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TECHNICAL

Efficacy of Business Insurance

Guidance for insurance buyers on achieving greater coverage, contract and claims certainty

Guide 2014



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Together Leading In Risk

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Section 1: Executive Summary

“Insurance will only become valued as an effective risk financing mechanism when coverage, contract and claims certainty are fully aligned with client expectations”

Chris McGloin,
Airmic Chair, 2014

Why businesses need insurance

For most companies, insurance represents one of their biggest investments and their largest source of contingent capital. It protects them from events that might otherwise threaten output, jobs and even the future existence of the company. It makes companies more secure as business partners and places to invest.

To understand the importance of insurance to the viability of a company, a policy should be treated as having a value equal to the limit of indemnity that is purchased. If a company pays £2 million to purchase a £100 million limit of indemnity, the contract should be viewed as being potentially worth £100 million.

Companies buy insurance to protect their balance sheets, and to reduce volatility in the profit and loss account caused by large insurable losses. Additionally, the purchase of insurance is often required by regulators, clients and customers in relation, for example, to professional indemnity exposures. Finally, insurance can facilitate business activities by providing financial security needed to cover exposures such as those associated with mergers and acquisitions, joint ventures or expansion into new markets.

Ensuring that claims will be paid promptly

If insurance is to do its job properly, the policy’s efficacy has to be tested and validated before inception for coverage, contract and claims certainty.

Issues to be considered when acquiring cover include:

- Wordings can be very complex and include clauses and conditions that restrict the level of coverage. Definitions, exclusions and warranty requirements are sometimes misunderstood.
- Policy issuance at or before inception is critically important. This may mean bringing forward the procurement or renewal process to allow more time.
- Claims certainty is a fundamental requirement; it can be affected by the circumstances of the claim, how it is notified and how the insurance company responds to that notification. The buyer needs to understand in advance how the policy would work in a full range of different scenarios.

In the experience of Airmic members, the main reasons why insurance claims are not paid as expected by buyers are:

- Failure to disclose material facts;
- Breach of warranty or other policy conditions;
- Inadequate level of insurance purchased;
- Late notification of the claim; and
- Policy wordings that do not cover the circumstances of the loss.

Even when claims are paid in full, the shortcomings listed above can cause delays. These, in turn, can lead to significant cash flow and accounting problems, and even result in a breach of banking covenants or require stock exchange notification by way of a profits warning.

To quote Anthony Hilton of the (London) Evening Standard:
“Companies need to wake up to the fact that a lot of watertight insurance cover out there is potentially full of holes and investors should be aware that a lot of companies whom the auditors say are going concerns, may well turn out not to be if their insurance fails”

The need for a robust governance framework

This guide draws on the considerable experience of Airmic members, who are responsible for the efficacy of the insurance policies they buy. Insurance buyers are responsible for ensuring that claims pay out as expected. Achieving the necessary level of efficacy is challenging, especially when substantial policy limits are purchased by large companies. These issues need to be proactively managed.

Insurance programs require a governance framework that sets out the roles and responsibilities of the various parties, both internal and external. In particular, the Board must be satisfied that the arrangements provide the required level of coverage and the policy terms and conditions are reliable, adequate and represent appropriate use of funds.

Insurance buyers need to consider a very wide range of issues when purchasing insurance programs. These include program design, insurer selection, wording reviews, scenarios testing and claims protocols. Also, buyers need to be aware of the importance of warranties and conditions precedent, together with the potential impact of basis clauses. Significant planning and professional expertise is necessary. The professional support of insurance brokers can be an important part of achieving the required level of efficacy of insurance contracts.

Buyers need to validate that the insurance structure is compliant with regulatory requirements around the world. If a master policy is purchased in the UK, it is essential that the program complies with regulations in all countries where it applies. This will be especially challenging when a captive insurance company is involved. The new Insight Risk Manager database of international regulatory requirements developed by Axco for Airmic and is available at no charge to Airmic members.

Insurance disputes, pitfalls and remedies

Underpinning these considerations is the legal framework. At present in England and Wales, the Marine Insurance Act 1906 provides the default regime for insurance contracts. The Law Commission are planning, with Airmic’s full support, to modernise the law. In the meantime, however, this guide seeks to help buyers achieve their objectives despite a framework that can be biased against them. They should also look to their brokers for support in achieving the required level of insurance efficacy.

If claims are to be paid as the insurance buyer expects, certain potential weaknesses in the policy need to be identified and corrected. Warranties and conditions precedent are examples of features that can cause nasty surprises. Claims handling procedures and the implications of subrogation actions following payment of an insurance claim can also undermine the contract. The concerns of many insurance buyers were summed up by an Airmic member: *“as a risk financing mechanism, insurance is an imperfect hedge”*.

It is essential, therefore, to identify actions to minimise the potential for insurance dispute and to ensure that, should one occur, there are resolution mechanisms in place. Overall, the desired position for insurance buyers is:

- that there is certainty about the coverage provided;
- the policy document is available from the time of inception; and
- procedures are agreed, so that claims will be settled as expected.

Guide to efficacy of insurance policies

This Airmic guide explores these issues in more detail and provides information on actions an insurance buyer may wish to take to increase the efficacy of the insurance programs. The need to update insurance contract law and achieve enhanced efficacy was summed up by an Airmic member in clear terms by the statement: *“I am pleased that Airmic is taking on the issues around hidden basis clauses and warranties. Insurance law needs to be brought into the 21st century.”*

The appendices describe two important aspects of buying insurance policies. Table E1 is a summary version of Appendix A and provides an overview of the required outcomes when buying business insurance and the important actions that should be taken to achieve coverage, contract and claims certainty. Additionally, checklists are provided throughout the guide in relation to achieving coverage, contract and claims certainty, as well as checklists for governance of insurance programs and dispute resolution.

Table E1:


Summary of the activities involved in buying business insurance

| | |
|-----------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Governance Structure | <ul style="list-style-type: none">• Establish insurance strategy and prepare market submission• Produce procedures manual to include roles and responsibilities |
| Coverage Certainty | <ul style="list-style-type: none">• Select potential insurers and open dialogue with underwriters• Undertake scenario testing and legal review of wordings |
| Contract Certainty | <ul style="list-style-type: none">• Bind cover and ensure timely issuance of policy documentation• Fulfil regulatory obligations and comply with policy warranties |
| Claims Certainty | <ul style="list-style-type: none">• Ensure timely notification of losses, claims and circumstances• Support claims management, handling and settlement procedures |
| Disputes Resolution | <ul style="list-style-type: none">• Pursue settlement of disputes in line with coverage expectations• Achieve dispute resolution related to coverage, contract or claims |

Table E2 is a summary version of Appendix B and provides a suggested timeline for achieving issuance of insurance policies at or before inception. The old attitude of ‘deal now, detail later’ is no longer acceptable. Day one policy issuance can be a challenge, but it is in the best interests of all parties.

Table E2:
Summary of suggested timeline for achieving contract certainty

| | Description of insurance renewal activity | Prior to inception |
|----------|--------------------------------------------------------|---------------------------|
| 1 | Collection of insurance renewal information | 180 – 150 days |
| 2 | Compile exposure and loss data for full disclosure | 150 – 120 days |
| 3 | Discuss with underwriters to ensure understanding | 120 – 90 days |
| 4 | Legal and professional review of suggested wordings | 90 – 60 days |
| 5 | Negotiation and testing, including scenario testing | 60 – 45 days |
| 6 | Agreement by all parties of final terms and conditions | 45 – 30 days |
| 7 | Accurate and timely policy documentation issuance | 30 – 15 days |
| 8 | Observe regulatory, tax and warranty requirements | 15 – 0 days |

A close-up photograph of a hand placing a white puzzle piece into a larger assembly. The hand is positioned at the top left, and the puzzle piece is being inserted into a gap. The background is a dark surface with other puzzle pieces scattered around. The overall scene suggests a process of completion or solving a problem.

“Companies need to wake up to the fact that a lot of watertight insurance cover out there is potentially full of holes and investors should be aware that a lot of companies whom the auditors say are going concerns, may well turn out not to be if their insurance fails”

Anthony Hilton

of the (London) Evening Standard

Part 1: Nature of Business Insurance

Section 2: Introduction to business insurance

1. Nature of business insurance

For large businesses, the insurance programs will be extensive and complex, and may well provide insurance cover in several territories around the world. This complexity gives rise to concerns about the efficacy of the coverage that is provided. For example, a policy purchased in London on a global basis needs to provide the necessary protection for assets and exposures in all of the countries where cover is required. It may be that the cover provided by a global policy is not allowed in certain territories. If the global insurance company is not licensed in a particular territory, the insurance provided will be on a non-admitted basis and there may be regulatory restrictions on non-admitted insurance.

To understand the importance of insurance, an insurance policy should be treated as having a value equal to the limit of indemnity that is purchased and not the value of the premium paid. If a company pays £2 million to purchase a £100 million limit of indemnity, the contract should be viewed as being potentially worth £100 million. This £100 million is the level of contingent capital that would be available in the event of an insurance claim.

When evaluating the efficacy of the insurance arrangements, the board of a company should be satisfied that the insurance arrangements provide the level of coverage that is required and that the contract terms and conditions are acceptable. The board should also seek assurance that claims will be paid as expected and this is normally undertaken by scenario testing. Adequate governance arrangements are necessary because the amount of insurance purchased by large companies is substantial. Finally, it is essential for the company to ensure that appropriate dispute resolution arrangements are in place should difficulties arise in relation to the settlement of a specific claim.

2. Reasons for buying business insurance

The main reason why companies buy insurance is to protect their balance sheet. Certain events could result in substantial losses, such as the destruction of valuable assets, including buildings, plant and machinery. Also, certain events could result in significant environmental damage and without the presence of insurance, a significant loss of company value and market capitalisation and/or huge damage to the balance sheet could occur. Likewise, significant liability issues associated with product liability and/or product recall can arise.

Insurance can serve to reduce volatility in the profit and loss account by providing funding for larger than expected losses. Although the losses that are suffered may not be sufficient to cause significant damage to the balance sheet, the variation in profits caused by the losses may be unacceptable. Insurance will be purchased to ensure the total losses in any budget period do not put the company in a position where the trading position and profitability are unacceptably affected.

Also, the purchase of insurance is often required by regulators, clients and customers. Sometimes, insurance is purchased because it is mandatory and third-party liability is frequently required in this category. The most common insurance around the world is motor third-party, whereby vehicles using public roads must be insured against loss, damage and injury to third parties. As well as being mandated by regulation, insurance is sometimes mandated by customers. Many companies will be obliged to buy insurance because customers insist that professional indemnity, public liability and/or product liability arrangements are in place. For example, clients often require professional advisers to buy professional indemnity insurance.

Finally, insurance can be used to facilitate certain activities by providing financial security that could underpin, for example, the financial exposures associated with mergers and acquisitions. A company that is selling land or other real estate may be required by the purchaser to have environmental impairment insurance in place for their benefit, in the event that the level of pollution is greater than anticipated. Having insurance in place that names the purchaser as co-insured on the policy will facilitate the sale.

3. Assessment of insurance needs

It is important that a company assesses its insurance needs and this approach is described in the Airmic 'Insurance Buyers Guide' (See *Appendix C, item 1*). In assessing insurance purchases, the company should consider the consequences of a loss and not just the premium cost. Good standards of risk management are critically important and insurance should be viewed as a control mechanism, rather than the whole solution. However, insurance funds may not be available if the policy does not have the required level of efficacy. It is important that the insurance policy responds accordingly. Exploring the availability of insurance may be especially important for the company in relation to new and emerging risks which are more difficult to quantify, such as cyber risk and supply chain.

Table 2.1 illustrates the classes of insurance that may be required by a company. This table represents the type of insurance required, depending on the activities, assets, potential liabilities and/or customer base of the company. It is important for the company to evaluate and assess insurance needs, so that the use of insurance as a control measure can be understood. It is also important that the company evaluate the nature and extent of emerging risks, especially where it is difficult to buy the required insurance because insufficient information about the risks is available.

Table 2.1:
Identifying the necessary insurance

| | Feature of the business | Associated insurance |
|-----|-------------------------------------------------|-----------------------------|
| 1. | Business has employees | Employers' Liability |
| 2. | Employees travel outside the country | Business Travel |
| 3. | Members of the public could be affected | Public Liability |
| 4. | Business supplies products or components | Product Liability/ Recall |
| 5. | Business provides professional advice | Professional Indemnity |
| 6. | Theft or dishonesty by employees could occur | Fidelity Guarantee |
| 7. | Business occupies business premises | Premises Insurance |
| 8. | Premises has machinery or other stock | Contents Cover |
| 9. | Business depends on machinery or computers | Engineering Insurance |
| 10. | Business could be disrupted by fire, flood etc. | Business Interruption |
| 11. | Business is involved in transporting goods | Goods in Transit |
| 12. | Business has motor vehicles on public roads | Motor TP (and AD) |
| 13. | Business provides life benefits to employees | Life and Health |
| 14. | Certain staff are key to operation of business | Key Person |
| 15. | Business would suffer in event of a bad debt | Trade Credit |
| 16. | Business has directors and/or officers (D&O) | D&O Liability |

The assessment of insurance needs may result in the organisation deciding that it needs to buy insurance, but it may not be available or may be too expensive. Indeed, one of the contradictions of insurance is that it is most required when there is greatest uncertainty about the risks that the company faces. In these circumstances, underwriters may require significant amount of information before insurance cover will be offered. When buying insurance for emerging risks, the insurance buyer will need to be satisfied that the level of efficacy of the insurance policy is adequate. The buyer will carefully consider whether the circumstances in which a claim may arise will be covered by the insurance. This activity is the basis of scenario testing to confirm insurance coverage.

4. Reasons for failure of insurance claims

The purchase of insurance for large complex companies is a technical and professional activity that requires the knowledge, experience, skills and competencies of an experienced insurance buyer. Despite this level of expertise, insurance claims sometimes fail and the five main reasons why insurance claims are not paid to the full extent expected by insurance buyers are:

- the underwriting presentation was not appropriate in that there was a failure to disclose material facts
- breach of warranty had taken place that led to the loss or resulted in it being more serious than anticipated
- there was an inadequate level of insurance purchased, especially in relation to the business interruption exposures
- late notification of claims had occurred, especially for liability exposures and notification to excess layers
- wordings were not wide enough to cover the precise circumstances, extent or nature of the loss

The insurance buyer will need to be satisfied that the terms and conditions of the insurance policy mean that the issues outlined above will not undermine payment of claims. The particular issue of remedies available in the event of a disputed claim is important in relation to satisfactory dispute resolution. The default legal framework for insurance contracts written under the law of England and Wales is the Marine Insurance Act 1906 (MIA). Some of the remedies available to insurers under this default legal regime may not be acceptable to insurance buyers, as they can undermine policy coverage. It is for the insurance buyer to negotiate alternative arrangements to those set out in the MIA and this guide discusses alternatives for insurance buyers to consider.

5. Guide to efficacy of insurance policies

An Airmic member expressed their concerns about the efficacy of the insurance arrangements in the following terms: “*as a risk financing mechanism, insurance is an imperfect hedge*”. This explains why helping members achieve greater efficacy of insurance policies is an Airmic priority and continuing initiative. The aims and intentions of this guide are to:

- outline the importance of business insurance and draw together the various Airmic guides and guidance
- provide an overview of the steps involved in buying business insurance and the roles and responsibilities of the various parties
- describe the required outcomes in terms of increased efficacy of coverage, contract and claims certainty
- explain the default regulatory framework in place in England and Wales governing insurance contract law
- provide an overview of buyer experiences of purchasing insurance for large complex multi-national companies
- explain why claims fail, including the need for compliance with regulatory requirements for non-admitted policies
- provide guidance on improving efficacy of insurance policies and suggest a timeline for purchasing insurance for large corporate risks

The scope of this guidance extends to measures designed to increase the efficacy of insurance policies. Achieving efficacy results in enhanced coverage, contract and claims certainty. Also, to achieve the appropriate level of insurance efficacy, sufficient attention needs to be paid to the governance of the insurance policies as well as a clear understanding of the framework for resolution of disputes. In the words of one member of Airmic:

“I am pleased that Airmic is taking on the issues around hidden basis clauses and warranties. Insurance law needs to be brought into the 21st century.”

Section 3: Importance of business insurance

1. Insurance, risk transfer and risk financing

Insurance is often viewed as a reluctant purchase, but it can also be a business enabler in certain circumstances. It is important that a company buys the optimum level of insurance and at the very least has insurance in place for the business critical assets and exposures. Additionally, there are many ways in which insurance can support strategy, tactics and operations, as well as providing compliance for situations where purchase of insurance is mandatory. It is important that risk control activities are undertaken so that decisions can be taken on risk financing. Risks that are retained by the company need to be within the risk appetite of the organisation.

There is a need to consider whether insurance is a cost-effective means of purchasing contingent capital. Banking covenants must not be exceeded and insurance can form an important means of supporting this aim, provided that when claims arise, it is almost certain that the claims will be paid. The important questions for insurance buyers are how much they are willing to spend on insurance to (1) protect the assets of the company; and (2) reduce volatility of the profit and loss account.

2. Insurance as a business enabler

Insurance can be a business enabler and it can enable the company to fulfil its strategy, tactics and operations, and ensure compliance. For example, insurance may be required to secure a contract or facilitate a sale, merger or acquisition. The company should identify circumstances where strategy, tactics, operations or compliance cannot be achieved without the support of insurance. However, if insurance is to be used in this way, the insurance policy must fulfil the required level of efficacy in relation to coverage, contract and claims certainty. An important consideration for insurance buyers is identifying the situations where the company cannot undertake an activity without the purchase of insurance and/or would be working beyond risk appetite to undertake that activity without insurance.

Many companies place great reliance on reputation, as well as the financial sustainability of the company, when deciding the business risks that the organisation is willing to take. It is important that the risk appetite of the company and the associated level of risk retention are considered when devising the insurance structure of the company. In terms of insurance policies, risks can often be retained by a company because of the reluctance of an insurer to offer the insurance that is required and/or because of the terms and conditions of an insurance policy are unacceptable. These terms and conditions are defined and often limited by the definitions and exclusions within the policy.

3. Design and placement of insurance programs

Insurance programs for large multi-national companies are very complex and require a professional insurance buyer to design the program so that they achieve the required level of efficacy (See *Appendix C, item 2*). Table 3.1 illustrates the features that are present in large corporate insurance programs and the percentage of respondents to the Airmic survey who indicated that the particular feature is present in their insurance arrangements. Related to the purchase of excess layers is the likelihood that many of these excess layers will have different conditions and drop-down provisions. Ensuring coverage efficacy will require the insurance buyer to carefully explore any potential gaps in cover.

The arrangement whereby the global excess layer will drop-down to make payments within the primary layer, once the primary limits have been exhausted is a feature of 'Difference in Conditions / Difference in Limits' (DIC/DIL) provisions. Purchasing insurance on a global basis can result in uncertainty regarding the regulatory requirements in territories where the insurer is not licensed. DIC/DIL provisions introduce significant complexity and the scope for reduced coverage certainty, because the DIC/DIL provisions will almost certainly be provided on a non-admitted basis in most territories around the world. This is non-admitted insurance and access to data in relation to regulatory requirements for non-admitted insurance is required by the insurance buyer.

4. Features of business insurance programs

The most common feature noted is excess layers in the insurance programs and this immediately introduces the consideration whether the excess layers are provided on exactly the same terms as the primary layer. The efficacy of an insurance program is much reduced if different policy wordings are present on each of the layers. As would be expected, most insurance programs for large companies have sub-limits for particular risks. It was also noted that nearly two thirds of insurance buyers purchase a class of insurance where there is a primary layer only. This illustrates the range of insurance classes of business purchased by a typical insurance buyer from the single layer policy to complex multi-layer international insurance programs.

Table 3.1:
Features of insurance programs

| Insurance feature | Response |
|-----------------------------------------------------------|----------|
| Excess insurance layer(s) above a primary layer | 92% |
| Excess / deductible or retained losses within the program | 88% |
| Sub-limits for particular risks | 75% |
| DIC / DIL cover in an excess layer | 69% |
| Primary layer only insurance | 63% |
| Long-term agreements with insurer(s) | 60% |
| Policies that name a co-insured | 52% |
| Fronted reinsurance captive | 40% |
| Umbrella policy within the insurance architecture | 38% |
| Multi-year policy / long term agreement | 33% |
| Direct writing captive insurance company | 29% |
| Co-insurance involving the captive | 26% |
| Cross class retention / deductible | 24% |
| Multi-line policy structure | 24% |
| Co-insurance primary layer | 21% |
| Co-insurance or market pool excess layer(s) | 12% |
| Tacit renewal or evergreen policy | 11% |

It is perhaps surprising that a significant number of Airmic members purchase multi-line multi-year policies and that 60% of Airmic members who responded to the survey have long term agreements in place. This indicates that insurance buyers recognise the benefits of long-term partnerships with an insurance company. In turn, this will increase coverage and contract certainty because the scope for non-disclosure is reduced and the policy wordings are well established and tested.

5. Risk appetite and risk retention

Risk appetite considerations are important, together with analysis of the risk retention held by the insurance buyer. Sometimes, organisations may have retained more risk than anticipated, because of the operation of deductibles and uncertainty about whether the deductible is applicable to each and every claim or whether there is an aggregate limit to the deductibles that will be applied. Again, these are considerations for the insurance buyer in relation to the coverage provided and the total risk retained. The overall requirement is that the total risk retained by the insurance buyer is within risk appetite.

There are other considerations relevant to risk appetite. The Financial Reporting Council (FRC) states that the boards of UK listed companies are responsible for determining the nature and extent of the significant principal risks the company is willing to take in achieving its strategic objectives. Companies are also required by the FRC to state whether they believe they will be able to continue in operation and meet their liabilities. A significant insurance claim that may not be paid in full or at all could also result in breach of banking covenants and the need to issue a profits warning. The need to ensure the efficacy of insurance policies becomes obvious when viewed in terms of the financial position of a company and the maintenance of its status as a going concern.

6. Captive insurance companies

The other feature of many programs purchased by Airmic members is that a captive insurance company plays a significant role. 40% of respondents have a fronted reinsurance captive, whereas 29% have a direct writing captive. Again, the operation of the direct writing captive is likely to give rise to coverage considerations since the insurance cover provided is likely to be on a non-admitted basis in the territories where it is provided. The other aspect worthy of note is that 38% of insurance buyers who responded to the survey have an umbrella policy. Typically, this is a multi-line policy operating as an excess layer above two or more different classes of insurance and will sometimes operate as an excess layer for the captive.

It should also be noted that captive insurance companies cannot act unilaterally if they are operating as reinsurance companies for a primary insurer. Difficulty can arise in relation to the setting up of reserves, whereby the fronting insurer establishes reserves and notifies the captive reinsurance company. These reserves can be imposed by the fronting insurer even when the claims being reserved are within the captive retention layers and the money that is being allocated for the claims is all captive money. Another aspect important to coverage certainty is whether the captive insurance company has aggregate protection, especially when it is writing, multi-line multi-year program. Also, the captive managers will need access to information about international insurance requirements, including the requirements of non-admitted policies.

7. Ensuring efficacy of business insurance

Efficacy of insurance policies is achieved when the insured has gained the appropriate level of coverage, contract and claims certainty. Often, the most common cause of uncertainties within the insurance policies is the existence of basis clauses and warranties. Warranties may be particularly troublesome if they have to be fulfilled before the policy is activated. These are usually referred to as conditions precedent. For example, in the case of property damage policy, there may be a condition precedent that a survey is undertaken and confirmation provided to insurers that there has been compliance with any recommendations

in the survey report. If such confirmation is not provided, the policy could fail to respond to a property loss, even though the recommendations had actually been completed.

Contract certainty is achieved when the policy is issued and it assures the insurance buyer that the insurance is in place. Airmic believes that day one policy issuance is necessary, so that the buyer has confirmation of the terms and conditions of the policy at inception. Day one policy issuance becomes a greater challenge when a company wishes to introduce specific insurance cover by way of bespoke wordings within the policy. It is important that the arrangements to achieve bespoke wordings do not delay the issuance of policy documentation and agreed insurance policy wordings are in place at the time of inception of the insurance policy.

8. Purchase of local policies

Professional insurance buyers are aware of the requirements of complex international insurance programs and the need, in certain circumstances, to buy local insurance cover. This may increase the overall cost of the insurance arrangements, but is often considered necessary by insurance buyers. Table 3.2 indicates the circumstances in which local insurance may be required and illustrates the considerations when deciding whether to buy local insurance policies to ensure local compliance and/or reduce the uncertainty associated with the efficacy of the DIC/DIL coverage in the global policy.

Table 3.2:
Reasons for buying local policies

| | Response |
|--------------------------------------------------|----------|
| Required by local law / regulator | 75% |
| Demanded by local management | 29% |
| Local covers provide broader / specific coverage | 23% |
| Advised by insurance brokers | 23% |
| Cost effective option | 14% |

Most insurance buyers decide to buy local coverage because it is required by local law or regulatory requirements. Other reasons for buying local cover include: (1) it is demanded by local management; (2) it provides broader coverage; or (3) insurance buyers have received advice from the insurance brokers that local cover is necessary. In summary, the main reasons for buying local cover are related to achieving coverage certainty. As stated by Airmic members:

“Global insurance for me works better when it sits as DIC/DIL above an agreed local level of insurance cover” and availability of cover in the local language is also important because it represents the “ability to issue certificates in local language from local admitted carrier”.

Part 2: Management of Business Insurance Programs

Section 4: Required outcomes and expectations

1. Procedures for placing business insurance

It is important for a company to realise the complexity of the insurance programs purchased for large risks and ensure that an appropriate professionally qualified insurance buyer is in place. Anthony Hilton of the (London) Evening Standard explained the difficulty when interpreting the coverage offered by an insurance policy in his column in the newspaper:

“The problem lies in the way insurance contracts are often written. Inevitably, the policy wording are complex but the way insurance law stands at the moment – heavily weighted towards the insurer rather than the client – a breach of any one clause, for however short a time, can be invoked by the insurer to invalidate the whole policy.”

The relationship between the insurance buyer and the insurance company can be an inequitable relationship, when the contract is based on the default legal regime in England and Wales. In these circumstances, the broker becomes vitally important in protecting the interests of the insurance buyer. However, it is very important that the status of the insurance broker is always clearly established because the broker may be operating as the agent of the insurance company in certain circumstances. This will be the case when the broker has binding authority or when responsibility for reporting claims to the insurance market rests with the broker.

In relation to contract certainty, the overall objective of the insurance buyers is that the policy is available on the day of inception. Day one policy issuance is not the market norm, and some of the recommendations in this guide are aimed at establishing a timeline to achieve day one policy issuance. Day one policy issuance will require changes to market practices, because the existing arrangements already appear to be strained. For example, more than a quarter of Airmic members who responded to the survey indicated that insufficient time was available for analysis and negotiation of renewal terms.

2. Coverage Certainty and compliance of programs

Coverage certainty refers to the requirement that the insurance program should provide adequate coverage for the risk, with no gaps in that coverage other than the agreed limits and deductibles and the possible involvement of a captive insurance company. (See *Appendix C, item 3*) Disclosure obligations are fundamental to insurance contracts and Section 6 on the resolution of disputes covers this issue in more detail.

Policies often require the insured to provide updated exposure information either during the policy terms or at expiry of the policy in order to adjust the premium for the year. Another example of the dynamic relationship between insured and insurer to consider is whether if the insurer credit rating falls during the policy period, the insured has the authority to cancel the policy without penalty.

A significant requirement related to coverage certainty is that global insurance policies will respond in territories where the policy provides cover on a non-admitted basis in that territory (See Appendix C, item 4). This will be especially important, if the policy is an excess layer policy with the DIC/DIL drop-down provisions. Another consideration for insurance buyers is whether the insurance company is offering the best wording and best coverage available. Typically, it will be for the insurance brokers to ensure that this is the case. Also, there should be no duplication of insurance and Airmic members reported that this is especially likely to arise in relation to insurance for employee benefits.

Table 4.1:
How policy limits are decided

| | Response |
|--------------------------------------------------|----------|
| Claims and loss experience analysis | 71% |
| Advice from broker / consultant | 70% |
| Loss scenario modelling | 66% |
| Historical insurance structure and limits | 56% |
| Legal / contractual obligations | 56% |
| Full replacement of declared asset values | 54% |
| Peer group comparison | 46% |
| Based on a benchmark standard | 29% |
| Analysis and advice by actuaries | 19% |
| As authorised by Finance Committee or similar | 18% |
| Whatever the budget will buy | 7% |
| Only purchase the minimum limits required by law | 3% |

It is also important that policy limits are agreed and the appropriate level of indemnity is provided by the policy. Table 4.1 illustrates the means by which many insurance buyers decide the total limit of indemnity that will be purchased. It indicates that the most common means of deciding the policy limit is advice from the broker or consultant. This is an important consideration, together with confirmation of deductibles, captive involvement and any sub-limits. Again advice and guidance will be required from the insurance broker. Sometimes operational considerations are influential, as one Airmic member confirmed:

“Limits [are needed] to sit above an operational level of risk which creates ownership within the business”

3. Review of policy wordings

Policy wordings are vitally important in providing coverage certainty. Wordings not only impact the amount and scope of coverage that is provided, but terms will also be included on cancellation clauses and the circumstances in which the insurer will be able to avoid coverage. Indeed, one of the biggest causes of uncertainty in relation to coverage is the existence of basis of contract clauses and warranties. These issues have increased the frequency of legal review of policy wordings.

A consideration for insurance buyers is whether they have a review undertaken of policy wordings. In the survey undertaken by Airmic, 40% of insurance buyers indicated that legal review was undertaken for many of their insurance policies. This included a review by the legal department, as well as review by third-party specialists. 44% of respondents to the Airmic survey indicated that the policy wording was reviewed by the insurance broker only. One Airmic member explained: *“We review all policy wordings internally and have periodically obtained legal review of the wording.”*

An approach to coverage certainty is to invite the insurance market to quote against the bespoke wordings that have already been developed and supplied with the market presentation. If an insurance buyer decides to offer bespoke wordings, the normal interpretation of wordings in court is that any ambiguity tends to be settled against the best interests of the party that developed the wordings. Therefore, insurance buyers developing their own wordings should consider having these wordings legally reviewed and scenario tested.

Achieving enhanced insurance efficacy includes actions related to coverage certainty. Efficacy Checklist No 1 provides a set of questions that the insurance buyer should consider when deciding whether a satisfactory level of coverage certainty has been achieved.

Efficacy Checklist No 1:

Coverage Certainty

| | How confident are you about the following: |
|---|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | Appropriate insurance policy terms and conditions <ul style="list-style-type: none">• Definition of 'material circumstances' and misrepresentation• Remedies available to insurers in the event of non-disclosure• Impact of claims experience on renewal terms and conditions |
| 2 | Adequacy of bespoke wordings in insurance contracts <ul style="list-style-type: none">• Best coverage available has been obtained• Timetable adequate for developing bespoke wordings• Bespoke calculations, such as BI coverage are correct |
| 3 | Structure of insurance programs with no gaps in coverage <ul style="list-style-type: none">• Operation of DIC / DIL clauses in the excess layers• Operation of deductibles, sub-limits and buy-back provisions• Application of each and every and/or aggregate deductibles |
| 4 | Compliance of global policies, including non-admitted coverages <ul style="list-style-type: none">• Assurance of compliance of global programs has been obtained• Impact of warranties and conditions precedent is understood• Applicable law and jurisdiction is appropriate |

4. Contract Certainty and policy issuance

Contract certainty relates to the desired state of affairs whereby a contract with all its terms and conditions is issued before inception of the policy (See *Appendix C, item 5*). However, the contract certainty initiative undertaken by the Financial Services Authority (FSA) in 2006 allowed the insurance market up to 30 days after inception to issue the policy wording. This is no longer acceptable to many insurance buyers. Contract certainty avoids the “*deal now / detail later*” approach that has historically been adopted by the insurance market. The risk for insurance buyers under the existing contract certainty regime is that the contract will be issued using default, rather than bespoke wordings.

A significant amount of work needs to be completed before policy issuance, and it is important that sufficient time is allowed to develop the insurance contract and include all of the bespoke wordings that are required. Important issues can arise with terminology, definitions and exclusions. However, work on bespoke wordings should not delay the issuance of the policy, as

was the experience of one Airmic member: “Complete wording review was carried out this year with master insurer. Various amendments had to be made resulting in considerable delay in policy issuance across all territories.”

Achieving enhanced insurance efficacy includes actions related to contract certainty. Efficacy Checklist No 2 provides a set of questions that the insurance buyer should consider when deciding whether a satisfactory level of contract certainty has been achieved.

Efficacy Checklist No 2:
Contract Certainty

| | How confident are you about the following: |
|---|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | Arrangements for negotiation, binding authority and agency <ul style="list-style-type: none"> • Timescale for analysis and negotiation of insurance quotes • Certainty about the agency status of the broker / intermediary • Arrangements for instructions for binding insurance cover |
| 2 | Arrangements regarding co-insurance, excess layers and captives <ul style="list-style-type: none"> • Contracts are in place with all participants in the program • The position of captive and excess layers are appropriate • Role and influence of re-insurers will not be unacceptable |
| 3 | Procedures for the review of insurance contract terms and conditions <ul style="list-style-type: none"> • Understand possible impact of definitions and exclusions • Requirements to notify changes in activities and/or exposure data • Operation of premium adjustment clauses on expiry of policy |
| 4 | Timely issuance of documentation and certificates of insurance <ul style="list-style-type: none"> • Policy documentation is always issued before inception • Proof of insurance is available in each jurisdiction • Claims procedures have been established before inception |

5. Claims Certainty and claims handling procedures

Claims certainty is the most important of the required outcomes and expectations of an insurance policy (See *Appendix C, item 6*). In order to achieve claims certainty, claims notification procedures will need to be clearly established and agreed. The claims handling process commences with the notification of a claim or circumstance likely to give rise to a claim. It is possible for a circumstance to arise within the insured company and the person responsible for liaison with the insurance company may not be aware. Claims notification procedures should make allowance for the knowledge of individuals in relation to any potential claim. This will ensure that the insurance buyer is not guilty of late notification on the basis of being unaware that a claim or circumstance has arisen.

An important consideration is whether the broker will be involved in claims notification. If the policy says that notification to the broker constitutes notification to the insurer, the broker will be acting as agent of the insurer and this could give rise to complications later in the claims handling process. For example, any loss adjusters report may be confidential between the insurer and the broker (as their agent) and the loss adjusters report may be denied to the insured. The circumstances could arise even if the ultimate payment of the claim will be made by the captive insurance company.

6. Reservation of Rights and other provisions

Discussions on claims certainty will also need to extend to a consideration of the circumstances in which Reservation of Rights letters will be issued (See *Appendix C, item 7*). Consideration of speed of settlement needs to take place and the possible use of arbitration may be the subject of terms and conditions in the policy. In order to achieve claims certainty, claims handling procedures need to be agreed in advance of the claim arising and recorded in a procedures manual.

Another important consideration for insurance buyers is the inclusion of a claims preparation clause in the insurance policy. Claims preparation clauses reduce the uncertainty and difficulties in relation to the preparation of the claim, although it could be argued that this gives more authority to the insurer and the loss adjusters. The benefit to the insurance buyer is that the difficulties associated with the compilation of the claim, the appointment of forensic accountants and obtaining the necessary information in order to settle the claim are reduced. This can result in a quicker speed of settlement and the payment of interim payments, although control of the claims process by the insurance buyer will be somewhat reduced.

In relation to claims efficacy, requests for further information can be difficult to satisfy and this can cause significant delay in claims settlement. Arbitration or some other means of dispute resolution may be valuable and the question of damages for

late payment is sometimes considered. The approach taken by Airmic is that speed of settlement and interim payments should be contractual agreements within the insurance policy rather than seeking compensation for late payment. It is for individual insurance buyers to negotiate with the insurance company and agree whether compensation for late payment is an option and, if so, whether additional premium will be required.

Achieving enhanced insurance efficacy includes actions related to claims certainty. Efficacy Checklist No 3 provides a set of questions that the insurance buyer should consider when deciding whether a satisfactory level of claims certainty has been achieved.

Efficacy Checklist No 3:
Claims Certainty

| How confident are you about the following: | |
|---------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | <p>Acceptability of definitions of loss / event / circumstance</p> <ul style="list-style-type: none"> • Review of definitions in the policy has been undertaken • Ability to provide stock price 'sensitive' information, if necessary • Arrangements in place to notify losses to excess layers |
| 2 | <p>Arrangements for notification and best practice in claims handling</p> <ul style="list-style-type: none"> • Ability to respond to any 'Reservation of Rights' letters • Satisfactory speed of settlement and interim payments • Post-loss underwriting will not take place in the event of a claim |
| 3 | <p>Claims handling procedures and roles of the parties involved</p> <ul style="list-style-type: none"> • Appropriate limits set for claims handling by TPA's • Inclusion of necessary claims preparation clauses in policies • Protocols agreed for information requests in event of a claim |
| 4 | <p>Arrangements for negotiation, settlement and subrogation</p> <ul style="list-style-type: none"> • Plans for possible sale of 'impaired' assets subject to a claim • Possible application of 'average' to loss / claim payments • Agreed arrangements in place for dispute resolution |

7. Testing efficacy of insurance policies

Testing the efficacy of insurance policies is substantially based on scenario testing. Sometimes, scenario testing is undertaken at the time of inception, but this is only valuable if the insurance company has agreed that any changes to wording arising or identified during this testing exercise will then be incorporated into the policy. Therefore, allowing sufficient time for the results of the scenario testing to be incorporated into amended wordings is critically important.

In order to ensure the efficacy of insurance policies, scenario testing coverage of the anticipated events will be important. Testing of policy wordings and agreement of bespoke wordings is an important mechanism to ensure that post loss or retrospective underwriting does not take place. This will also be a means of identifying the adequacy of the limit of indemnity that has been purchased. It is the experience of Airmic members that deciding on the limit of indemnity is particularly important, but especially difficult in relation to business interruption claims.

Section 5: Governance of insurance programs

1. Role and responsibilities of insurance buyers

This section discusses the roles and responsibilities of individuals in ensuring the efficacy of the insurance programs. A summary of typical roles and responsibilities for insurance programs is set out in Table 5.1. The role of the insurance broker is critically important, including ensuring that the insured fully understands their responsibility to provide full disclosure of material circumstances and ensure that the risk is not misrepresented.

Table 5.1:

Roles and responsibilities for insurance programs

1. Buyer Responsibilities

- Accurately complete any proposal form and disclose all material facts
- Review the policy wording to ensure that it meets business needs
- Pay the premium and taxes on time, as this may be a warranty on the policy
- Comply with the requirements of the policy – seek clarification as necessary
- Notify changes in the material facts and circumstances about the business

2. Broker / Agent Responsibilities

- Discuss and advise on the types and level of insurance cover that may be required
- Disclose all sources of income on the account and manage any conflicts of interest
- Supply details of the insurers approached and quotes received to the insured
- Ensure that all documents and notifications are sent to the insurers in good time
- Monitor claims activity and pursue and/or advise on claims recoveries

3. Insurer Responsibilities

- Issue the policy by the time it takes effect to achieve contract certainty
- Advise when any terms in the policy are less favourable than might be expected
- Provide and communicate procedures for resolving any disputes
- Deal with claims fairly, efficiently and as quickly as possible
- Provide confirmation of any changes in the cover terms and conditions

Roles and responsibilities in relation to the governance of insurance programs should be established and include the responsibilities of all parties involved. The insurance buyer, insurance broker, insurance company, as well as other service providers, such as claims administrators, loss adjusters, forensic accountants and legal advisers should all be included in a full list of responsibilities.

The responsibility for the collection of underwriting information, evaluation of insurance quotes, binding of insurance coverages, claims procedures and compliance of insurance programs should all be specified. The list of tasks that need to be undertaken may be the sole and/or shared responsibility of the insurance buyer, broker, carrier, loss adjuster and/or third party administrator (TPA). As well as being included in a procedures manual, the roles and responsibilities are often established by the use of Terms of Business Agreements (ToBA's) and/or Service Level Agreements (SLA's).

2. Role of the insurance broker

The role of the insurance broker is critical in ensuring the efficacy of insurance programs (See *Appendix C, item 8*) and Table 5.2 sets out the responsibilities of insurance brokers as reported by Airmic members during a survey in April 2014. An important consideration in relation to insurance brokers is the law of agency and conflicts of interests that can arise when the broker is acting as agent of the insurer. The broker role is critical in relation to the purchase of insurance programs that have necessary efficacy and insurance buyers place a good deal of reliance on their insurance broker.

Table 5.2:
Role of the insurance broker

| | Response |
|----------------------------------------------------|----------|
| Recommend design of the insurance programs | 93% |
| Placement of all classes of insurance | 90% |
| Preparation of policy documentation | 87% |
| Preparation of the insurance market submission | 83% |
| Claims advice when large claims arise | 82% |
| One-off or project based consultancy services | 60% |
| Advice on multi-national non-admitted compliance | 59% |
| Risk control advice / surveys / training | 51% |
| Advice on multi-national tax compliance | 49% |
| Management of captive insurance company | 32% |
| Direct claims handling services | 23% |
| Acts as agent of the insurer in some circumstances | 22% |

The insurance broker acts as a professional adviser to insurance buyers, as well as having a pivotal role in the procurement transaction for insurance policies. Broker transparency is important and the broker should declare information on a wide range of issues to the insurance buyer. These issues include the services they provide, the capacity in which they are operating, the extent of the professional advice they are providing to the insurance buyer, the extent of the searches and enquiries they undertake in the insurance market, the scope for potential conflicts of interest and they should also provide remuneration information when requested.

3. Potential broker conflicts of interest

Insurance buyers should understand whether the broker is acting in the role of professional adviser and/or transaction facilitator. Table 5.2 indicates that in almost all circumstances, the insurance broker provides recommendations on the design of the insurance programs and structure. Likewise, the broker is almost always responsible for the placement of all classes of insurance. The role of professional adviser and transactional facilitator are separable roles that give rise to different levels of broker risk exposure. Insurance buyers may wish to have separate discussions with brokers in relation to the limit of indemnity related to professional advice and the limit in relation to insurance transactions undertaken by the broker.

More than 80% of Airmic members who responded to the survey reported that they use their insurance brokers to prepare the insurance market submission and prepare the policy documentation. There is also a similar reliance on insurance brokers to provide advice when large claims arise. However, it was noted that in excess of 20% of cases, there were circumstances where the broker was acting as the agent of the insurance company. Insurance buyers need to discuss with their insurance brokers whether these circumstances could give rise to conflicts of interest.

Other activities undertaken by insurance brokers for the majority of Airmic members were advice on multi-national compliance, in regard to both tax requirements and non-admitted insurance requirements. Compliance of multi-national insurance programs is a major concern for insurance buyers, and broker advice and support are critically important. Many insurance buyers will also seek direct access to information on multi-national compliance requirements. Although some brokers undertook risk control advice, service and training, there was less use of brokers in relation to direct claims handling services.

4. Broker limits of indemnity

Insurance buyers should look at the limit of indemnity offered by the insurance broker should there be a need to claim on the professional indemnity or errors and omissions policies of the insurance broker. Airmic members recognise that insurance brokers will typically put a limit on the exposure in relation to professional advice. Brokers may also seek to limit their indemnity in relation to insurance transactions. It is for the insurance buyer to negotiate the limit of indemnity that will apply to insurance transactions undertaken by the broker. One Airmic member reported the result of their negotiations as; *“Broker’s limit of liability is equal to highest level of any policy limit of indemnity at £200 million”*

Airmic asked members about the discussions that have been undertaken with insurance brokers concerning limits of indemnity. Although 10% of respondents indicated that there had been no discussion and a further 10% indicated that there had only been informal discussion, nearly 40% were able to report a fully documented review of the limit of indemnity offered by the insurance broker.

About 12% of insurance buyers accepted the limit suggested, a further 37% were able to negotiate a higher limit than initially suggested and about 8% agreed unlimited indemnity. The limits applied to professional advice for 21% of respondents, but only 16% accepted a lower limit applicable to insurance transactions. In summary, limited liability for professional advice is acceptable to the Airmic members, but limits of liability for transactions are less acceptable.

5. Role and responsibilities of insurance carriers

Insurance carriers have a great deal of responsibility for ensuring the efficacy of insurance programs. A major responsibility relates to compliance of the multi-national insurance program and a good deal of effort is put into ensuring compliance. Insurance companies need to ensure an adequate credit rating as well as working towards compliance with Solvency II. Also, insurance companies will often be responsible for the appointment of loss adjusters following a loss and the role, responsibilities and expectations of loss adjusters need to be clearly specified. Although some insureds will look to appoint their own loss assessors, this may not be acceptable to the insurer and may be against the terms and provisions of any claim preparation clause in the insurance contract.

If an insurance company places warranties, subjectivities or exclusions on certain activities, the insurance buyer should expect that specific attention will be drawn to these contract conditions. Also, the inclusion of any basis clauses should be specifically brought to the attention of the insurance buyer. However, some concern was expressed by Airmic members about an apparent lack of liaison between underwriters and claims managers within

insurance carriers. In some case, underwriters were providing assurances that certain exposures were covered by the policy, but claims managers took a different view when a particular claim or circumstance arose.

6. Role of other service providers

Third party administrators and other service providers also have an important role to play, especially in relation to small insurance claims. However, there needs to be a specific service level agreement (SLA) in place. Sometimes, the insurance carrier will outsource management of smaller claims to the third party administrator (TPA) and insurance buyers need to ensure they have sufficient liaison with the TPA. In some cases, preparation of policy wordings and policy documents is the responsibility of a third party service provider and insurance buyers need to be aware of these arrangements in order to ensure that contract certainty is achieved.

A wide range of third party service providers, such as third party administrators for insurance claims, loss adjusters, legal advisers and others can be involved in the operation of insurance programs. Typically, third party administrators are engaged to look after the small claims, where these were previously managed by in-house claims departments in many cases. TPAs typically look after claims within deductible for the insurance buyer. Careful liaison is required so that claims that are initially considered to be within deductible are handed over to the insurance company to manage as soon as it becomes obvious that the claim is more serious than originally thought.

7. Governance of insurance arrangements

Governance of insurance programs is important both in terms of governance of the relationship between the insured and their insurers and brokers, but also in terms of internal governance of the insurance programme within the company. The insured needs to look at the administration and governance of the insurance programme, including legal review of the terms and conditions of the insurance contract and authorisation of the purchase itself. Governance also includes review of broker limits of indemnity, as well as the need to liaise with internal procurement professionals in some large organisations and public organisations that may be subject to the Official Journal of the European Union (OJEU) procurement procedures.

The establishment of a suitable and sufficient disclosure process within the insurance buyer company is vitally important. This disclosure process should be agreed with underwriters. Underwriters should demonstrate that they are engaged with the process and ask for further information, as necessary. A governance checklist is required for insurance programs and insurance buyers should ensure that arrangements are in place within their own organisations to authorise the purchase and structure of the insurance programs.

The means for providing information to underwriters was also investigated in the Airmic survey and more than three quarters of insurance buyers provide a copy of the annual report and accounts to underwriters. With the increasing availability of electronic data, in excess of 20% of insurance buyers now give brokers and insurers access to an electronic data room as a means of providing market presentation information.

Achieving enhanced insurance efficacy includes actions related to governance of insurance programs. Efficacy Checklist No 4 provides a set of questions that the insurance buyer should consider when deciding whether a satisfactory level of governance has been achieved.

Efficacy Checklist No 4:
Governance Arrangements

| | How confident are you about the following: |
|----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | Design and placement of necessary and relevant insurance programs <ul style="list-style-type: none"> • Reasons for buying insurance and relevance of insurance • Identification of business assets and risk exposures • Evaluation of risk financing and insurance needs undertaken |
| 2 | Negotiation, analysis and evaluation of insurance contracts <ul style="list-style-type: none"> • Specific clauses that can reduce cover explained by insurers • Legal review of insurance contracts undertaken, as necessary • TPA and other service provider contracts in place |
| 3 | Administration and compliance of insurance programs <ul style="list-style-type: none"> • Loss notification protocols, including excess markets established • Additional services to be provided by insurers and brokers agreed • Cancellation circumstances and procedures fully established |
| 4 | Broker role, remuneration and potential conflicts of interest <ul style="list-style-type: none"> • Status of broker and potential for conflicts of interest understood • Any limitation on broker liability discussed and documented • Broker security rating of insurers and influence on cancellation |

Section 6: Resolution of insurance disputes

1. Selection of applicable law and jurisdiction

The default regime for resolution of insurance disputes under the law of England and Wales is currently under review by the Law Commission and a draft Insurance Contracts Bill was published in 2014. This section relates to the obstacles that can cause reduced efficacy of insurance policies, and many of these are associated with current insurance contract law, which is the Marine Insurance Act 1906 (MIA). Allegations of failure to comply with warranties and the existence of basis of contract clauses can permit the insurer to avoid all liabilities under an insurance contract.

It is for insurance buyers to seek to eliminate the unacceptable components of the default regime by suitable clauses, such as the basis of contract draft clause recently issued by Airmic (See *Appendix C, item 9*) and advice on elimination of conditions precedent clauses (See *Appendix C, item 10*). Several aspects of the MIA are considered to be unacceptable by insurance buyers because the remedies available to insurance companies are unreasonably harsh. Insurance buyers need to be aware of unacceptable contract terms and conditions in the default legal regime and seek policy wording amendments to eliminate or neutralise these conditions.

Perhaps the most important of the governing principles for insurance contracts relates to disclosure of all material circumstances. Insurance contracts are currently considered to be contracts of 'utmost good faith' under the provision of the MIA. It is for the insurance buyer to ensure that they disclose all material circumstances and not misrepresent the risk in a way that will induce an underwriter to offer more favourable terms than appropriate. This may appear to be a reasonable requirement, but it is the remedies available to the insurer that can result in unreasonable outcomes.

2. Remedies for breach of disclosure obligations

The critical issue related to non-disclosure are the remedies available to the insurer in the event of non-disclosure under the present MIA regime. The insurer can avoid the policy 'ab initio' (from inception) in the event of non-disclosure. This is a disproportionate remedy and the draft 'Insurance Contracts Bill' recently published by the Law Commission suggests that more proportionate remedies should be introduced and avoidance of the insurance policy should only be available in cases of fraudulent misrepresentation. Insurance buyers are, of course, free to negotiate alternative remedies that are more favourable, but the buyer should always be aware of the default remedies set out in the MIA.

Airmic has published a report on suitable and sufficient disclosure processes. The critical issue is for insurance buyers to provide disclosure of all material circumstances and provide a fair representation of the risk. The desire of insurance buyers is that

underwriters are actively engaged in a dialogue with the insurance buyer to ensure that the writer has understood the risks.

Also, the scenario testing undertaken should confirm that coverage certainty has been achieved. One Airmic member summarises the current position as follows:

“I do not think that insurers / underwriters are clear in confirming what they deem as material and whether or not they have fully understood the risk that they are underwriting. I think insurers should do a presentation back to the company summarising their understanding of the risks that they are underwriting and so that any discrepancies can be clarified.”

One reassuring outcome from the survey of Airmic members is that for nearly half the market presentations, underwriters seek further information pre-inception. This indicates that underwriters are becoming engaged in the disclosure process and are seeking further information from the insurance buyer prior to inception of the policies.

3. Impact of warranties and possible remedies

As well as avoidance of the policy or non-disclosure, insurance companies may also be able to avoid the policy in relation to warranties, subjectivities and basis of contract clauses. These are considered to be unfair and disproportionate and the Insurance Contracts Bill puts forward more balanced remedies that would be available to insurance carriers. The insured should undertake a legal review of the insurance contract and seek to eliminate or neutralise any basis of contract clauses and other unfair policy terms.

Warranties can be particularly unfair in their application, as the loss does not need to be related to any breach of warranty. For example, if the intruder alarm is subject to a warranty, but is not operational at the time of a flood, the insurance company would be entitled to avoid the policy because the intruder alarm warranty was not being fulfilled. This is a disproportionate remedy. Linking the loss to any breach of a warranty is more appropriate, although it may require careful drafting of the relevant clause(s) in the insurance contract.

Conditions precedent are considered by Airmic to be unfair and buyers of insurance should seek to eliminate or neutralise such clauses. Conditions precedent apply when a policy is only activated or cover is only attached when certain conditions are met. If the conditions are not met at the time of inception of the policy, coverage will never exist, even though the condition may later be fulfilled. For example, if it is a condition precedent that a specified number of crew are present on a ship at the start of a voyage, but that number was not actually present at the start of the voyage, a condition precedent would allow an insurer to claim that coverage never attached and increasing the crew numbers to the required level later in the journey does not attach cover.

4. Suitable and sufficient disclosure process

Other unsatisfactory aspects of insurance contracts are basis clauses, whereby the insurance company is in a position to avoid a policy ab initio on the basis that every piece of information provided becomes the basis of the contract. Any incorrect information, no matter how trivial and no matter how irrelevant to the circumstances of any claim, would be sufficient for the insurance company to deny coverage. Airmic has published a guide on basis clauses that suggests that insurance buyers should ensure that such clauses are eliminated or neutralised in all of their insurance policies.

In relation to disclosure processes, Airmic members were asked about their level of confidence in the disclosure processes and two thirds of respondents were confident that the disclosure processes and responsibilities were well-defined and the consolidated exposure information was carefully validated. Nevertheless, about a third of those who responded to the survey indicated that the preparation of exposure information required improvement. A similar number indicated that overall, the collection processes are time-consuming and inefficient.

An important further consideration in relation to establishing a suitable and sufficient disclosure process is to identify where the information about material circumstances is held in the company. The person responsible for the insured's insurance would normally be considered to be the person responsible for disclosing all of the information they have available. It will, of course, be necessary for the responsible person to make appropriate enquiries so that information can be collected in order to disclose all material circumstances. Normally, the responsible person will collate the information that is then authorised by a more senior individual in the company for release to the insurance market.

5. Claims procedures and subrogation

Subrogation has become a much more important issue in relation to claims handling in recent times. Insurance companies have always had an expectation that they would pay the loss suffered by the insurance buyer, but would then seek to recover the cost of the payment from a third party held to be responsible. For example, if a fire occurs in a restaurant caused by failure to maintain a deep fat fryer, the insurance company for the restaurant will pay for the fire damage and will seek subrogation rights against the company responsible for the maintenance of the deep fat fryer.

From the point of view of the insurance buyer, there will often be an expectation in the insurance policy that the buyer will fully co-operate with the insurance company in these subrogation activities. In any case, subrogation is usually taken in the name of the insurance buyer and may be undertaken by the insurance company against a business partner, or key supplier of the insurance buyer. This could cause difficulties for the insurance

buyer and their ongoing relationship with that supplier. It is therefore important that insurance buyers review subrogation clauses and ensure that unacceptable subrogation clauses are modified or eliminated.

Subrogation could give rise to difficulties in circumstances where the insured has given indemnity to a third party. This could occur when a supplier has been given indemnity or waiver of subrogation by the company in relation to, for example, liability claims. Granting of indemnity to a supplier may be considered to be a material circumstance that should be reported to insurers. Failure to report the existence of such a deed of indemnity to insurers may result in a claim being disputed on the basis of non-disclosure. Alternatively, the insurer decides to seek subrogation against the supplier against the wishes of the insured because the insurer does not acknowledge the validity of the deed of indemnity.

For example, a deed of indemnity may be granted to a sub-contractor operating within the same premises as the company. This could arise if the previously in-house department was set up as a separate trading company as an outsourcing arrangement. In order to facilitate this 'privatisation', a waiver of subrogation may be put in place as part of the outsourcing arrangement. If this occurs, it is important to notify the insurer of the new arrangements. Finally, it is also worth noting that a company may be in a position where the company itself is the subject of a subrogation action by the insurance company of a customer. The identification of the potential for this to arise and the possible implications should be part of scenario testing.

6. Reservation of Rights and speed of settlement

Both Reservation of Rights and speed of settlement are the subject of Airmic market agreements. Responding to Reservation of Rights notifications can be difficult, but the insured should seek agreement with the insurer prior to any claims as to how Reservation of Rights notifications will be handled. In summary, insurance buyers should:

- Request written confirmation of the Reservation of Rights
- Seek a clear statement of the precise issues of concern
- Communicate receipt of the reservation within their company
- Liaise with underwriters to test each of the reasons given
- Respond to requests for additional information
- Request removal when the information has been provided

Compensation for late payment of claims is not considered to be a major problem by Airmic survey respondents. Nevertheless, there is no reason why an Airmic member could not insert a late payment clause into insurance contracts; pay any additional premium that may be associated with this additional clause; and thereby put themselves in a position to be able to claim compensation for late payment of insurance claims.

There is also the question of the influence of re-insurers and how this may affect the handling of a claim by the primary insurer. The typical position taken by Airmic members is that the insured is a client of the primary insurer and is not a client of the reinsurer. Accordingly, any reinsurance terms and conditions should not influence the settlement of a claim.

Achieving enhanced insurance efficacy includes actions related to disputes resolution. Efficacy Checklist No 5 provides a set of questions that the insurance buyer should consider when deciding whether a satisfactory framework for disputes resolution has been achieved.



Efficacy Checklist No 5:
Disputes Resolution

| How confident are you about the following: | |
|---------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | <p>Disclosure and misrepresentation of all material circumstances</p> <ul style="list-style-type: none"> • Scope / opportunity for avoidance of the policy by insurers • Existence of a suitable and sufficient disclosure process • Identification of persons with disclosure responsibilities |
| 2 | <p>Impact of warranties, subjectivities and basis of contract clauses</p> <ul style="list-style-type: none"> • Operation of warranties and subjectivities understood • Basis of contract clauses excluded from proposals forms • Policy cancellation rights understood and acceptable |
| 3 | <p>Arrangements for satisfactory claims handling and settlement</p> <ul style="list-style-type: none"> • Choice of law and jurisdiction for insurance claims agreed • Agreement regarding consequences of fraudulent claims • Agreement regarding any damages for late payment |
| 4 | <p>Structure and detailed provisions of insurance contracts</p> <ul style="list-style-type: none"> • Understanding of claims made and claims occurring policies • Limits of indemnity established as 'per occurrence' or 'aggregate' • Sub-limits, deductibles and subrogation arrangements agreed |

7. Draft Insurance Contracts Bill 2014

The Law Commission published proposals for reform of the Marine Insurance Act 1906 in the spring of 2014. The key provisions of the proposed Insurance Contracts Bill in relation to disclosure and the impact of warranties are summarised below.

Insurance Contracts Bill 2014

- Before a contract of insurance is entered into, the insured must make to the insurer a fair presentation of the risk. A fair presentation of the risk is one that discloses every material circumstance which the insured knows or ought to know, or gives the insurer sufficient information, in relation to those material circumstances, to put a prudent insurer on notice that it needs to make further inquiries.
- A circumstance is material if it would influence the judgment of a prudent insurer in determining whether to take the risk and, if so, on what terms. A material representation is substantially correct if a prudent insurer would not consider the difference between what is represented and what is actually correct to be material.
- An insured who is an individual knows what is known to one or more of the individuals who are responsible for the insured's insurance. An insured who is not an individual knows only what is known to one or more individuals who are part of senior management or responsible for the insured's insurance. Whether an individual or not, an insured ought to know what would have been revealed by a reasonable search of information.
- An insurer knows something only if it is known to one or more of the individuals who participate on behalf of the insurer in the decision whether to take the risk and if so on what terms. Knowledge includes not only actual knowledge, but matters which the individual suspected, and of which the individual would have had knowledge but for deliberately refraining from confirming, or enquiring about, them.
- The insurer has a remedy against the insured for a breach of the duty of fair presentation only if the insurer shows that, but for the breach, the insurer would not have entered into the contract at all, or would have done so only on different terms.
- An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied. Breach of a warranty may not be relied upon by the insurer to exclude, limit or discharge its liability for loss of a different kind or at a different location or time.

Part 3: Achieving Efficacy of Business Insurance

Section 7: Experiences of insurance buyers

1. Survey of Airmic member efficacy experiences

The experience of insurance buyers was investigated by way of a survey of Airmic members in April 2014. The intention of the survey was to discover the experiences of members in relation to the efficacy of their insurance policies. Several tables of information have been extracted, together with information on the responses to critical issues that are included in other sections of this report. The importance of insurance is clear from the wide range of business sectors responding to the Airmic survey, including financial institutions, utilities and retail.

In excess of 75% of those who responded had a turnover of £5 billion or more. Table 3.1 reflects the complexity of the insurance programs purchased by Airmic members in that so many features that can cause complications are present and Table 7.1 describes broader features associated with insurance renewal. Ensuring the efficacy of insurance programs when there are so many components present is a challenge for insurance buyers and demonstrates that large organisations need qualified competent insurance buyers.

It was helpful when compiling this report to have views from a very wide range of insurance buyers experienced in purchasing insurance programs with all of the features that create complexity and uncertainty in the purchase of multi-national insurance programs for global companies. The survey also demonstrated that insurance is a business enabler and the quote below shows that insurance can support business success:

“A lot of our banking covenants require insurance to be in place. Our lenders take a tremendous amount of comfort from this.”

2. Disclosure and negotiating contract certainty

One of the main requirements for insurance buyers is to ensure full disclosure of material circumstances and not to misrepresent the risks that they are seeking to insure. This can be very challenging for Airmic members, especially when they are undertaking this work against a very tight timescale. Table 7.1 lists the difficulties that Airmic members reported in seeking to undertake disclosure and negotiate contract certainty. The greatest difficulty reported by respondents was meeting the timescale required to produce a bespoke fully compliant global insurance program. The importance of policy wordings, terms and conditions were emphasised during the survey, with particular emphasis on policy wordings for all types of policies.

Table 7.1:

Difficulties faced by buyers on renewal

| | Response |
|---------------------------------------------------------------------|----------|
| Collection of insurance renewal information | 37% |
| Meeting desired timescales for allocated actions / responsibilities | 31% |
| Meaning of exclusions, policy conditions and warranties | 31% |
| Time available to develop bespoke wordings | 31% |
| Delays in receiving certificates of insurance | 31% |
| Time available for analysis and negotiation of renewal terms | 27% |
| Primary policy wordings, terms and conditions incorrect | 25% |
| Insufficient level of detail included in proposed renewal terms | 25% |
| Local policy wordings incompatible with master policy | 24% |
| Time available to undertake legal review of policies | 23% |
| Existence of 'basis of contract' clauses in the policy | 21% |
| Subjectivities not being fully communicated or explained | 13% |
| Excess policy wordings differing from primary wording | 11% |
| Presentation of renewal information to current / potential markets | 11% |
| Insurer cancellation rights unacceptable | 7% |
| Procedures for reporting changes during the policy period | 6% |
| Procedures for binding policy cover | 4% |

In summary, the greatest difficulties were associated with the collection of information, negotiation of policy wordings and analysis of policy conditions and warranties. The importance of compliance is emphasised and Table 7.2 identifies the difficulties in global programs related to DIC/DIL insurance clauses. Also, warranties, as well as the imposition of limits and unacceptable sub-limits, proved to be problems for insurance buyers.

Table 7.2:
Compliance issues of greatest concern

| | Response |
|-------------------------------------------------------------------------|----------|
| Compliance of non-admitted policies in overseas territories | 50% |
| Compliance with international premium tax requirements | 46% |
| Concerns over the effectiveness of DIC / DIL insurance clause | 41% |
| Existence and / or operation of warranties | 41% |
| Imposition of unacceptable limits and / or sub-limits | 35% |
| Non-availability of risk information for international operations | 35% |
| Difficulties with international claims handling procedures | 31% |
| Existence and / or operation of 'basis of contract' clauses | 27% |
| Issuance of 'proof of insurance' paper in overseas territories | 25% |
| Communication to broker / insurers of binding instructions | 23% |
| Concerns over the effectiveness of follow form / follow fortune clauses | 22% |
| Concerns over the operation of agreed buy-back provisions | 2% |
| Compliance with UK insurance tax requirements | 2% |

Compliance with non-admitted insurance policies, non-availability of risk information on international operations and compliance with international premium tax requirements were also particular difficulties. Emphasis was also placed on the difficulties associated with international claims handling arrangements.

3. Compliance and achieving coverage certainty

Coverage certainty is related to scenario testing and legal review of wordings by legal and other insurance professionals. It is also important for the insurance buyer to obtain the best terms that are currently available and the knowledge and expertise of insurance brokers is essential in supporting this requirement. In relation to disclosure requirements, 50% of Airmic members reported that materiality is clearly defined and there is clarity regarding what is material to the underwriter in accepting risk. However, 25% of respondents reported that the risk disclosure arrangements needed to be improved.

Compliance issues are also significant for many insurance buyers. Automatic renewal of policies, by way of 'evergreen' policies or tacit renewal is not commonplace for insurance buyers. However, many insurance buyers favour this approach because of the reduced disclosure requirements that arise from having a long-term partnership with the same insurance company and underwriter.

4. Claims certainty and preparing for large claims

The difficulties in preparing for large claims are reported in Table 7.3, although the majority of insurance buyers reported that formal claims notification procedures were in place and had been agreed. In half of the responses, managers and employees had been briefed on what to do in case of a potential claim and overall roles and responsibilities have been identified. In nearly two thirds of cases, the appointment of loss adjusters had been identified before the claim arose.



Table 7.3:

Preparations in advance for large claims

| | Response |
|-----------------------------------------------------------------------|-----------------|
| Appointment / selection of loss adjustors in advance | 65% |
| Prepared a formal claims notification procedure with insurers | 57% |
| Established agreed procedures with brokers to notify claims | 51% |
| Managers / employees briefed on actions in event of a potential claim | 47% |
| Defined roles and responsibilities in case of a potential large claim | 36% |
| Claims preparation clause in the insurance policy | 35% |
| Informal expectation that insurance buyer will take control | 34% |
| Arrangements will be developed in response to the specific claim | 31% |
| Appointment / selection of lawyers in advance | 31% |
| Undertaken loss response rehearsals / scenario testing | 24% |
| Formal agreement that the insurance buyer will take control | 17% |
| Appointment / selection of forensic accountants in advance | 16% |
| Formal agreement that broker or TPA will take control | 10% |
| Appointment / selection of loss assessors in advance | 4% |

Table 7.3 illustrates the overall claims difficulties and concerns faced by insurance buyers and these relate primarily to the appointment of appropriate defence counsel with particular difficulties associated with reservation of rights, slow settlement of claims, and unreasonable requests for further information by insurers. The inclusion of preparation of claim clauses in insurance contracts was found to be beneficial by many insurance buyers, although this does limit the availability to appoint a loss assessor.

It is not uncommon for various parties to an insurance program to appoint their own lawyers, including co-insurers. The role of loss adjusters proved to be particularly difficult. Also, a greater tendency to challenge large claims and seek legal opinion was reported by many insurance buyers. This represents an unwelcome development and Airmic members report that this has resulted in large claims being contested far more frequently than was previously the case.

It is important for insurance buyers to have claims handling procedures and protocols established in advance of claims arising in order to make disputes much less likely. Many insurance buyers report that meeting with the insurer claims department before claims arise provides a sound basis for equitable negotiation and subsequent settlement of the claim. Meeting with underwriters only is considered not to be sufficient and meeting with claims handlers enhances relationships with the insurance company.

5. Procedures for renewal of insurance policies

It was noted by many survey respondents that underwriters require information that is not readily available and this was found to be the case in a quarter of all responses. In nearly a third of cases, underwriters require information that is confidential or market sensitive, and insurance buyers had particular difficulty in meeting these requests. Of particular interest was the fact noted by 20% of insurance buyers that problems increase when there is a change of insurance carrier.

However, it appears that a new underwriter at the same insurer gives more difficulties than changing insurance companies: 32% of insurance buyers reported that a new underwriter created greater problems, whereas only 20% reported that a change of insurance companies presented problems. The issues related to the relationship between insurance buyer and the underwriter were expressed by one Airmic member as:

“Underwriters are beginning to want greater information on areas where they were quite relaxed and set out in a particular way” and “New underwriters slow the process as they tend to refer decisions upwards that have previously been agreed.”

Section 8: Steps to increasing insurance efficacy

1. Achieving desired insurance policy outcomes

The purchase of a multi-national global insurance program requires a good deal of knowledge and expertise on behalf of the insurance buyer. The use of insurance specialists and insurance brokers is essential because the brokers have day-to-day knowledge of the insurance market and detailed experience of the design of complex multi-national global insurance program. The importance of the insurance broker is emphasised by the fact that many of the insurance markets are broker only markets and it is important for insurance buyers to have access to these markets.

The 8 steps to the achievement of enhanced efficacy of insurance policies are described in Appendix A. The desired outcome for insurance buyers is increased coverage, contract and claims certainty. For many insurance buyers, it is no longer considered acceptable that policy documentation should follow 30 days after inception. The desired outcome in terms of coverage and contract certainty was expressed by one Airmic member as:

“More flexibility, to produce policy wordings that reflect, in simple language, what we ask for”

Most Airmic members require bespoke wordings and are seeking policy issuance at the time of inception. If this is to be achieved, an extended renewal period is required, as outlined in Appendix B. Appendix A sets out the 8 steps to achieving this and the various sections of this guidance describe the issues that should be considered and the governance structure that should be in place to support the purchase of insurance programs. In order to provide further detailed information, Airmic has published a series of guides to efficacy of insurance programs and these are described in Appendix C.

2. Overcoming weaknesses in insurance arrangements

To ensure insurance efficacy, as described in Appendix A, measures should be taken to overcome weaknesses in insurance arrangements. The primary responsibility for ensuring that there are no weaknesses in the insurance arrangements rests with the insurance buyer. Accordingly, the insurance buyer should ensure that adequate risk assessments are undertaken to identify the insurance needs of the company. Having recognised the insurance needs, the next stage is to design insurance programs that will fulfil the insurance and risk financing needs of the company.

Having identified the insurance needs, the next stage is to identify insurance companies that are willing to participate in the proposed arrangements. During negotiations with potential insurance partners, several issues need to be discussed and overcome in relation to the potential policy that will ultimately be produced as the insurance contract between the insurance buyer and the insurance company.

The legal framework that should be achieved should be clear as to the remedies available to the insurance company in the event of disputes over insurance cover, perhaps arising from failure to disclose all material circumstances, to comply with warranties or to follow claims notification procedures. In all of these circumstances, the remedies available to the insurance company and/or the penalties that will be applied need to be fair and equitable.

3. Fulfilling insurance roles and responsibilities

Fulfilling insurance roles and responsibilities can be viewed as the governance arrangements for the insurance programs. Governance arrangements include information on the roles and responsibilities for the particular insurance program that is purchased. This is focused on the individual insurance buyer who will be responsible or held ultimately responsible for the efficacy of the insurance programme that protects the assets and liabilities of the insured. This is the first line of defence in terms of the procurement of insurance programs.

Several different insurers will be involved in each multi-national insurance program and each will provide different components of cover within the insurance structure. These are suppliers of insurance cover and will have obligations to provide coverage, contract and claims certainty. Ensuring that the appropriate level of efficacy is achieved will primarily be the responsibility of the insurance buyer as the first line of defence. The second line of defence in ensuring that such levels of efficacy are achieved will be professional advisers to the insurance buyer, such as the insurance broker.

Other service providers will also be involved in the insurance arrangements, including third party administrators, legal advisers, loss adjusters and others. These all need to be evaluated by the insurance buyer with the help of the insurance broker to ensure that they provide the required level of service. However, all parties to designing and procuring the insurance programs need to work together and this may not always be the case, as identified by one Airmic member: *“Brokers are also now pretty focused on the issues, but can be somewhat reluctant to push the market hard enough.”*

The insurance arrangements need to be validated by financial specialists within the insured, possibly including the chief financial officer or group finance director, financial controller, head of tax, corporate treasurer, company secretary, head of legal affairs and others. It is important that the insurance buyer does not operate alone in making these decisions. The internal resources should monitor the efficacy of the insurance programs and they represent the third line of defence in ensuring the efficacy of insurance programs. The three lines of defence, taken together, represent the governance arrangements for insurance within the company.

4. 8 steps to increasing efficacy of insurance policies

Appendix A describes the 8 steps to increasing the efficacy of insurance policies and these steps represent the activities and processes that must be undertaken in order to ensure appropriate efficacy of insurance programs. All parties will be involved in almost all stages and it is by cooperation and partnership that increased efficacy of insurance programs will be achieved. More detailed checklists are included in this guide to coverage, contract and claims certainty, as well as governance arrangements and dispute resolution.

Insurance buyer concerns are reported in Table 8.1. Airmic members stated that 75% of buyers would prefer day one policy issuance and that means issuance of the policy at or before inception. It was also reported that 75% of insurance buyers are satisfied with their disclosure processes, although only half of those think that underwriters are sufficiently engaged in the disclosure process. The failure of underwriters to engage in the disclosure process indicates that underwriters do not fully understand the risks they are insuring and this increases the chances of unsatisfactory claims response by the insurer.



Table 8.1:
Insurance buyer difficulties and concerns

| | Response |
|-------------------------------------------------------------------|----------|
| Appointment of appropriate defence counsel | 55% |
| Speed of settlement of an insurance claim | 48% |
| Establishing and / or notification of reserves | 41% |
| Receiving a Reservation of Rights notification | 41% |
| Difficulties regarding claims quantification | 30% |
| Claim challenged over late notification | 26% |
| Negotiation of settlement arrangements | 26% |
| Subrogation procedures against third parties | 18% |
| Unreasonable information requests from insurers | 16% |
| Appointment of appropriate adjuster, assessor, etc. | 13% |
| Notification or reporting of claim to primary insurer | 12% |
| Access to and availability of claims files / records | 12% |
| Notification or reporting of claim to excess insurers | 8% |
| Inadequate size / timings of interim payments | 8% |
| Inadequate sums insured or limit of indemnity | 7% |
| Claim challenged over alleged breach of warranty | 5% |
| Unfair application of 'average' to a claim | 5% |
| Use of arbitration or alternative dispute resolution | 5% |
| Undue influence of re-insurers on claims settlement | 5% |
| Claim challenged due to operation of a 'basis of contract' clause | 3% |
| Inadequate indemnity period purchased for BI claims | 3% |
| Difficulty in seeking damages for late payment | 0% |

There are many obstacles to achieving the required level of insurance efficacy and this guide describes many of the pitfalls and solutions that can be agreed between the parties. These are complex negotiations that result in a complex and detailed contract. It is necessary for all parties to act in good faith and ensure that the required level of efficacy is obtained in relation to coverage, contract and claims certainty.

5. Timeline for renewal of insurance policies

Appendix B shows a suggested timeline for the achievement of day one policy issuance. It may be easier to achieve the deadlines when renewal is taking place with the existing insurance carriers and the existing underwriter. However, it was reported by Airmic members that not all parties to the renewal process appear to be fully committed:

“Prompt policy issuance is still perceived as non-urgent by some brokers and insurers and the delivery is much too slow.”

The suggestion in Appendix B is that the renewal process should commence about 180 days before the renewal date with the collection of underwriting information by the insurance buyer, probably with the assistance of their insurance broker. Having compiled the insurance renewal information and deciding the insurance renewal strategy, the presentation should then be taken to the insurance market about 120 days before renewal.

The remaining activities throughout this 120-day period are summarised in Appendix B and will lead to the issuance of the insurance policy at or before inception. By ensuring that the insurance policy is issued at inception, contract certainty can be achieved. By scenario testing and undertaking the other actions described in this guidance on coverage certainty, enhanced efficacy of coverage certainty will be achieved. Only two thirds of Airmic survey respondents reported that policy issuance is achieved by 30 days after inception and half of those who responded to the survey indicated that, even after 30 days, the contract did not meet the requirements of the insurance buyer.

6. Insurance Conduct of Business Sourcebook (ICOBS)

The Financial Conduct Authority (FCA) has retained guidance previously prepared by the Financial Services Authority (FSA) in relation to treating customers fairly. This FCA guidance appears in the Insurance Conduct of Business Sourcebook (ICOBS) and applies to all types of customers, including buyers of business insurance. A brief edited summary of the guidance to insurance companies from the FCA website is set out below.

Insurance Conduct of Business Sourcebook (ICOBS)


This guide summarises ICOBS, the rules regulating general and protection insurance products sales. The overall aim of ICOBS is to ensure that your customers are treated fairly. You should give your customers clear, fair information when you sell them insurance.

ICOBS outlines the high-level standards that apply to all insurance product sales:

Suitability: You must take reasonable care to ensure your advice is suitable for your customers. This includes guidance that an insurance company should take reasonable care to ensure a policy is suitable for its customer's demands and needs, taking into account the policy's level of cover, cost, relevant exclusions, limitations and conditions.

Product disclosure: You must take reasonable steps to ensure your customer is given appropriate information about a policy in good time and in a comprehensible way so they can make an informed decision. This applies before and after they buy the product and it includes price. The information you give will depend on the customer, the policy's terms and its complexity.

Claims handling: Insurers or those acting for them must treat customers fairly when handling claims.

A close-up photograph of a hand placing a white puzzle piece into a larger assembly of white puzzle pieces. The hand is positioned at the top left, with fingers gripping the piece. The puzzle pieces are interlocking and have a slightly textured surface. The background is a solid red color.

“I am pleased that Airmic is taking on the issues around hidden basis clauses and warranties. Insurance law needs to be brought into the 21st century.”

An Airmic Member

Part 4: Appendices and further information

Appendix A: 8 steps to buying business insurance

| | Activity | Description | |
|---|---------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
| 1 | Evaluate insurance needs and prepare market submission Governance Structure | <ul style="list-style-type: none"> • Undertake a risk assessment to determine insurance needs • Obtain broker advice to establish strategy and program structure • Collect data, prepare market submission that includes all material circumstances | |
| 2 | Review insurance market responses Coverage Certainty | <ul style="list-style-type: none"> • Invite potential markets to quote and evaluate initial responses • Select preferred insurers and open dialogue with underwriters | |
| 3 | Test insurance market responses Coverage Certainty | <ul style="list-style-type: none"> • Undertake legal and/or professional review of wordings • Arrange scenario testing to evaluate completeness of cover | |
| 4 | Bind contract and receive documentation Contract Certainty | <ul style="list-style-type: none"> • Issue binding instructions to selected insurers, perhaps via broker • Ensure timely issuance of policy documentation | |
| 5 | Fulfil insurance contract obligations Contract Certainty | <ul style="list-style-type: none"> • Appoint service providers to support the insurance arrangements • Fulfil policy obligations and comply with warranties and conditions precedent • Ensure compliance with regulatory and tax requirements | |
| 6 | Notify claims and support handling Claims Certainty | <ul style="list-style-type: none"> • Ensure timely notification of claims and circumstances as they arise • Support claims management, handling and settlement procedures | |
| 7 | Co-operate in dispute resolution Disputes Resolution | <ul style="list-style-type: none"> • Support resolution activities related to coverage, contract or claims disputes • Ensure disputes are settled in line with policy terms and conditions | |
| 8 | Produce insurance 'Procedures Manual' Governance Structure | <ul style="list-style-type: none"> • Produce 'Procedures Manual' to include roles and responsibilities | |

Considerations

- | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> • Establish risk appetite • Cost and availability of insurance • Define insurance strategy | <ul style="list-style-type: none"> • Broker selection and advice • Establish disclosure processes • Exposure data and loss experience |
| <ul style="list-style-type: none"> • Prepare market presentations • Engage with selected underwriters | <ul style="list-style-type: none"> • Review insurance strategy • Credit rating of preferred insurer(s) |
| <ul style="list-style-type: none"> • Challenge basis clauses etc. • Legal review and scenario testing • Review subrogation and arbitration | <ul style="list-style-type: none"> • Place excess and captive layers • Ensure multi-national compliance |
| <ul style="list-style-type: none"> • Finalise insurance structure • Bind cover with selected markets | <ul style="list-style-type: none"> • Calculate premium allocation • Achieve issuance on inception |
| <ul style="list-style-type: none"> • Establish servicing arrangements • Agree ToBA's and SLA's | <ul style="list-style-type: none"> • Comply with warranties etc. • Appoint advisers, loss adjusters etc. • Ensure ongoing compliance |
| <ul style="list-style-type: none"> • Notify claims promptly • Follow established claims protocols | <ul style="list-style-type: none"> • Respond to information requests • Manage 'Reservation of Rights' • Liaise with loss adjusters etc. |
| <ul style="list-style-type: none"> • Contest unfair policy interpretations • Challenge warranties and conditions | <ul style="list-style-type: none"> • Engage in agreed arbitration • Monitor subrogation activities |
| <ul style="list-style-type: none"> • Define roles and responsibilities • Possible conflicts of interest | <ul style="list-style-type: none"> • Establish broker indemnity limits |

Appendix B: Suggested timeline for achieving contract certainty

This Appendix suggests a timeline for achieving contract issuance before inception of the insurance policy. It is assumed that the insured will have undertaken an assessment to determine insurance needs, with the support of the insurance broker, before an approach is made to the insurance market. Also, it is assumed that steps will have been taken to evaluate the adequacy of the insurances being purchased in line with the requirement to achieve coverage certainty.

After contract certainty has been achieved, the insured should produce a 'Procedures Manual' that confirms insurance roles and responsibilities, including reference to claims notification and handling procedures to achieve claims certainty. The table below is only concerned with the process that leads to contract certainty and timely issuance of the insurance policy.

| | Description | Responsibility | Days before inception |
|---|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------|-----------------------|
| 1 | Collection of insurance renewal information <ul style="list-style-type: none"> Broker discussion on insurance strategy and program structure Consider the required bespoke wordings and coverages | Insured Broker | 180 – 150 |
| 2 | Compile exposure and loss data to achieve full disclosure <ul style="list-style-type: none"> Finalise the process for producing insurance market submission Finalise bespoke wordings and coverage requirements | Insured Broker | 150 – 120 |
| 3 | Discuss with underwriters to ensure understanding <ul style="list-style-type: none"> Present market submission to selected insurance markets Document underwriter discussions as part of disclosure process | Insured Broker Insurer | 120 – 90 |
| 4 | Legal and professional review of suggested wordings <ul style="list-style-type: none"> Obtain detailed market quotes, terms and conditions Evaluate cover and whether it represents the best available | Broker Insurer | 90 – 60 |
| 5 | Discussion, negotiation and testing, including scenario testing <ul style="list-style-type: none"> Presentation of final terms for renewal by the insurance market Selection of the preferred market(s) for further discussions | Insured Broker Insurer | 60 – 45 |
| 6 | Formal agreement by all parties of the final terms and conditions <ul style="list-style-type: none"> Further and final negotiation of renewal terms and conditions Ensure no gaps in cover with excess and umbrella layers | Insured Broker Insurer | 45 – 30 |
| 7 | Ensure accurate and timely policy documentation issuance <ul style="list-style-type: none"> Issue binding instructions in accordance with agreed coverage Monitor distribution of multi-national documents and certificates | Insured Broker Insurer | 30 – 15 |
| 8 | Ensure compliance with regulatory, tax and warranty requirements <ul style="list-style-type: none"> Document and agree insurance governance structure and activities Audit issuance of all insurance contracts before inception | Insured Broker Insurer | 15 – 0 |

Appendix C: References and further Airmic guidance

| | Subject of guide |
|----|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | <p>Insurance Buyers Guide (2007)</p> <p>Airmic guide for SME's about buying business insurance that describes how to identify insurance needs and how to buy insurance cost-effectively. It also emphasises the importance of good risk management.</p> |
| 2 | <p>CIPS and Airmic guide to insurance procurement (2010)</p> <p>Guide jointly produced by the Chartered Institute of Purchasing and Supply (CIPS) and Airmic. It provides an overview of the activities involved in purchasing business insurance for large organisations.</p> |
| 3 | <p>Disclosure of material facts and information in business insurance (2011)</p> <p>Airmic guide that describes an approach to developing a suitable and sufficient disclosure process that will achieve disclosure of all material facts and information and not misrepresent the business.</p> |
| 4 | <p>Compliance of multi-national insurance programs (2010)</p> <p>Airmic guide that outlines the difficulties associated with achieving compliance of multi-national insurance programs and provides a structured approach to actions that will ensure increased compliance.</p> |
| 5 | <p>Contract Certainty (2006)</p> <p>Airmic guide to achieving contract certainty, as defined by the Financial Services Authority (FSA) market initiative designed to ensure that the vast majority of insurance policies are issued before inception.</p> |
| 6 | <p>Claims best practice guide (2009)</p> <p>Airmic guide describing the key components that must be in place in the claims department of an insurance company in order to be able to deliver excellence in business insurance claims handling.</p> |
| 7 | <p>Reservation of Rights (2011)</p> <p>Airmic guide produced with the support of Herbert Smith Freehills LLP providing advice to insurance buyers on how to respond when a Reservation of Rights letter is received following an insurance claim.</p> |
| 8 | <p>Broker remuneration and transparency guidance (2010)</p> <p>Airmic guidance to broker transparency, disclosure and conflicts of interest in the commercial insurance market and the range of information that the insured should seek from their insurance intermediary.</p> |
| 9 | <p>Basis Clauses (2012)</p> <p>Airmic guide produced with the support of Herbert Smith Freehills LLP to enable insurance buyers to understand the effect of basis clauses and ensure that these are removed from their insurance policies.</p> |
| 10 | <p>A practical guide to conditions precedent in insurance policies (2014)</p> <p>Airmic guide produced with the support of Herbert Smith Freehills LLP to warranties in insurance policies and how buyers should seek a policy endorsement to render warranties suspensory in their operation.</p> |



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ISBN 978-0-9928275-2-6



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