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The Insurance Act 2015 – 10 months on

Guide 2017

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1 Introduction

August 2016 marked the most fundamental change to insurance law since the Marine Insurance Act 1906 (the 1906 Act). The Insurance Act 2015 (the Act or the Insurance Act), which applies to all commercial policies placed, amended or renewed after 12 August 2016 makes significant changes to the operation of policies with the aim to reflect commercial practice and address what was perceived as an imbalance between insurers and insurance buyers under the 1906 Act.

The Act has now been in force for 10 months, and several Airmic members have experienced their first 'post-Act renewal'. This paper reports on how the Act has changed the way insurers, brokers and buyers interact with each other during the placement process, and provides guidance for members on how to ensure they are gaining full benefit of the Act.

This is the third paper from Airmic on the Insurance Act and follows two papers that provide relevant information and guidance:

- *The Insurance Act 2015 – what risk managers need to know* summarises the provisions of the Act
- *The Insurance Act 2015 – The Duty of Fair Presentation* provides practical guidance on complying with the Act.

Airmic thanks its sponsors, Axa Corporate Solutions and Mactavish, for sharing their experiences with Airmic during the preparation of this paper, and Airmic sponsors Herbert Smith Freehills for contributing to and undertaking a legal review of the content.

2 The Insurance Act – key changes

The Act makes several key changes affecting the disclosure process, policy terms and claims handling, as described in Figure 1. This paper will look at the implications of each of these changes in practice. Further information on each can be found in *The Insurance Act 2015 – what risk managers need to know*.

Figure 1 Summary of changes made by the Insurance Act 2015

The Duty of Disclosure / Fair Presentation

Marine Insurance Act

- Duty on insured to disclose all material circumstances that it knows or ought to know in the ordinary course of business
- An insurer may avoid the policy in the event of a material non-disclosure or misrepresentation

Insurance Act

- Duty on insured to disclose all material facts that it knows or ought to know including the knowledge of defined parties and knowledge revealed by a reasonable search
- Failing that the insured should provide 'sufficient information to put a prudent insurer on notice that it needs to make further enquiries'
- Duty to make the disclosure in a clear and accessible manner

Policy Terms

Marine Insurance Act

- Warranties must be strictly complied with and breach discharges the insurer from all liability under the policy
- Basis of contact clauses can turn all statements made in the proposal form into warranties

Insurance Act

- All warranties are converted to 'suspensive conditions'
- Basis clauses are abolished
- The insurer cannot discharge its liability where the insured was in breach of a term that related to a particular type of loss and where that breach could not have increased the risk of the loss that occured

Insurer remedies for a breach of the Duty of Disclosure

Marine Insurance Act

- Insurer can avoid the policy ab initio and refuse all claims, even in the event of innocent non-disclosure, provided it was material and induced the underwriter to write the risk

Insurance Act

- Insurer can avoid the policy ab initio if the breach was deliberate or reckless, or can prove it wouldn't have written the risk at all
- Insurer has access to a range of proportionate remedies if the breach was innocent or careless and not fraudulent (i.e. neither deliberate or reckless)

3 The Duty of Disclosure / The Duty of Fair Presentation

The Insurance Act provides guidance on what the insured needs to disclose to insurers in order to provide a 'fair presentation' of the risk. Unsurprisingly, the precise meaning of this guidance was the top area of focus for insurers, brokers and insureds in the lead up to the Act going live. However, there is still no consistent approach by insurers or brokers to what these terms mean. Airmic members report that individual underwriters or brokers within the same organisation may even have different interpretations.

The following have been areas of debate and change since August 2016.

3.1 Agreeing a fair presentation with insurers

A recent trend has emerged where brokers and insureds seek agreement from insurers that a 'fair presentation' has been provided and have this reflected in the policy. Here, an insurer may have effectively waived its rights entirely in the event of non-disclosure. These clauses appear to generally only be offered where the insured has taken time to present and can demonstrate an appropriate and well thought through disclosure process. This could include articulating its approach to fair presentation and senior management involvement, and an explanation of the risk enquiries run across the business. Members have reported that it can be harder to gain these clauses with excess layer insurers, where there is less of a relationship than they enjoy with primary layer insurers. Documenting the approach to fair presentation and sharing this with all insurers is therefore advisable.

Airmic believes that insureds should be cautious about relying on an agreement that a fair presentation has been made if the process leading to 'sign-off' is not supported by extensive review and discussion of the disclosure process and the risk enquiries undertaken. The Act was designed to enrich the dialogue between the insurer and the insured, and lead to enhanced understanding of the risk by both parties. Seeking sign-off without extensive discussion about what fair presentation means in the context of the particular insured and class of policy ignores these positive aspects of the Act. Of course it may be that certain insurers will give a 'sign off' of fair presentation to some insureds based on particular information provided and agreed practices of limited scope, but this just emphasises the need for specific dialogue to ensure as robust an outcome as possible for the insured.

'We see the duty of fair presentation as an opportunity to enhance the relationship and trust with our clients. Therefore, we aim to engage with our existing and new clients, and freely discuss their business and their process for collecting and presenting disclosure information. This increases our understanding of the business and enables us to provide the most relevant cover.'

Paul Lowin, Regional Commercial Manager, Axa Corporate Solutions

Additionally, there is an inevitable risk that policy terms that are considered an agreement of fair presentation at placement may be disputed in the event of a claim. These agreements have yet to be tested. Airmic recognises the risk that a 'fair presentation agreement' might be said by insurers to be reduced to 'fair presentation based on the information presented' in the event of a perceived non-disclosure. Insureds should feel comfortable that, in the event of a dispute, they can evidence that they presented their interpretation of fair presentation to the insurers and provided opportunity for the insurers to comment. In other words it would be prudent to focus on the substance of the fair presentation and rely on the clause for additional protection, rather than the other way around.

Airmic is aware that some insurers within specialist lines of business with historically well-defined and stable information requirements, e.g. marine and aviation, are not always forthcoming with invitations to discuss how fair presentation may alter the disclosure information required or what a specific insured may need to consider in addition to the 'standard' questions. The onus is inevitably on each insured, working with its broker, to drive forward those conversations.

Airmic recommends that members focus their attention on reviewing what a fair presentation means in the context of their specific business and insurance cover. They should push for insurer conversations to clarify their interpretation, before relying on any 'sign-off' clause in the policy.

3.2 Defining 'knowledge of senior management' with insurers

There is currently no general interpretation or definition of the term 'senior management' across the market. However, several insureds have agreed a list of individuals who represent 'senior management' (or certain roles in the insured, where incumbents may change) and have arranged to have this list reflected in their policy wording. This seeks to limit the parameters of this otherwise uncertain obligation. Several insurers have accepted these definitions. However, this is generally on a case-by-case basis and no definitive list of what constitutes senior management has appeared from the market.

Airmic recommends that members discuss their interpretation of what individuals they will and won't speak to when fulfilling the senior management obligation with their insurers and broker.

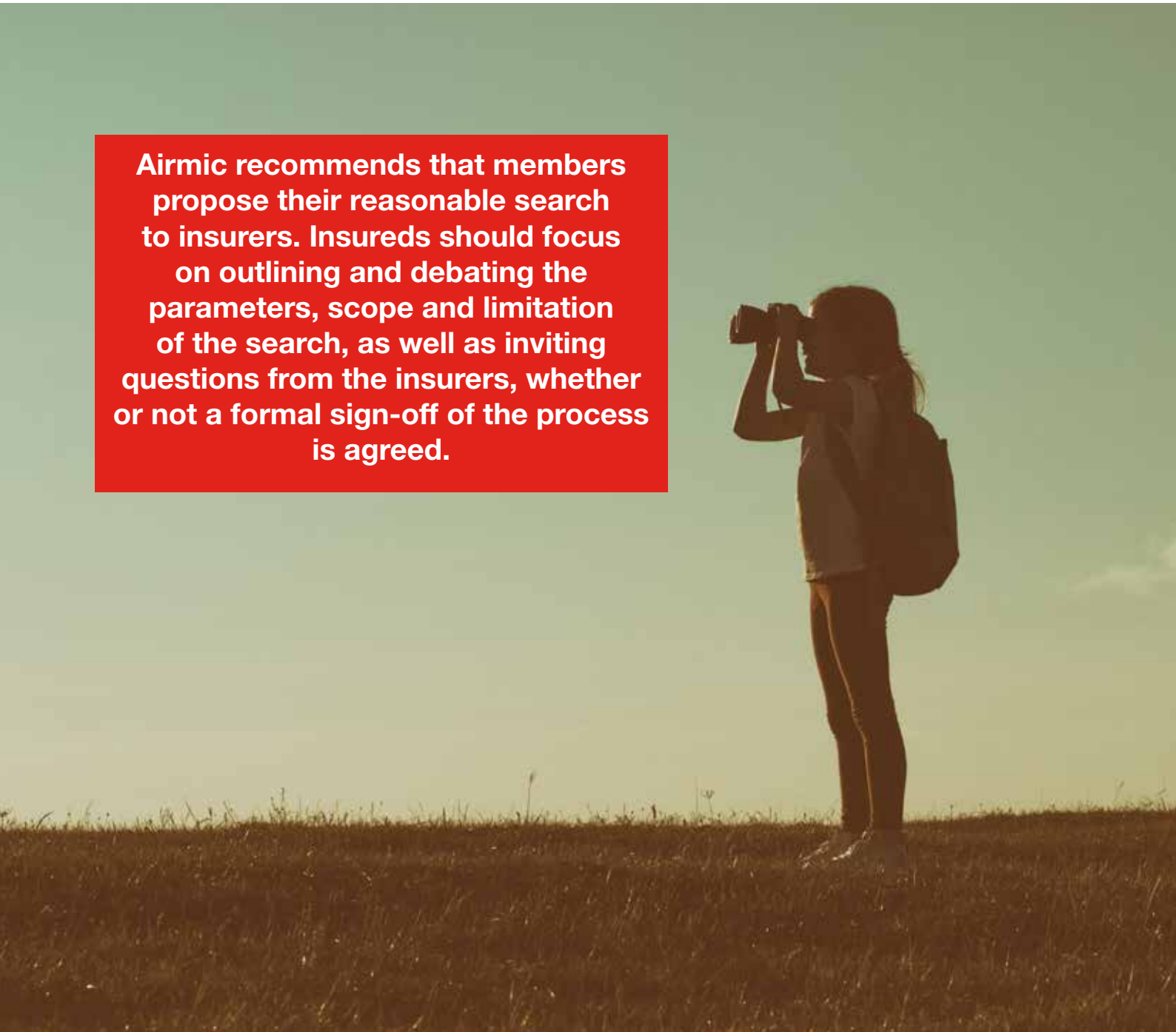
Even if the insurer does not embed the definition into the policy, the discussion process gives underwriters the opportunity to understand who is engaged and why, and to ask for further detail where they think necessary, placing the insured in a positive position.

3.3 Defining ‘information reasonably revealed by a reasonable search’

There is no general interpretation or definition of what ‘reasonable search’ means across the market on a sector by sector or class by class basis. Airmic suspects that, like ‘senior management’, the reasonable search aspect is unlikely to reach a general definition and this is probably inevitable since the concept of reasonable search is rooted in an objective assessment of what each insured ought reasonably to have done in the circumstances.

Some brokers and insureds have been looking to agree and sign off the search process with insurers, with the aim to limit the parameters of the required search for the given policy and, critically, to agree any known limitations. However, despite informal agreement between the parties being achieved regularly, insurers have generally been reluctant to sign off the reasonable search process or include a description in the policy. This is unsurprising as the reasonable search is unique to the scale, complexity and nature of each insured, and consists of several ‘unknown unknowns’ from the insurer’s perspective. All that said, some insureds have secured insurers’ agreement to what constitutes a reasonable search and it is those who are best prepared in their approach that are likely to have most success.

Airmic recommends that members propose their reasonable search to insurers. Insureds should focus on outlining and debating the parameters, scope and limitation of the search, as well as inviting questions from the insurers, whether or not a formal sign-off of the process is agreed.



3.4 Making use of technology to provide a clear audit trail

The most common practical change to the disclosure process post-Act has been an increase in the use of technology by insureds, including to:

1. **Provide an audit trail for the disclosure process**

   Technology can be used to provide robust evidence that a full search has been undertaken as defined in the requirements of the Act. This can include evidencing the reasonable search and receiving information from relevant parties, e.g. brokers or claims handlers.

   This is useful even where there hasn't been an agreement of what fair presentation means in the policy. The disclosure itself can be used to demonstrate that the search process was clearly outlined to insurers and then undertaken in full.

   Record-keeping of what information was gathered, and from where, can be called upon in the event of an insurer disputing a claim on the ground of non-disclosure. An insured that fails to disclose a material fact may still be able to say that it made a fair presentation of the risk if it carries out a reasonable search for information, explains to the insurer what was done and provides the output of the search, so as to put the insurer on notice to ask questions. This is not a course of action Airmic encourages members to rely on – they should focus on gathering information and making a positive presentation of it – but if members need to do so then good record-keeping will be essential as to the information gathering process and the information provided to the insurer.

   Airmic has been made aware of some insurers doing more internally to evidence why they took certain decisions during underwriting and identifying what they would have done, e.g. increased premium or imposed additional terms, if they had been given different information. This reinforces the need for insureds to develop corresponding records on where information was gathered, where it wasn't gathered, and why.

2. **Ensure the presentation is made in a clear and accessible manner**

   Although making a presentation searchable is an onerous task, insurers have welcomed the clear signposting, emphasis of key points and libraries of information that some insureds have added to their presentation. Insurers have occasionally reflected this by confirming that a 'reasonably clear and accessible' presentation was made in the policy.

3. **Facilitate the 'sufficient information to put a prudent insurer on notice to make further enquiries'**

   Technology can be used to record which information has been reviewed by which underwriters and to co-ordinate insurer questions and responses to these. The response information can also be built into the insurance submission as a supplemental update. In addition to this, insureds should make careful minutes of all conversations relating to any material aspect of risk disclosure to avoid future misunderstanding.

However, Airmic is concerned that there has possibly been an over-reliance on technology and insureds should take care to ensure that they are not just using this to present information but are also strategically considering what data is available to them, what they are presenting and why.

Insureds should consider the growing importance of big data across all industries. As insureds and their brokers have ever more data available to them and the technology to mine this data, the parameters of what is a reasonable search may grow. This will also affect insurers – as their data grows, the information they are considered to know or are presumed to know could additionally widen.

Airmic recommends that members take time to provide a clear audit trail of their disclosure search, including the response to insurer follow-up questions. Even if advanced technology is not available, a clear audit trail can provide useful evidence of the insured fulfilling the duty of fair presentation.

However, insureds should not focus on providing this trail at the expense of reviewing the information that must be supplied as part of the disclosure.

3.5 Clarifying broker responsibilities with regards to the Duty of Fair Presentation

Brokers have, in general, provided useful information to their clients on how to fulfil the duty of fair presentation. However, how the brokers themselves will contribute to this duty has not always been made clear. Airmic members report that standard Terms on Business Agreement (ToBA) wordings emphasise the duties of the insured and limit the broker's own involvement.

Airmic encourages members to focus on avoiding any ambiguity in this area. Information held within the broker forms a key part of fair presentation. The insured must disclose all material information held by the broking team directly involved with the placement (being individuals responsible for the insured's insurance) as well as any additional information reasonably revealed by a reasonable search of information held across the wider broking / agent firm. Insureds can also insert additional terms within their ToBAs that clarify the broker's role. Examples of these terms include the process for logging and checking insurer enquiries, and passing any material answers over to all interested insurers.

Airmic recommends that members clarify how information held within the broker will be collected and presented to both the insured and the insurers. This process and the mutual responsibilities of the broker and insured within the disclosure process should be recognised formally in the ToBA and/or Service Level Agreement. Insureds should carefully review, using lawyers where considered relevant, the standard ToBA wording and amend it as necessary.

4 Policy terms

The first action of many insurers and brokers when preparing for the Insurance Act to go live was to review all policy wordings and ensure that all clauses were 'compliant' with the Act. However, many new clauses issued by individual insurers and market associations do not replicate perfectly the provisions of the Act (which would apply in any event in the absence of the new clauses). Further, many new clauses have not been tested through claims as yet and Airmic members should take care to understand the changes made. Be particularly careful of clauses incorporated into slips or policies by reference where all that is referred to is a standard clause number – make sure you have the full clause wording included in the policy.

"There has been a proliferation of new clauses issued by insurers, market associations and brokers since the Insurance Act came into force. Some of the clauses put the insured in a worse position than under the Act. Others introduce conditions precedent in ways not previously seen. Proper policy reviews focussing on the substance of these clauses and their impact on the insured's business are more important than ever."

Alexander Oddy, Partner, Herbert Smith Freehills LLP

The following have been areas of debate and change since August 2016.

4.1 Identifying and understanding conditions precedent

The Act removed basis clauses and changed the effect of warranties, both of which are welcome developments for Airmic members. Some insurers are now promoting their polices as 'warranty-free' or 'Insurance Act compliant' as a result. However, these positive steps have also led to some insurers relying more heavily on exclusions and other terms. Airmic members report an increase in the use of conditions precedent to the attachment of cover and conditions precedent to the insurer's liability to pay claims to maintain some of the pre-Act remedies available to them.

Conditions precedent may be necessary to the policy to control aspects of the cover, and many previous warranties and claims conditions may now be labelled (or interpreted) as conditions precedent accordingly. However, Airmic believes that conditions precedent should be kept to a minimum. A breach of a condition precedent to the attachment of cover may mean that the policy cover never attaches, or is lost as soon as the policy incepts. A breach of a condition precedent to the insurer's liability can entitle an insurer to reject a claim or certain aspects of the indemnity. It is vital that insureds request that conditions precedent be removed wherever possible and, where that is not possible, that conditions precedent are identified with express words and the consequences of a breach are clearly set out and understood. Insureds should request that these are expressly labelled as 'conditions precedent' in the wording. There is a risk that the use of conditions precedent may undermine the changes to the law relating to warranties. Further, if they apply to the provision of information by the insured, they might also undermine the changes to the remedies for any non-compliance with the duty to make a fair presentation.

Airmic will be producing a specific guide on the approach to conditions precedent later in 2017.

In the meantime members should take additional care over the use of conditions precedent in three areas:

- Look for 'sweep-up clauses' that turn all policy terms into conditions precedent, and look to have these removed from the wording.

- Identify any conditions precedent that relate to the accuracy of pre-contractual statements. Insurers may use conditions precedents in this way to provide a remedy if a piece of critical information provided by the policyholder is found to be inaccurate. This can have a similar effect to a basis clause. However, insureds should clarify what information these terms relate to (and indeed if they relate to all information provided during placement) and have the terms amended or removed as far as possible.

- Look carefully at conditions precedent in post-loss terms, e.g. relating to loss notification, insurer consent and other claims conditions. Airmic detected a clear increase in the number of claims disputes relating to late notification in the 12 months leading up to the Act going live (Airmic pre-conference survey 2016) and expects insurers to have a greater reliance on claims conditions to decline claims in the future.

Airmic recommends that members take time to review each policy term carefully and undertake a legal review of key policy wordings if possible. Insureds must identify conditions precedent and clarify the consequences of a breach in relation to these terms with their insurers. Conditions precedent should be appropriately limited in scope wherever possible.

4.2 Understanding 'section 11' terms

Section 11 (s11) of the Insurance Act prevents insurers relying on breaches of certain terms unconnected to the loss to avoid paying a claim and is an area where the Law Commission anticipated litigation.

This is an element of the Act that has not been tested by historic case law, and only real-life claims experience will bring this to life. However, Airmic understands that some insurers may attempt to prevent insureds relying on s11, perhaps by contracting out of s11 at placement (although in a competitive market, this does not appear to have emerged). There is some evidence of insurers in specialist classes seeking to identify whether certain policy terms are or are not terms to which s11 applies. While the approach to bringing certainty is encouraging in principle, the question of whether the insurer's assessment that s11 does or does not apply to a particular policy term is appropriate is more difficult and may need to be challenged at placement. The status of any such term may be open to question

Alternatively, insurers may gather more early evidence of causal connections between a breach and a loss in order to dispute an insured's reliance on s11. The Act places the burden on an insured that has breached a term to prove s11 applies and that the breach could not have increased the risk of loss that in fact occurred, which may be challenging. Therefore, in the event of a claim and alleged breach of a policy term, insureds will need to focus on gathering their own evidence to show that the breach of the term could not have increased the risk of the loss that actually occurred.

Insureds will additionally need to carefully identify the terms in the policy that apply to a loss of a particular kind, location or time (and are protected by this part of the Act), as well as the terms in the policy that 'define the risk as a whole' (and are not protected), and ask insurers to clarify the status of those that remain ambiguous.

'Based on all of our policy work, working together with barrister partners, it is clear that one of the areas with greatest potential for test cases lies in establishing where section 11 will and will not apply. There is a great deal of uncertainty and a proper review of key policy wordings could not be more timely, as insureds need to establish total clarity over how various policy terms will be applied to their risk.'

Rob Smart, Technical Director, Mactavish

Airmic recommends that members review the terms of their key policies in full. Insureds should look to obtain clear policy wordings that set out exactly what risks the policy terms are intended to reduce and seek to avoid any increase in the use of terms that are designed to apply to the policy as a whole, depriving the insured of the benefit of s11 of the Act.

5 Insurer remedies for a breach of the Duty of Disclosure

The Act maps out a clear set of proportionate remedies in the event of non-disclosure, based upon how the actual underwriter would have behaved if a fair presentation had been made. In a competitive marketplace, insurers have been willing to alter these remedies to differentiate themselves. However, insureds should take care when accepting remedies outside of the Act..

5.1 Brokers and insureds seeking to limit the remedies available in the event of non-disclosure

Some insureds and their brokers have incorporated a variety of clauses that narrow the provisions of the Act. The following approaches have been seen:

- **Requiring payment of additional premium, rather than reducing the claim proportionately in the event of non-disclosure**

  This popular approach has been adopted by some insurers for all policies and by some insurers on a case-by-case basis.

- **Offering insureds the choice of paying additional premium or a reduction in claims payment, to be decided in the event of a claim**

- **Insurer remedies only available in the event of a deliberate or reckless (i.e. fraudulent) breach of the duty of fair presentation**

  This very wide approach goes beyond the provisions of the Act. This appears to be offered on classes of insurance or to clients which already had very wide non-disclosure clauses, to maintain the pre-Act way of working.

Insureds should however take great care before including clauses that differ from the Act. Insureds should consider which available option is more appropriate for them in light of claims frequency and, critically, severity. Insureds should also note that if they opt to pay the additional premium then this may be payable even in the event that there is no claim on the policy. Insureds should carefully review the drafting of these terms, as the details can differ in many subtle ways. Some standard clauses available in the market are significantly less advantageous to the insured than the general law as reflected by the Act.

Airmic recommends that insureds carefully review their claims experience when reviewing clauses that address the insurer's proportionate remedies in the event of a breach of the duty of fair presentation. Again, the primary focus of insureds should be on providing a well-structured presentation of the information; clauses limiting insurer remedies beyond the position of the Act offer additional protection but are not a substitute for the insured discharging their own Duty of Fair Presentation.

6 The Enterprise Act

The Insurance Act has been amended itself by the Enterprise Act 2016, which places an implied term in every policy placed or renewed on or after 4 May 2017 that gives policyholders a potential right to claim damages in the event of unreasonable late payment of claims.

6.1 Limiting liability under the Insurance Act

The Enterprise Act places insurers in a position where they may pay a claim beyond the policy limit for the first time. Therefore, there has been some quiet movement by insurers to limit their liability under the Insurance Act. P&I clubs have been seen to contract out of the timely payment duty entirely.

It is too early for any consistent patterns to be reported but Airmic suspects that there will only be limited steps taken by general insurers and this might be confined to capping their liability for late payment damages rather than full contracting out. The majority of efforts to vary or contract out of the Act so far have been in favour of the insured and, in a competitive market, it is likely to be challenging for insurers to take steps which place the insured in a worse position than under the law. However, the Enterprise Act affects all polices placed or renewed on or after 4 May 2017, and insureds should seek to identify their insurer's approach as soon as possible.

It is too early to predict the extent to which late payment damages disputes will lead to litigation. The insured will themselves have an onerous burden to prove that the loss for which damages are being sought was foreseeable and suffered because of a demonstrably unreasonable delay in insurer claims payments.

Airmic recommends that members insureds ask their insurers to clarify their position with regards to damages for late payment after 4 May 2017. If the insurer does contract out or limit its liability, the insured should also ask for clarification of any other areas where the insurer is contracting out of the Act.

Appendix Summary of post-Act activity and steps for Airmic members

Market behaviour	Airmic member action
The Duty of Disclosure / Fair Presentation	
In some cases, insurers are agreeing that a 'fair presentation' of risk has been given by the insured	• Ensure you have a thorough discussion on what a fair presentation means with underwriters • Focus on the substance of the fair presentation and rely on any 'sign off' for additional protection, rather than the other way around
Several insureds have agreed a list of 'senior management' with insurers	• Propose a definition of senior management (by reference to roles held) to insurers, highlighting any limitations and inviting insurer questions • Agree and reflect this list in the policy, where possible
A limited number of insureds have agreed that parameters of a 'reasonable search' with insurers	• Propose a process of reasonable search relevant to the risk being placed to insurers, highlighting any limitations and inviting insurer questions
Insureds are using technology to collect and present submissions and produce a thorough audit trail of the disclosure process	• Produce a clear audit trail of the disclosure collection and presentation process, whether using technology or not • Maintain a similar focus on improvement in the information disclosed, and not just the method of presentation and record-keeping
Some brokers have been unclear on their own contribution to the insured's duty of fair presentation	• Clarify how information held at the broker will be disclosed to insurers • Review the standard ToBA wording and ensure that the broker's role in relation to fair presentation is reflected in this
Policy terms	
Insurers are relying more heavily on exclusions, conditions precedent and 'sweep-up' clauses to control cover	• Undertake a legal review of policy wordings to identify all exclusions and conditions precedent • Look for 'sweep-up' clauses and try to have these removed • Take care to review the wording of claims conditions and understand the consequence of their breach • Seek to remove conditions precedent where possible or at least ensure they are specifically identified
The insurance market anticipates that section 11 terms will be a source of dispute	• Undertake a legal review of policy wordings and identify which terms are 'risk mitigation' and which 'define the risk as a whole' • Avoid where possible any terms that are designed to define the risk as a whole, depriving the insured of the benefit of s11 of the Act
Insurer remedies for non-disclosure	
Several insureds and brokers are seeking to narrow the proportionate remedies available to insureds in the event of non-disclosure A variety of alternative clauses have been introduced by insurers and brokers	• Review the organisation's claims experience carefully, before restricting the proportionate remedies available in the policy • Review the detail of proposed wordings carefully for hidden risks • Focus on providing insurers with a fair presentation of risk and engaging with insurers on this
Enterprise Act	
There is a suggestion that insurers may look to limit their liability for damages for late payment or contract out of this entirely	• Clarify your insurer's position with regard to damages for late payment as soon as possible

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