airmic TECHNICAL

GUIDE

Reservation of Rights

Commentary and guidance on avoiding the service of a Reservations of Rights letter, the implications of receiving a Reservation of Rights letter and the actions that should be taken

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HERBERT SMITH FREEHILLS

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One of the main objectives of Airmic is to help members make a significant contribution to the success of their employer organisation. Airmic achieves this by running a series of seminars and training courses, as well as publishing guides to a wide range of risk management and insurance topics. In order to undertake these activities, Airmic depends heavily on partner organisations and other Airmic Marketplace / preferred service providers.

Airmic is grateful to Herbert Smith Freehills LLP for providing the major contribution to this guide to the topic of Reservation of Rights. The guide provides valuable insight for Airmic members into the issues associated with Reservation of Rights letters. Appendix A1 provides a draft insurance contract clause drafted by Herbert Smith Freehills for Airmic members to consider including in their insurance contracts. The intended operation of the clause is explained in Appendix A2.

The contents of this guide do not constitute legal advice. Airmic members should seek specific advice on their specific circumstances.

2. Introduction to Reservation of Rights

2.1 Definition of a Reservation of Rights

A Reservation of Rights is a communication from an insurer which will normally make clear that an insurer's rights are reserved and none of its statements or actions should be understood as waiving its rights to raise for example a defence to a claim under the express wording of the policy or otherwise. Reservations of Rights are commonly, but not exclusively, issued following notification of a claim or a circumstance.

An insurer will often repeat the Reservation of Rights on the receipt of further correspondence from the insured. Whilst repeating the Reservation of Rights is not obligatory, insurers may adopt this approach to remove any doubts as to their position.

2.2 Circumstances in which a Reservation of Rights would be issued

In a claims context, while a claim is being investigated, an insurer wishes to preserve the ability to assert policy defences without an insured asserting that, through an insurer's actions in investigating the claim, it has waived a defence that may have been available. The Reservation of Rights will allow an insurer to investigate whilst preserving the full range of policy defences including:

- material non-disclosure or misrepresentation;
- breach of warranty;
- breach of condition (including late notification);
- the application of exclusions; or
- other policy terms which impact on coverage.

A Reservation of Rights does not act to decline a claim but to protect an insurer's rights. By putting in place a Reservation of Rights, an insurer is then able to liaise with an insured and explore whether the claim is covered under the policy. This may also provide an insured with the opportunity to discuss their concerns with the insurer.

If, in the course of its investigation, an insurer identifies a policy defence, it will wish to preserve its ability to rely on the defence identified (potentially while continuing to work with an insured) without it being said that the point has been waived. Consequently either a separate (more) specific Reservation of Rights may be imposed or a general Reservation of Rights repeated.

2.3 Language of a Reservation of Rights

There is no prescribed form for a Reservation of Rights, however in most cases an insurer will send an insured directly, or via a broker, a brief communication setting out the Reservation of Rights. Typical language might be as follows:

"Pending its investigation and consideration of the matter, the insurer's position has to be and is fully reserved in relation to coverage for the notified claim [reference] under policy no. [ ] and at law."

To ensure that it is effective, the Reservation of Rights must be clear to the insured. If an insurer has not clearly communicated that it reserves its rights, it may still be able to assert that there has been no waiver of a defence if it can be shown that an insured was in fact aware that an insurer had reserved its rights, albeit not explicitly.

There is no requirement on an insurer to provide an explanation as to why it has put a Reservation of Rights in place, but it may choose to provide reasons.

3. Airmic member experience of Reservation of Rights

3.1 Concerns about Reservation of Rights

In undertaking a series of initiatives on claims handling, Airmic is seeking to achieve a position for the Airmic members whereby a greater level of coverage certainty and claim certainty, in addition to contract certainty, is achieved. Airmic will continue with this work in order to support the Airmic membership in achieving a greater level of certainty with respect to the insurance contract in place with the insurer.

The survey reported below clearly indicates that Airmic members are receiving Reservation of Rights letter in circumstances that are considered to be inappropriate. Avoidance of circumstances that lead to the issue of Reservation of Rights letter is important to Airmic members and this guide is intended to help members avoid the issue of a Reservation of Rights letter and manage the situation if one is issued.

This guide is an updated version of the guide issued in June 2012 and it includes a clause drafted by Herbert Smith Freehills to govern the service of a Reservation of Rights letter by an insurer. This clause is included as Appendix A1 of this guide, with guidance notes explaining how it is intended to operate included as Appendix A2. Airmic members should evaluate the potential use of this clause and discuss it with insurers and insurance brokers. Note that, as part of this work on claims handling, Airmic published (in January 2009) a guide to best practice in insurance claims entitled "Delivering Excellence in Insurance Claims Handling".

3.2 Survey of Airmic members

Airmic completed a survey of its membership in January 2012 on the subject of Reservation of Rights. The survey discovered the following:

- 33% of respondents had received at least one Reservation of Rights letter within the previous two years
- 62% of those surveyed reported that they believe the Reservation of Rights letter(s) was issued unfairly
- 57% of those responding to the survey indicated that the matter was not resolved to their satisfaction

It was also reported by Airmic members who responded to the survey that the insurer appointed a law firm to conduct the claim in 50% of cases where a Reservation of Rights letter had been issued.

3.3 Insurance market agreements

67% of Airmic members reported that they are aware of the "Statement of Principles regarding Insurers' Reservation of Rights" voluntary code agreed between Airmic and its insurer partners in September 2008. A copy of this Statement of Principles is included in this guidance as Appendix B.

On the basis of the results of this survey of members, Airmic decided to create a draft policy clause intended to be binding on both parties. It is the opinion of Airmic that Reservation of Rights letters are issued too frequently and, in some cases, as a matter of routine. Airmic further believes that steps could and should be taken through the terms of the insurance contract between the insurer and their insured to reduce the frequency of use of Reservation of Rights letters. In other words, a clause setting out the agreed protocol leading to the issue of a Reservation of Rights letter should be part of the insurance policy documentation.

Following on from the 2008 "Statement of Principles regarding Insurers' Reservation of Rights" voluntary code, Airmic undertook a further negotiation with insurance partners in 2009. The result of these discussions was the "Statement of Principles regarding Insurers' Speed of Settlement" voluntary code. A copy of this Statement of Principles is included in this guide as Appendix C.

4. Reservation of Rights commentary

4.1 Duration of a Reservation of Rights

Provided an insurer has done nothing which is inconsistent with the Reservation of Rights, for example accepting the claim, the Reservation of Rights will last at least until an insurer has the appropriate knowledge to make an informed choice as to whether a defence to the claim is available and if so whether it wishes to rely on it. This means that an insurer will need to be aware of sufficient relevant facts to decide how to respond to the claim, for example through a loss adjuster's report, an expert report or legal opinion. An insurer should then determine whether it has a proper basis to maintain the Reservation of Rights.

If an insurer wishes to maintain the Reservation of Rights it may do so by making this position plain to an insured by clarifying or repeating the Reservation of Rights. Silence by an insurer at this stage will not, however, automatically invalidate its Reservation of Rights.

4.2 Responding to a Reservation of Rights

A Reservation of Rights may (but does not necessarily) indicate that the insurer has concerns in relation to the availability of a defence to the claim. The Reservation of Rights should put the insured on notice of such concerns and generally it will be appropriate to exercise appropriate caution in the future handling of the claim whilst continuing to comply with policy obligations. The insured should consider whether further assistance is required with the claim at this stage.

The insured does not have to do anything. In due course the insurer should communicate its response to the claim. However, the insured may wish to ensure that the Reservation of Rights has been recorded properly, for example if it was received orally, the insurer should be asked for a written confirmation. If it is vague, the insurer should be asked to clarify precisely what issue(s) are of concern and the reasons why it has reserved its rights. Logically, if there are no issues of concern, the insurer will have nothing to waive, and therefore have no basis for reserving its rights.

Where possible, the insured should respond to the insurer on any issues/reasons it has raised underlying the Reservation of Rights in a straightforward way, recognising that the policy will normally require the insured to cooperate with the insurer's investigations and make information and documents available. If the information is not available or cannot be produced directly, the insured should explain this directly to the insurer. As the claim progresses, the insured should regularly seek an update of the insurer's position and where practical, press for removal of the Reservation of Rights.

Also, the insured must be careful to continue to comply with the terms and conditions of policy, to prevent further defences being raised by the insurer. This is generally the case even if the insurer has explained the basis for an existing Reservation of Rights and it appears a policy defence is or may be available to the insurer.

In addition, where the insured has received a Reservation of Rights, but is not ready to submit full details of the claim or loss, the insured should consider whether it is practicable or advisable to seek an interim payment, with such information as is available. This may crystallise any further areas of concern to the insurer.

If the insured establishes that the Reservation of Rights concerns either the insurer's ability to avoid the policy for material non-disclosure or misrepresentation, or a breach of warranty (the effect of which will be to bring coverage to an end from the date of breach), the insured may wish to consider with the broker as a matter of urgency putting in place contingent cover.

The insured may wish to consider whether the Reservation of Rights can be challenged. The crucial element to achieving this will be to show that the insurer through words, actions or omissions has waived its right to raise a defence to the claim. Conduct by the insurer which is inconsistent with the Reservation of Rights may provide this opportunity, for example:

- accepting payment of premium under the policy where it is suggested there may be a right to avoid;
- taking steps consistent with the existence of on-going coverage (premium adjustments, signing endorsements etc.) where it is suggested there may be a breach of warranty such that cover would be at an end; or
- correspondence with the insured which expressly or impliedly suggests the claim has been accepted.

Examples of questions the insured may wish to ask the insurer are as follows:

- What are the insurer's reasons for imposing the Reservation of Rights?
- What information does the insurer require to clarify its concerns?
- How long will the insurer require to carry out its investigations?
- Accounting consequences of a Reservation of Rights

It is impossible to provide an opinion regarding the accounting consequences of a Reservation of Rights that will be correct in all circumstances, however Airmic has consulted with a major accounting firm and requested an opinion on what would typically be the accounting situation. Whilst emphasising that every situation would have to be evaluated individually, it appears to be the case that the relevant recovery will only be treated as an asset once receipt is "virtually certain". The existence of a Reservation of Rights will demonstrate that receipt of the claims payment is not "virtually certain".

In the circumstances, the value of the claim could not be included in the accounts of the insured. However, engaging with an insurer may well assist in determining the issues and potentially narrowing an insurer's concerns in the interim. Once this has been achieved, there could be scope for identifying a portion of the claim for which the insurer accepts coverage. This will allow that portion of the claim to be treated as "virtually certain" and therefore recognisable as an asset.

5. Implications and options available for Airmic members

A Reservation of Rights acts to protect an insurer from any argument by an insured, based on an insurer's behaviour, that it has waived the right to deny coverage for a claim or raise other suitable defences. If an insurer is made comfortable that an insured will not raise any such argument, there may well be scope to prevent the service of a Reservation of Rights letter.

Herbert Smith Freehills LLP, in discussion with the Airmic insurance partners has developed a sample clause for inclusion in insurance policies. This clause is included as Appendix A1, together with an explanation of how the clause is intended to operate, as Appendix A2. Discussion of the inclusion of the clause will facilitate a discussion of the attitude of the insurer to the use of Reservation of Rights letters. This will also enable the insured to plan actions to avoid the issue of a Reservation of Rights letter, as well as plan actions to respond to such circumstances, if they do arise.

In conclusion, research undertaken by Airmic regarding the service of Reservations of Rights letters by insurers indicated that Reservation of Rights letters were typically issued too frequently and often unnecessarily. Airmic is seeking to achieve a position whereby the issuing of Reservation of Rights letters is governed by an individually negotiated and agreed clause in the insurance contract. Each Airmic member should consider the clause and decide whether it meets their needs and is in their best interests. The possible inclusion of a clause should be discussed with their broker and inclusion of the clause negotiated individually with each insurer, as appropriate.

It is Airmic's aspiration on behalf of its members that the issuing of Reservation of Rights letters will cease to be a routine procedure; will become less common; and that all Reservation of Rights letters that are issued will clearly indicate the basis on which this action has been taken.

Appendix A1: Clause addressing Reservation of Rights

Note to those drafting policy wordings and intending to incorporate this clause: - This Clause is intended for use in policies governed by English law. This language does not form part of the clause.

RESERVATION OF RIGHTS

1. The Insured agrees that it shall not make any legal claim or otherwise allege that any act or conduct of the Insurer during the period of 90 days from the date on which a notification of any circumstance or claim is made to this Policy (a "Notification") shall be deemed to have been a waiver of any of the Insurer's rights under the Policy or at law.
2. The period specified in clause [1] above shall be used by both parties to communicate and co-operate in relation to a Notification including, but not limited to, any requests for documents.
3. For the period specified in clause [1] above the Insurer shall not reserve its rights under the Policy or at law (to whatever extent) in respect of the subject matter of the Notification.
4. If, following the period specified in clause [1], the Insurer decides to issue a reservation of rights, this shall be done in writing. The Insurer agrees that any such reservation of rights shall:

   4.1 Specify the reasons for it and the facts and matters relied upon; and

   4.2 Identify precisely the information required from and/or steps to be taken by the Insured which may allow the Insurer to lift the reservation of rights; and

   4.3 Identify any reasons why part or all of a claim under this Policy or any subsequent claim might not be payable by the Insurer.

5. If at the end of the period specified in clause [1], any requests for documents and/or co-operation remain outstanding or the Insurer decides to reserve its rights, a meeting shall be held between the Insured and the Insurer as soon as practicable (unless the Insured elects not to proceed with the meeting). The purpose of the meeting shall be to resolve any outstanding requests for documents and/or co-operation and, if appropriate, for the Insurer to explain and discuss any actual or proposed reservation of rights. All representations at this meeting, shall not constitute or be taken as waiving the rights of the Insured and the Insurer under the Policy or at law.

6. Notwithstanding any of the foregoing, the Insurer shall inform the Insured in writing as soon possible (including during the period specified in clause [1]) after becoming aware of any facts or matters that the Insurer considers may entitle it to avoid the Policy or suspend or discharge coverage hereunder.

Appendix A2: Clause with guidance notes

Note to those drafting policy wordings and intending to incorporate this clause: - the Clause is intended for use in policies governed by English law. This language does not form part of the clause.

RESERVATION OF RIGHTS

1. **The Insured agrees that it shall not make any legal claim or otherwise allege that any act or conduct of the Insurer during the period of 90 days from the date on which a notification of any circumstance or claim is made to this Policy (a "Notification") shall be deemed to have been a waiver of any of the Insurer's rights under the Policy or at law.**

- The reason why insurers need to reserve rights is to avoid the risk of something they say or do being taken by an insured and used to argue that the insurer has waived their rights to take a point or defence. For example, if an insurer is in the process of identifying a potential non-disclosure that might entitle it to avoid the policy, but processes an endorsement amending cover or pays an additional premium, the insured could say that was an act consistent with electing to treat the policy as in place, and the insurer's right to avoid has therefore been lost.
- Clause 1 is an agreement by the insured that they will not rely on any actions by the insurer in relation to any possible defence the insurer may have in respect of anything done by the insurer during the 90-day period.
- This protection is needed by the insurer to enable it not to impose a reservation of rights safely.

2. **The period specified in clause [1] above shall be used by both parties to communicate and co-operate in relation to a Notification including, but not limited to, any requests for documents.**

- This makes clear that the 90-day window is to be used by insured and insurer to co-operate, making information and documents available where requested. The insurer should communicate with the insured throughout the 90-day period, keeping the insured fully informed of any progress made in respect of their claim.
- This clause does not override other policy terms on specific co-operation obligations.

3. **For the period specified in clause [1] above the Insurer shall not reserve its rights under the Policy or at law (to whatever extent) in respect of the subject matter of the Notification.**

- This is the insurer's agreement not to reserve its rights for the 90-day period, which it can give safely because of the insured's agreement in clause 1. This includes rights under the policy and any other potential legal defences from pre-contract matters.
- As specified in clause 1, the 90-day period begins to run from the date on which a notification of circumstance or claim is made in respect of the policy.
- There is no reason why, by agreement, the period specified in clause 1 cannot be extended.

4. **If, following the period specified in clause [1], the Insurer decides to issue a reservation of rights, this shall be done in writing. The Insurer agrees that any such reservation of rights shall:**

    4.1 Specify the reasons for it and the facts and matters relied upon; and

    4.2 Identify precisely the information required from and/or steps to be taken by the Insured which may allow the Insurer to lift the reservation of rights; and

4.3 Identify any reasons why part or all of a claim under this Policy or any subsequent claim might not be payable by the Insurer.

- After the 90-day period, the insurer will be in one of the following positions:
  - it will have investigated and be clear there is no point or defence to take at that point, in which case no reservation of rights is required to protect its position;
  - it will not have concluded its investigations, or otherwise have further requests of the insured. At this stage, it may be appropriate to impose a reservation if (and only if) a potential policy defence has been identified. No reservation is necessary or appropriate unless the insurer is on notice of a particular policy or other defence; or
  - it will be clear that a policy point is available and the insurer should explain the position to the insured.
- To ensure transparency and certainty in the claims handling process, the reservation of rights must be issued in writing and include a detailed explanation of the point to be taken or under investigation as well as the basis for it.

5. If at the end of the period specified in clause [1], any requests for documents and/or co-operation remain outstanding or the Insurer decides to reserve its rights, a meeting shall be held between the Insured and the Insurer as soon as practicable (unless the Insured elects not to proceed with the meeting). The purpose of the meeting shall be to resolve any outstanding requests for documents and/or co-operation and, if appropriate, for the Insurer to explain and discuss any actual or proposed reservation of rights. All representations at this meeting, shall not constitute or be taken as waiving the rights of the Insured and the Insurer under the Policy or at law.

- A meeting should be held at the end of the 90-day period if (i) the parties cannot agree on the documents / information to be provided or (ii) the insurer wishes to reserve its rights. This will enable the parties to address any concerns and where relevant, to discuss the reasons behind the insurer's intention to issue a reservation of rights.
- In order to facilitate open discussion, the parties agree that their statements and actions at the meeting shall not be taken to waive or alter any rights they would have under the policy or otherwise.

6. Notwithstanding any of the foregoing, the Insurer shall inform the Insured in writing as soon possible (including during the period specified in clause [1]) after becoming aware of any facts or matters that the Insurer considers may entitle it to avoid the Policy or suspend or discharge coverage hereunder.

- During the course of its investigations, the insurer may become aware of facts or matters which could give rise to the following defences:
  - material non-disclosure or misrepresentation, potentially allowing the insurer to avoid the policy; or
  - a breach of warranty, the effect of which would be to bring the coverage to an end from the date of breach.

In these circumstances, it is important that the insurer communicates with the insured as soon as practicable, as the insured may, for example, wish to put contingent cover in place as a matter of urgency.

Appendix B: Reservation of Rights

<u>**STATEMENT OF PRINCIPLES REGARDING INSURERS' RESERVATION OF RIGHTS**</u>

September 2008

Introduction

Airmic and various insurers have reviewed the question of when and how a reservation of rights ("RoR") should be used. This review has been undertaken in a spirit of partnership and the aspiration is that all stakeholders can work together to achieve a pragmatic approach that is fair to all. There are circumstances in which an RoR is necessary in order to protect the parties' positions, but care needs to be taken to ensure that it is not over-used and that when it is considered necessary a dialogue takes place so that the parties are fully aware of the reasons.

This Statement of Principles is designed to address those issues in respect of policies issued in England or Wales and which are subject to English law and the jurisdiction of England and Wales. Generally insurers will not reserve their rights in the early days of a claim; will investigate possible common ground with the insured during that period; and in the event that a RoR is necessary, will speak to the insured about it. At the same time it is expected that an insured will continue to respond positively to requests for information and documentation made by the insurer should a RoR be raised.

Statement of Principles

This Statement of Principles applies on notification of a potential loss or series of potential losses under a contract of insurance reasonably anticipated to exceed £2.5m ("the Potential Loss") from the date of first notification of the Potential Loss to the insurer for a period of 90 days ("the Period").

1. The insurer will not pre-emptively initiate any formal dispute resolution proceedings, including but not limited to any court or arbitration proceedings, nor issue any form of RoR under any relevant contract of insurance arising from the Potential Loss.
2. As soon as is practical following the notification of a Potential Loss, the insurer and/or its representatives will communicate with the insured and the broker to discuss the following on a without prejudice basis:
    a) how the contract of insurance may respond to the Potential Loss;
    b) what information is required to support the Potential Loss;
    c) the timetable for resolution of any potential issues regarding coverage
3. In the event that it is not possible during the Period to agree those matters set out in 2(a), 2(b) and 2(c) above the insurer will proceed without reference to the Statement of Principles. However, if the insurer and insured agree, the Period may be extended with regard to a particular Potential Loss.
4. The Statement of Principles will apply only to a policy which is issued in England and Wales and which is subject to both English law and the jurisdiction of England and Wales.
5. In the event of a Potential Loss arising in any territory outside of England and Wales, the Statement of Principles will apply only if it does not prejudice the insurers' rights under the prevailing local law.

6. It is open to the insurer to conclude at its absolute discretion that the Statement of Principles is not appropriate for a particular Potential Loss. In the event that an insurer does so conclude none of the provisions of this Statement of Principles will apply to that Potential Loss. In the event that the insurer does reach such a conclusion in respect of a particular Potential Loss, it will, however, explain the position to the insured before imposing a RoR within the Period.
7. Any insurer which indicates that it intends to commit to the Statement of Principles will do so on its own behalf and that indication will not affect the interests of follow or co-Insurers of that Insurer in any way.
8. An indication of a commitment to this Statement of Principles by an insurer is not to be taken in any way as an indication that any contract of insurance is affirmed by that insurer.

Appendix C: Speed of Settlement

STATEMENT OF PRINCIPLES REGARDING INSURERS' SPEED OF SETTLEMENT

August 2009

Introduction

Airmic and various insurers have reviewed the question of how to ensure an appropriate speed of payment of commercial claims for property damage and business interruption that exceed £2.5 million (a "Claim"). This document sets out a Statement of Principles that recognises the need of policy holders under commercial insurances to achieve payment of claims in an appropriate and timely manner, in accordance with the following principle:

The insurer recognises the importance of timely payment of claims in accordance with the circumstances of the loss and the terms of the policy. The aim is to use staged payments during the settlement of the claim to reflect the insured's cash-flow needs and to try to achieve a cash-flow neutral position in respect of insured losses, minimising the need for any alternative funding requirements.

This Statement of Principles extends to the provision of interim payments to cover costs incurred as a result of the insured loss and so assist in maintaining the business as a going concern. The insurer should take appropriate actions to achieve the timely settlement of claims within the terms of the insurance policy and any existing service level agreements.

Statement of Principles

The scope of this Statement of Principles is limited to claims as defined above.

1. For each claim within the scope of this Statement of Principles, a "Cost and Cash-Flow Plan" should be developed by the appointed loss adjusting team as soon as is practical. Progress against the Cost and Cash-Flow Plan should be reviewed at regular intervals. The Cost and Cash-Flow Plan should be agreed by the insured and insurer and/or their representatives or agents. It should be updated as necessary throughout the claim settlement process.
2. The Cost and Cash-Flow Plan should, where appropriate and practicable, include information about the following:
   - (a) obligations of the insured regarding availability of information;
   - (b) level of supporting evidence that is required;
   - (c) involvement and obligations of loss adjusters, forensic accountants and others;
   - (d) arrangements for authorisation of expenditure;
   - (e) circumstances in which interim payments will be made to cover, for example, on-going business costs, additional costs associated with property repairs, or increased cost of operation;
   - (f) payment flow and whether brokers will be involved; and/or
   - (g) any additional information that may be required to enable the insurer to confirm liability
3. This Statement of Principles proceeds on the basis that the insured will provide all necessary information relevant to the claim on a timely basis. It is also assumed that the insured will act at all times to minimise the costs and losses associated with the claim.

4. The Statement of Principles will apply only to a policy which is issued in England and Wales and which is subject to both English law and the exclusive jurisdiction of the courts or tribunals of England and Wales.
5. It is open to the insurer to conclude at its absolute discretion that the Statement of Principles is not appropriate for a particular claim. In the event that an insurer does so conclude none of the provisions of this Statement of Principles will apply to that claim. In the event that the Insurer does reach such a conclusion in respect of a particular claim, it will, however, explain the position to the insured.
6. Any insurer which indicates that it intends to commit to the Statement of Principles will do so on its own behalf and that indication will not affect the interests of follow or co-insurers of that insurer in any way.
7. An indication of a commitment to this Statement of Principles by an insurer is not to be taken in any way as an indication that any contract of insurance is affirmed by that insurer.
8. This Statement of Principles can be used in conjunction with the earlier Airmic statement of principles on Reservation of Rights, or other Airmic statements of principle where appropriate.