NEW UK INSURANCE ACT COMING INTO FORCE IN AUGUST 2016

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Insurance Coverage Alert

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The new Act is designed to provide a more up to date framework for commercial insurance in England and Wales, with a focus on transparency and certainty over the rules that govern contracts between commercial policyholders and insurers. The Act will replace certain provisions of the Marine Insurance Act 1906, which had been applied to commercial policies in both a marine and non-marine context.

The following is a summary of some of the key changes, focusing on those impacting on policyholders:

DISCLOSURE AND MISREPRESENTATION

The Act replaces the insured's current duty of disclosure with a requirement that the insured must make a "fair presentation of the risk".

Going forwards, commercial policyholders will be required to disclose every material circumstance that they know or ought to know. Failing that, they will need to give their insurers information that is sufficient to put the insurer on notice that further enquiries may be necessary, for the purpose of revealing those material circumstances. The aim of this is to put the onus on the insurer to ask questions about the information provided and to ensure that the insurer takes a more pro-active approach to the disclosure process.

For disclosure purposes, the insured will be taken to know what is known to the insured's "senior management" which will vary depending on the size of the organisation but is likely to include the board of directors. The insured will also be taken to know what is known by "individuals responsible for the insurance" which will again vary depending on the structure of the organisation, but in practice may include insurance managers, risk managers, company secretaries, finance directors and general counsel.

What an insured "ought to know" will be assessed objectively i.e. what should reasonably be revealed by a reasonable search of information available to the policyholder. This increases the burden on insureds in so far as it imposes a positive obligation on insureds to undertake a search for information held by them or by any other person, including any broker or other agent.

The fair presentation of risk also requires the insured to make the disclosure in a manner which would be "reasonably clear and accessible to the prudent insurer". The aim here is to discourage "data-dumping" or simply bombarding the insurer with vast amounts of information without any attempt to assess whether it is relevant or not. Insureds now need to take positive steps to ensure that disclosure information is clearly and properly presented but at the same time avoiding overly brief or cryptic disclosure presentations.

In terms of an insurer's remedy for breach of the duty of fair presentation, the new Act provides for a range of remedies which are intended to be more flexible and proportionate. If the breach was deliberate or reckless, the insurer will be entitled to avoid the policy and need not return the premium. If the breach was not deliberate or reckless, the onus will be on the insurer to demonstrate what it would have done had it received a fair presentation of the risk. Where the insurer would not have entered into the contract on any terms, the insurer can avoid the policy but must return the premium paid. Where the insurer would have written the policy on different terms, a claim on the policy will be assessed applying those different terms. Alternatively, if the insurer can show it would have written the policy on the same terms but charged additional premium, the claim will be reduced proportionately to the amount of premium that would have been paid.

The duty of fair presentation introduces important changes from the insureds' perspective and insureds need to consider carefully what changes are required to their existing disclosure processes in order to meet the new requirements.

WARRANTIES AND OTHER POLICY TERMS

Under the existing law, a breach of warranty discharges the insurer from all liability under the insurance contract, even if the breach is trivial and has no connection with the insured's loss. Under the new Act, a breach of warranty will not automatically take the insurer off risk. Instead warranties will be of suspensive effect such that an insurer will not be liable for losses incurred whilst the insured is in breach, but will come back on risk if the breach is subsequently remedied (where the breach is capable of being remedied).

At present, insurers often rely on so called "basis of contract" clauses as a means of converting pre-contractual statements and information supplied to insurers into warranties. The use of "basis of contract" clauses has been the subject of much criticism, because of their potentially draconian consequences. The Act effectively abolishes the use of "basis of contract" clauses which is a welcome development for policyholders.

The Act also provides that insurers cannot rely on a breach of warranty or certain other policy terms which are not relevant to the actual loss. Where a loss occurs, and such policy term has not been complied with, insurers will be prevented from relying on the non-compliance to exclude, limit or discharge their liability if the insured can show that the non-compliance did not increase the risk of loss which actually occurred in the circumstances in which it occurred.

CONTRACTING OUT

The Act is intended to operate as a default regime for commercial contracts and allows parties to any commercial contract to contract out of the legislative changes.

Contracting out is only permitted where insurers comply with the Act's transparency requirements, by taking steps to highlight to the policyholder any disadvantages of the term to which they are agreeing, in so far as it puts the insured in a worse position than under the Act. The term must also be clear and unambiguous in its effect.

Parties cannot, however, contract out of the "basis of contract" clause prohibition.

FRAUDULENT CLAIMS

The Act has sought to clarify the remedies available to insurers in the event of fraud. Where an insured makes a fraudulent claim, the insurer will now not be liable to pay any part of the claim, regardless of whether only part of the claim is fraudulent. The insurer can also elect to terminate the contract and refuse to pay claims relating to any losses suffered after the fraud occurred. However, the insurer will remain liable for any losses legitimately incurred before the fraudulent claim was made.

The Act also enables any fraudulent member of a group policy to be separated from the other members. The insurer will have no liability for the fraudulent claim and the option to terminate the policy with effect from the date of the fraud, but only as regards the fraudulent claimant. The aim is to ensure that innocent members of the insured group are not unfairly prejudiced.

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