practice where a company makes misleading statements about its environmental credentials to attract investment or to increase sales of goods or services. This is something which is increasingly under the spotlight for the regulators in the UK and the US and in other jurisdictions such as Australia and Canada.

Corporate disclosures - in December 2020, the FCA introduced rules for large companies to make financial disclosures in line with the Taskforce for Climate-Related Financial Disclosures ("TCFD") and similar regimes are either in force or coming into force in the US, Europe and elsewhere.

The FCA's Principle 3 requires companies to identify ESG risks relevant to the business and to make the senior management aware of these risks.

The Senior Managers and Certification Regime introduced by the FCA aims to reduce potential harm to customers and to strengthen the integrity of the market by making individuals responsible for identifying and managing ESG risks.

There is a tension, with which Insurers are grappling, between a hesitancy to stop writing business in particular sectors ...and the undoubted heightened risk which comes with the public's growing awareness of ESG-related issues.

While there has been a heavy focus on the "E" in ESG, it is certainly true that insurers and businesses are becoming increasingly aware of the pervasive nature of the social pillar (the "S") of ESG and the regulatory pressure which is likely to be applied in relation to companies' policies on diversity and inclusion, social value and employment practices.

ACTIVIST SHAREHOLDERS AND EMPLOYEES

The derivative action launched by ClientEarth is the first such action to be brought in the world to argue that directors ought to be held personally liable for alleged failures to prepare for the transition away from the use of fossil fuels. The Court recently upheld its decision not to allow the claim to continue after oral representations were made by both sides at a hearing on 12 July 2023, however, ClientEarth has indicated that it will appeal that decision.

If the appeal is successful then this would be a watershed moment.

Whilst derivative actions are common in jurisdictions such as the US and Australia, insurers will be keen to learn whether this case will be allowed to continue in order to assess whether this costly category of litigation might become more typical in the UK courts.

We have seen derivative actions filed in the US against the directors of McDonalds for an alleged failure of the duty of oversight over an HR Manager which, it was alleged, led to a culture of sexual harassment and misconduct. The action did not survive a Motion to Dismiss in the Delaware Chancery Court as the court held that the directors had policies in place which were reasonable.

The court did, however, hold that the claim against the HR manager could continue. This is significant because many D&O policies will cover roles such as HR manager and other employees who carry out managerial functions.

Again in the US, a shareholder derivative action was launched in March 2023 against the directors of Wells Fargo, the bank, for a failure to promote equality and diversity in line with its own published guidelines which has, it has alleged, caused financial losses to be suffered by the company.

These types of action are on the increase in several jurisdictions and, if the ClientEarth claim is allowed to continue by the courts, it is likely that this form of claim will become more commonplace in the UK. Whatever the decision of the court in ClientEarth, however, these types of claim are likely to attempted by activist shareholders and employees far more frequently, which will increase defence costs spend for Insurers.

The last 12 months or so have seen a rise in claims relating to forced labour and this means that companies need to consider not only their own employment practices, but also those of their supply chain. Shareholders are increasingly looking at the supply chains and the policies of those in the supply chain and could bring claims if employment practices are revealed to be damaging to individuals' human rights.

THE TYPES OF CLAIMS WHICH MIGHT ARISE

In addition to the claims against the D&O and FI policies of companies, we consider that there are risks to insureds' professional indemnity policies which arise from ESG.

Construction professionals such as architects and engineers will face scrutiny over designs to ensure that they adhere to green protocols and also the client's wishes in terms of social value and the well-being of their employees.

This extends to other professions such as recruitment consultants and IT consultants tasked with implementing ESG-friendly policies into their client's projects. Accountants, auditors and investment managers will also be under pressure to ensure that they advise clients to invest in appropriate funds and other investments, and not ones which are likely to attract scrutiny from regulators and other bodies.

Finally, the issue of sanctions is high on the news agenda and with increased tensions between the US and China over Taiwan, there is the potential for a further swathe of sanctions to be imposed later this year or next year to add to the sanctions brought following Russia's invasion of Ukraine in early 2022. This will cause businesses to have to look at supply chains and investments and might cause claims to arise against boards of directors but also the professionals who might have advised them in relation to investment strategies.

To discuss how any of these issues might affect you, please contact

Nathan Penny-Larter
Partner
+44 (0)20 7469 0498
n.penny-larter@beale-law.com

Nathan Modell
Partner
+44 (0)20 7469 0442
n.modell@beale-law.com

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FINANCIAL INSTITUTIONS

For Financial Institutions ("FIs"), any predictions made in January 2022 were rapidly undermined by a number of significant events: the war in Ukraine; spiralling energy and fuel costs; the Truss/Kwarteng 'mini-budget'; rapid inflation; higher interest rates; and an escalating cost of living crisis. Whether or not the major world economies ultimately tip over into recession remains to be seen (at the time of writing the UK has narrowly avoided that) but, on any view, FIs face a time of increasing uncertainty and pressures from a range of factors, with inevitable implications for the FI insurance market.

ESG

As we discuss elsewhere, Environmental, Social and Governance ("ESG") issues are becoming increasingly important to investors and consumers, and an ever-increasing focus of regulators. The FI sector is no exception. Whilst the increased focus on ESG is a positive step in a cultural sense, and undoubtedly represents a substantial commercial opportunity for FIs, the focus on ESG also comes with substantial risks. The Financial Conduct Authority's ("FCA") ESG strategy, published in November 2021, included proposals in respect of greenwashing, i.e., making of misleading public statements about matters relating to environmental commitments and sustainability. The proposals contained an anti-greenwashing rule which reiterated requirements that all regulated firms making sustainability-related claims must ensure these are clear, fair and not misleading. This applies not only in relation to particular investments, but also more generally.

FIs can be in no doubt that the FCA will robustly scrutinise and challenge regulated firms on their fund strategies and disclosures relating to ESG...

FIs are increasingly turning to third-party providers to support their statements and data in this regard, but in a June 2022 feedback statement, the FCA expressed its support for a government proposal to introduce regulatory oversight of ESG data and ratings providers. Whilst such proposals remain under consideration, in November 2022 the FCA announced the formation of a group to develop a Code of Conduct for ESG data and ratings providers and in September 2022 the FCA wrote to CEOs setting out the risks of poor disclosures for ESG benchmarks, which was considered to be a matter of particular concern: "*The ESG sector is rapidly growing, and fund data show increasing flows into passive equity funds promoted as sustainable*". In March 2023 the FCA wrote again to CEOs, and as that letter stated in clear terms: "*ESG matters are high on our regulatory agenda*".

Ultimately, FIs can be in no doubt that the FCA will robustly scrutinise and challenge regulated firms on their fund strategies and disclosures relating to ESG, and we expect that increasing standardisation of definitions and requirements will bolster regulators' efforts in this respect. US regulators have already acted, with the Bank of New York Mellon receiving fines from the SEC totalling $1.5 million in May 2022 for alleged 'greenwashing'. This shows an increased focus on regulation under the Biden administration than was witnessed under the previous Trump regime.

FRAUD AND THE EXTENSION OF THE 'QUINCECARE' DUTY

The current economic turmoil is predictably fertile ground for fraudulent activity. In the first nine months of 2022, over 309,000 cases were recorded to the National Fraud Database, a 17% rise compared with 2021 and an 11% rise compared with pre-pandemic levels. In addition, in 2022 almost 50% of banking claims in the High Court involved fraud; in 2016, fewer than 10% of claims were fraud related.

FIs are expected to take appropriate steps to guard against such risks, and the expectations upon FIs in this regard have been somewhat alleviated by the Supreme Court's decision in *Philipp v Barclays Bank PLC [2023] UKSC 25*, which ruled that the long-established Quincecare duty did not apply where bank customers had fallen victim to authorised push payment ("APP") fraud, provided that the customer's instructions had been clear and given by the customer personally or by an agent acting under apparent authority.

In Philipp, the claimant was the victim of APP fraud (i.e., where the fraudster tricks the victim into paying money directly to them). The claimant brought a claim against Barclays Bank ("the Bank") to recover the monies she had lost as a result of the fraud on the basis that the Bank owed a duty not to carry out her payment instructions as it had reasonable grounds to believe she was being defrauded. At first instance, the High Court granted summary judgment in favour of the Bank on the basis that the Quincecare duty did not apply in cases of APP fraud. On appeal, the Court of Appeal overturned the High Court's decision ruling that the Quincecare duty was to be applied in situations where the customers had themselves authorised a payment induced by fraud.

Overturning the decision of the Court of Appeal, the Supreme Court unanimously held that the Quincecare duty is not a special rule of law but simply the application of the general duty of care owed by a bank to interpret, ascertain and act in accordance with the customer's instructions. The validity of the customer's instructions was never in doubt and it was held that "*the bank's duty is to execute the instruction and any refusal or failure to do so will prima facie be a breach of duty by the bank*". Therefore, the Bank owed no duty of care to Mrs Philipp. The Supreme Court restored the High Court's order granting summary judgment to the bank (but varied it to permit the claimants to maintain an alternative claim based on the Bank's alleged failure to act promptly to try to recall the payments after the fraud was discovered).

The Supreme Court's decision has provided momentary relief in closing the floodgates of potential claims against FIS related to APP fraud. However, the court noted the progress being made outside of litigation to provide redress and protection to victims of APP fraud. One notable example is found in the Financial Services and Markets Act 2023 which recently received royal assent on 29 June 2023. The 2023 Act is expected to introduce mandatory requirements for FIs to reimburse customers who fall victim to APP fraud where payments are made through the Faster Payments Scheme.

The Supreme Court Judgment (which was handed down in July 2023) gave an important analysis of the scope of the Quincecare duty owed by banks to their customers. Before acting on a mandate from a customer, FIs should exercise caution when assessing what might be sufficient to give rise to a duty to make enquiries as to the authority of an agent. This might include conflicts of interest between the agent and the customer, whether there is a benefit to the customer in carrying out the mandate, or whether there are any particularly unusual aspects to the transaction. It will ultimately fall to a question of what the FI knew, or ought to have known, at the time it failed to make the inquiry.

It seems unlikely that the judgment will prevent further Quincecare-type claims as parties seek to test the boundaries of the court ruling. Accordingly, FIs are likely to take various actions in any event, including further investment in new fraud prevention technologies (it is not difficult to foresee a large role for AI here), reviews of procedures and training and reviews of insurance arrangements to ensure they are adequately covered for the increased risks in this regard.

INCREASED TRANSACTIONAL SCRUTINY

FIs are increasingly susceptible to money laundering, which is estimated in the UK at an annual figure of £88 billion (the second highest figure in the world after the US). London, in particular, has long been a key target, including via the purchase of property via anonymous companies, but there was a step-change in this field with the invasion of Ukraine and the litany of sanctions that followed against Russian and Russian-affiliated citizens. The government hurriedly passed into law the Economic Crime (Transparency and Enforcement) Act 2022 which requires overseas entities that own

or wish to own property in the UK to identify the beneficial owners and to register them with Companies House. It also strengthened the regime of unexplained wealth orders and, perhaps most importantly for present purposes, introduced a strict civil liability test for the imposition of fines. This means that businesses can be held liable even where they have no knowledge or reasonable cause to suspect that a transaction is in breach of sanctions, with such civil fines being limited to £1 million or, if greater, 50% of the value of the money laundered. In addition, the Office for Financial Sanctions Implementation can prosecute businesses for breaches of financial sanctions where it can show there is knowledge or reasonable cause to suspect a transaction is in breach of sanctions, and this can result in fines or even custodial sentences.

Another key area of risk in relation to money laundering lies in the growth of cryptoassets. The lack of regulation around cryptoassets makes them a key target for criminals. In the UK, the National Crime Agency's ("NCA") National Assessment Centre estimates that it is likely that over £1 billion of illicit cash is transferred overseas using cryptoassets. It also estimates that hundreds of millions of pounds are laundered via over-the-counter crypto brokers and professional money launderers have widely adopted cryptoassets to facilitate crime.

Finally, times of economic difficulty tend to coincide with an increase in tax evasion, and to that end another key piece of legislation potentially affecting FIs is the Criminal Finances Act 2017, which gave enforcement agencies greater powers in various respects, including money laundering and tax evasion. Directors can be made personally liable for the deliberate non-payment of various taxes, and under the 2017 Act companies and partnerships can be strictly criminally liable for failing to prevent facilitation of tax evasion by employees, agents, sub-contractors etc.

CYBER RISK ONE OF THE BIGGEST THREATS FACINGS FIS

Such is the pace of change, the inclusion of 'cyber risk' in an article about current trends might at first sight seem almost out of date. However, whilst cyber risk has featured on the radar of FIs for several years, it remains one of the biggest threats facing FIs, with an EY survey reporting in January 2023 that 72% of global Chief Risk Officers viewed cybersecurity as the leading risk for banks in 2023. Reflecting that concern, a survey by the cybersecurity firm Bridewell reported that financial services firms have seen an 81% surge in cyberattacks since Russia's invasion of Ukraine.

As new technology develops apace, and businesses become increasingly reliant on it, it has never been more important for FIs to track trends in cyber risk in order to combat bad actors who are themselves increasingly sophisticated. Risks arise not only to FIs directly, but also via the supply chain such as through software provided by third parties. It is essential for FIs to take appropriate precautionary steps to prevent attacks and to have in place appropriate plans to mitigate against any successful attacks.

CONSUMER PROTECTION

The FCA is currently heavily focused on the treatment of consumers by FIs. In particular, the FCA's new Consumer Duty must be implemented by 31 July 2023 and is underpinned by a new Consumer Principle, under which firms will be required to act to deliver good outcomes for retail customers. The purpose of the introduction of the duty is to prevent financial services firms from causing harm *"including presenting information in a way that exploits consumers' behavioural biases, selling products or services that are not fit for purpose, or providing poor customer support"*, and it is likely to require FIs to carry out a wholesale review of their products and services provided to retail customers. Given the importance of this initiative to the FCA, it seems likely that non-compliance will be keenly enforced, particularly if there is any detrimental effect to vulnerable customers. There is no – at least not yet – private right of action for non-compliance under s.138D FSMA, although this was considered and the FCA may review that position once the new scheme has been properly embedded. In the meantime, we expect that the industry standards by which negligence claims are judged will be influenced by the superior requirements imposed on FIs by the Consumer Duty, and we expect to see these requirements making their way into the preamble in negligence claims against FIs in any event.

The FCA has also been keen to stress that FIs will be expected to act quickly when patterns of wrongful behaviour are uncovered, and not to wait until the end of FOS complaints before taking steps to offer wider redress. It was even suggested by the FCA that FIs, and their relevant individuals, that did not quickly deal with any wider issues requiring redress could be seen to be acting in bad faith (with all the regulatory sanctions that can follow a failure to act in a fit and proper manner).

BANKING STABILITY

Barely had the annus horribilis of 2022 come to a welcome conclusion, when the FI sector was faced with the wholly unwelcome return of fears of a banking crisis, this time caused by liquidity rather than credit issues. The sudden collapse of Silicon Valley Bank ("SVB") (the 16th largest bank in the US) in March 2023 was prompted by a £1.7 billion hole in its finances caused by a decline in customer deposits and a reduction in value of bonds caused by the increase in interest rates. The resulting fear of collapse, which spread especially quickly as a consequence of social media, resulted in a 'run' on the bank and forced the US regulator to step in. While the situation of SVB, which was heavily reliant on the tech sector, was relatively unique, that did not stop a global banking sell-off and fears of contagion. Shortly thereafter, the US regulator was also forced to close Signature Bank (the 19th largest bank in the US) and First Republic Bank was seized and sold by regulators to JPMorgan Chase at the end of April 2023.

Whilst not causally connected, March 2023 also saw the collapse of Credit Suisse, the second largest bank in Switzerland, which was taken over by UBS following a series of scandals and rumours of impending collapse from Summer 2022.

The full extent of claims arising out of these events remains uncertain, although wide-ranging and multi-jurisdictional litigation is a certainty. As noted elsewhere in this report, there are pending and current claims against directors of the US institutions by its shareholders, as well parent companies. There have also been claims against Credit Suisse by its US investors alleging that the bank misrepresented its prospects in its 2021 annual report, and a whole range of investors will no doubt be seeking advice. By way of example, according to the terms of the transaction with UBS, bonds held by Credit Suisse investors worth £13.9 billion were written-off by the Swiss regulator.

THE INSURANCE MARKET

Given the challenges faced by FIs in 2023 (and indeed the inherently risky nature of the industry generally), it will come as no surprise that the FI insurance market is extremely hard. The market has and will continue to evolve in response to the changing needs of the industry and the changing nature of the risks involved, but the increasing risk of cyber-attacks and fraud, the geopolitical situation, the heightened appetite for regulatory intervention and enforcement, and other factors such as the importance of data protection in this sphere, mean that the cost of insurance for FIs is high and increasing. Indeed, it was a very hard market even before the turmoil of 2022 and early 2023, and it is difficult to see anything changing in the short to medium-term. It is ever more essential that FIs stay informed as to the nature of the risks which they face and take steps to obtain appropriate protection, via insurance and otherwise.

To discuss how any of these issues might affect you, please contact

Ross Baker
Partner
+44 (0)20 7469 0509
r.baker@beale-law.com

Nathan Penny-Larter
Partner
+44 (0)20 7469 0498
n.penny-larter@beale-law.com

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