airmic

EXPLAINED GUIDES

2021 || sponsored by: HERBERT SMITH FREEHILLS

MAKING THE MOST OF THE INSURANCE ACT 2015

Acknowledgements

About Airmic
The leading UK association for everyone who has a responsibility for risk management and insurance for their organisation, Airmic has over 450 corporate members and more than 1,300 individual members. Individual members include company secretaries, finance directors, internal auditors, as well as risk and insurance professionals from all sectors. Airmic supports members through training and research; sharing information; a diverse programme of events; encouraging good practice; and lobbying on subjects that directly affect our members. Above all, we provide a platform for professionals to stay in touch, to communicate with each other and to share ideas and information.

www.airmic.com

airmic

About Herbert Smith Freehills
Herbert Smith Freehills is a full service international law firm with a market leading insurance practice. It is an Associate Partner of Airmic and has assisted Airmic and its members on insurance law issues for many years.

Herbert Smith Freehills lawyers have an outstanding reputation in complex, high profile insurance disputes and for providing strategic legal advice and representation to corporate policyholders. The firm assists with the resolution of major claims across all classes of policy as their core expertise, including advice on coverage, claim project management and claims advocacy to secure appropriate settlement of claims using the full range of dispute resolution procedures including litigation, arbitration and all the forms of Alternative Dispute Resolution.

This unrivalled hands-on experience of coverage disputes informs Herbert Smith Freehills' approach to policy wording reviews and drafting. The team also advise on the interface between insurance and contractual risk allocation regimes in commercial contracts.

Herbert Smith Freehills' large dedicated contentious insurance practice is ranked as top-tier in both Chambers UK and Legal 500 in representing policyholders in the largest most complex coverage disputes in the London and international market.

www.herbertsmithfreehills.com

HERBERT SMITH FREEHILLS

CONTENTS

01 Introduction

This EXPLAINED guide aims to assist risk managers in making the most of the benefits of the Insurance Act 2015 ("the Act"), whilst ensuring their own compliance with the duties placed upon them.

The Act was the most fundamental change to the law of England and Wales, Scotland and Northern Ireland governing commercial insurance and reinsurance since the Marine Insurance Act 1906. The Act governs all polices placed, amended or renewed after the 12th August 2016 and aimed to address the imbalance between insurer and insured rights and encourage a deeper understanding of the risk by all relevant parties.

The Act made significant changes to: the pre-contract duty of disclosure, insurer remedies in the event of a breach of the new duty of fair presentation and certain terms used in policy wordings.

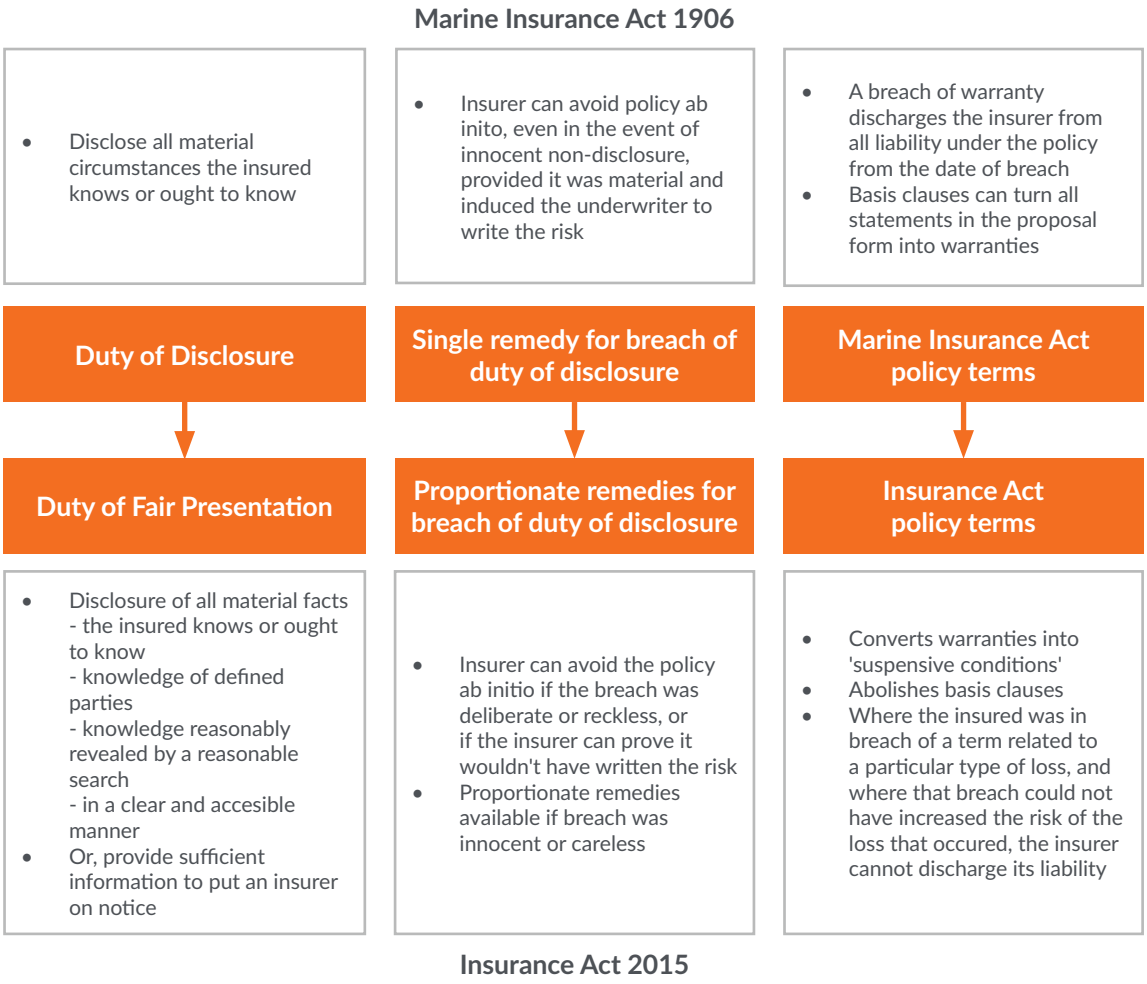

Figure 1: Summary of changes made by the Insurance Act 2015

Contracting out

Parties can choose to contract out of the provisions of the Act (except for the abolition of basis clauses). Any policy term which would put the insured in a worse position than under the Act must comply with certain transparency requirements. This means that the term must be brought to the attention of the insured before the contract is entered into and must be clear and unambiguous as to its effect.

Policyholders must, therefore, ensure that care is taken in drafting any policy terms which seek to contract out of the Act. Helpfully, to the extent an insurer seeks to contract out of the Act, this should be clear from the wording and the effect of the term clearly stated. However, policyholders should be aware that an insurer can satisfy the requirement under the Act to bring such a term to the attention of the insured by bringing it to the attention of the broker.

02 The duty of fair presentation of the risk

The ‘duty of fair presentation’ provides a structured framework for the information that a commercial insured must provide to an insurer before it enters into or renews an insurance contract or when a contract is varied or amended.

In particular, the duty of fair presentation (summarised in Figure 2) is specific on whose knowledge must be disclosed. Insureds should consider what information they need to disclose, who holds this information and how they will capture it.

> **The duty of fair presentation requires the insured to disclose every material circumstance that it knows or ought to know. The test of materiality remains unchanged from the Marine Insurance Act 1906: ‘It would influence the judgement of a prudent insurer in determining whether to take the risk, and if so, on what terms.’**

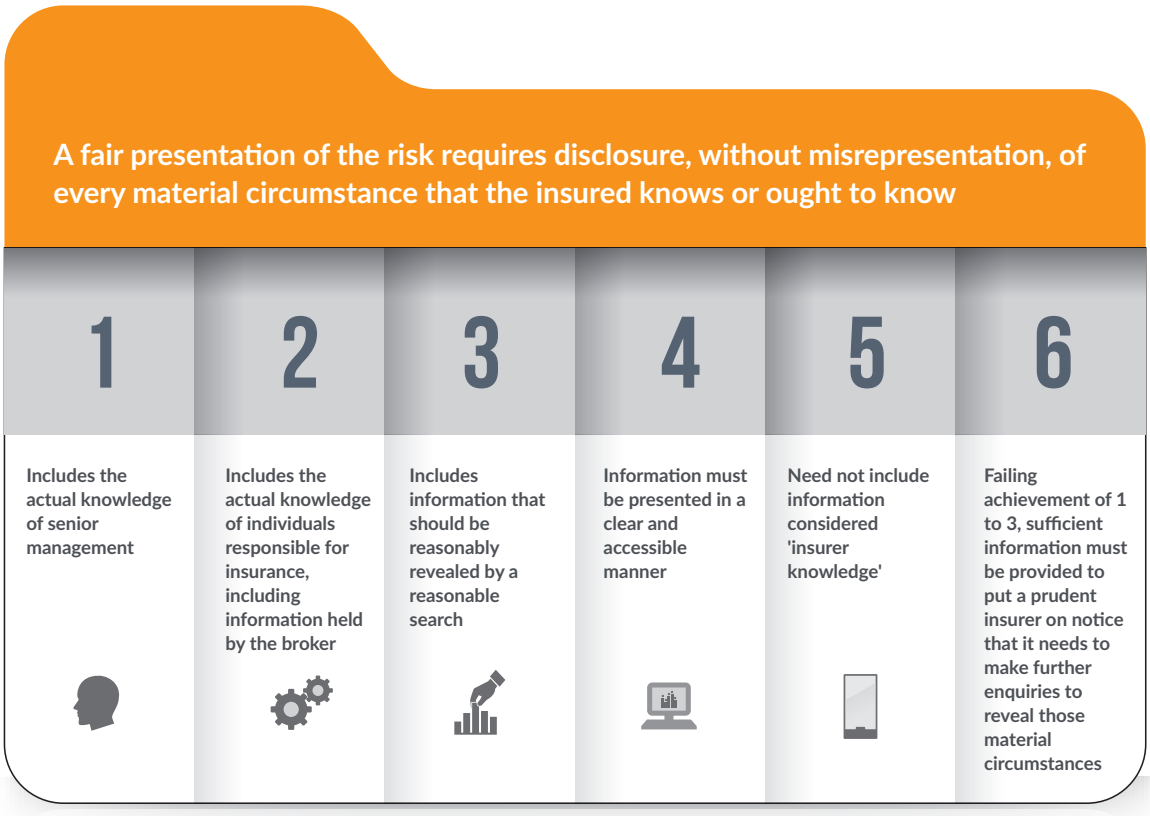

Figure 2: Six key elements of a fair presentation

Implications for captives

Members who utilise a captive should be aware that both inward and outward captive placements must comply with the duty of fair presentation so that risk is transferred effectively to the insurance market. There must be complete and transparent communication of knowledge between the insured, captive and insurer.

Implications for the disclosure timeline

Policyholders are encouraged to meet their insurer as early as possible to discuss their information requirements, a process of reasonable search and agree a timeline for disclosure. Policyholders will then be in a position to review their internal collection processes against the requirements of the Act and the requests of the insurer.

Appendix 1 is a suggested insurance placement timeline that reflects the duties under the Act.

Engagement with the insurer

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. It is, therefore, advisable for an insured to document its approach to fair presentation and share this with all insurers. Insureds should make sure that they feel comfortable that, in the event of a dispute as to whether a fair presentation was made, they can evidence that they presented their interpretation of a fair presentation to the insurer and provided opportunity for the insurer to comment.

When the Act came into force, some brokers and insureds tried to seek agreement from insurers that a 'fair presentation' had been provided and have this reflected in the policy. These clauses do not appear to have gained much traction in the market. This is not surprising given that an insurer is effectively being asked to waive its rights entirely in the event of a non-disclosure. To the extent any such clauses are offered by an insurer, an insured will need to demonstrate that it has an appropriate and well thought through disclosure process. It is also important to remember that 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 and that these agreements have yet to be tested. Insureds should focus on the substance of the fair presentation and rely on any clause for additional protection, rather than the other way around.

> **Airmic recommends that members focus their attention on reviewing what a fair presentation means in the context of their specific business and insurance cover and engage the insurer in a dialogue to clarify their interpretation.**

02 The duty of fair presentation of the risk

A fair presentation of the risk requires disclosure, without misrepresentation, of every material circumstance that the insured knows or ought to know

1	2	3	4	5	6
Includes the actual knowledge of senior management	Includes the actual knowledge of individuals responsible for insurance, including information held by the broker	Includes information that should be reasonably revealed by a reasonable search	Information must be presented in a clear and accessible manner	Need not include information considered 'insurer knowledge'	Failing achievement of 1 to 3, sufficient information must be provided to put a prudent insurer on notice that it needs to make further enquiries to reveal those material circumstances

2.1 Fair Presentation – the knowledge of senior management

An insured who is not an individual knows only what is known to one or more of the individuals who are -
a) Part of the insured's senior management

Section 4(3)(a), Insurance Act 2015

The Act specifies that the insured must disclose material information known by senior management to the insurer. This includes 'blind-eye knowledge' which is suspected by the individual. The Act describes this as 'those individuals who play significant roles in the making of decisions about how the insured's activities are to be managed or organised'. Although the Act's guidance notes advise that this definition is to be construed relatively narrowly, the Act applies to the full range of commercial insureds, and provides no distinctions based on organisational size.

Challenges for Members

The challenge of capturing knowledge of 'senior managers' is two-fold:

1. For larger policyholders, senior management potentially includes a large number of individuals in many different territories.

Members should propose a specific and brief list of 'senior management knowledge holders' by reference to their role to their broker and insurer as a priority, and therefore restrict the individuals whose actual knowledge must be disclosed to the insurer. Members should take significant care in preparing such a list, and shouldn't simply use a suggested list provided by HR or their insurer.

2. Senior management has generally been accepted to include management aware of strategic risk as well as 'the Board'. However raising insurance onto the Board agenda has historically been a challenge for insurance managers. But the Covid-19 pandemic has brought a renewed focus on insurance for many Boards.

Engagement with the insurer

Airmic understands that some insureds have been able to agree 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.

Tips to engage the Board

- **The risk environment is constantly changing and becoming more connected and complex, with the emergence of new and less tangible threats such as cyber and supply chain disruption**

- **Insurance policies are among the largest commercial contracts many companies enter into, and boards therefore have a duty to understand them**

- **The Act provided greater protection for commercial policyholders, but also places greater obligations on them**

- **Insurance can act as a strategic enabler, underpinning companies' ambitions and allowing them to seize new opportunities**

Checklist for Airmic members – senior management	
Start early in each renewal cycle.	*Senior management input may require collection of information from overseas, which will take longer to collect.*
Propose your interpretation of senior management to the insurer, highlighting the individuals you will and won't speak to when fulfilling this obligation.	*Provide underwriters with the opportunity to understand who is engaged and why.*
Review the corporate structure and identify the highest level of senior management.	*Additionally, identify any positions with oversight of strategic and operational risk.*
Identify both the positions and the individuals that fall within senior management.	*Monitor recent and ongoing changes in personnel that affect these positions to ensure relevant information is collected at the initial disclosure and for ongoing notification of material changes.*
Prepare business unit packs that outline the information required from the business and that will be disclosed.	*Packs can be signed off by a controller, CFO or head of operations for each area, who effectively holds responsibility for the information disclosed.*
Raise awareness and engage individuals immediately, and keep up the momentum.	*Attribute the costs of insurance and the costs of covered losses for the business area in question over the last year, to demonstrate the value of insurance.*

02 The duty of fair presentation of the risk

2.2 Fair Presentation – the knowledge of individuals responsible for insurance, including the broker

An insured who is not an individual knows only what is known to one or more of the individuals who are – (b) responsible for the insured's insurance

Section 4(3)(b), Insurance Act 2015

The Act specifies that the insured must disclose material circumstances known by those individuals who participate 'in the process of procuring the insured's insurance, whether the individual does so as the insured's employee or agent, as an employee of the insured's agent or in any other capacity'. This includes 'blind-eye knowledge' which is suspected by the individual.

Challenges for Members

This provision brings potential challenges for policyholders.

Airmic members need to specifically identify those involved in the purchase of insurance for the organisation. Whilst the identity of individuals involved within the insured organisation is normally well established, the Act provides more clarity on the role of the broker, who is treated by the Act in the same way as the insured's own staff. Therefore, the knowledge acquired by individual brokers (both within placement and servicing teams) must be established and disclosed to the insurer.

Airmic members should take specific action to understand how broker knowledge is captured and recorded, and how it is then communicated to the insurers. Airmic members may wish for all information to be consolidated by a central team within a broker, which they can then review and sign off before submission. Where possible, these instructions should be included in the terms of business agreement and service level agreement. Airmic members also need to consider how confidential information should be dealt with.

It is suggested that policyholders should reference the existence of any confidential information, and explain how it impacts the risk. This should be sufficient to place the insurer 'on enquiry'. However, individual members should ensure that they discuss any individual circumstances with their brokers.

A fair presentation of the risk requires disclosure, without misrepresentation, of every material circumstance that the insured knows or ought to know

1	2	3	4	5	6
Includes the actual knowledge of senior management	Includes the actual knowledge of individuals responsible for insurance, including information held by the broker	Includes information that should be reasonably revealed by a reasonable search	Information must be presented in a clear and accessible manner	Need not include information considered 'insurer knowledge'	Failing achievement of 1 to 3, sufficient information must be provided to put a prudent insurer on notice that it needs to make further enquiries to reveal those material circumstances

Checklist for Airmic members – individuals responsible for insurance	
Prepare a list of who internally and externally is responsible for insurance procurement.	*Consider the risk/insurance team, the procurement team, individuals giving instructions to the broker, the employees who collect risk data, the brokers and other intermediaries, and the actual individual broker or agent of the insured.*
Identify both the positions and the individuals who hold these positions.	*Monitor recent and ongoing changes in personnel that affect these positions to ensure relevant information is collected at the initial disclosure and for ongoing notification of material changes.*
Clarify the actual knowledge of the individuals at the broker or any other agent responsible for the insured's insurance, including any independent information collected by the broker.	*Ensure that there is clear agreement with the broker on who is responsible for capturing, storing and disclosing this information to the insurer and recognise this formally in the Terms of Business Agreement*
Request to have oversight of any communication between the broker and insurer.	*Insist on reviewing and signing off submissions to gain full understanding of the submission and to ensure that no information has been 'diluted'.*
Be aware where the broker may have been involved in the organisation's insurance for longer than the insurance team.	*Discuss with the broker how knowledge gained from previous placements, but that is still relevant, is recorded and disclosed. When changing broker, allow extra time to record the knowledge of the previous broker.*
Seek to agree a specific and brief list of individuals who are 'responsible for the insured's insurance' with the broker and insurer.	*Contain the actual knowledge that must be disclosed.*

Engagement with brokers

Brokers, in general, provide 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 insurer. 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.

02 The duty of fair presentation of the risk

A fair presentation of the risk requires disclosure, without misrepresentation, of every material circumstance that the insured knows or ought to know

2.3 Fair Presentation – information reasonably revealed by a reasonable search

Whether an individual or not, an insured ought to know what should reasonably be revealed by a reasonable search of information available to the insured (whether the search is conducted by making enquiries or by any other means).

Section 4(6), Insurance Act 2015

The Act describes the material information that an insured ought to know as that which 'should reasonably be revealed by a reasonable search.' This includes information held:

- within the insured organisation itself
- by persons covered by the insurance, e.g. co-insureds, subcontractors or the supply chain
- by the broking firm used as a whole, not just the individual agent, e.g. information collated in a portfolio generally referring to an industry area
- any other person e.g. other agents, not only those involved in the procurement of insurance.

Reasonable search

Reasonable search' casts the net of what must be disclosed much wider. The concept of reasonable search is intentionally broad to allow application to the entire range of commercial insureds and is consequently open to wider interpretation. This is likely to be where case law ultimately plays a role although we have yet to see any decisions from the courts on this issue.

It is therefore vital that policyholders engage with their broker and insurer to clarify and document a common interpretation of reasonable search that is satisfactory for all. Of equal importance, having agreed a process of reasonable search with the insurer, the insured must take care to complete the search and evidence it in full to create a thorough and traceable audit trail.

The Act requires the search to reveal information that would reasonably have been revealed by a reasonable search. Insurance managers should discuss what this means for their organisation in the context of the particular policy being sought with their broker and insurer. However, members should take care to sense check the information revealed, to ensure that all material circumstances that they are aware of are disclosed.

Engagement with the insurer

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. If agreement with an insurer is not possible, the insured should at least make clear what it has and has not included in its reasonable search, potentially putting the onus on to an insurer to ask questions if it deems the search insufficient.

> **'Reasonable search should be a key focus for policyholders. Airmic members should think carefully about what a reasonable search looks like for their organisation and look to engage in a dialogue with insurers on this sooner rather than later. Those policyholders who can demonstrate a thorough disclosure process carried out with the Act in mind are more likely to find favour with insurers when it comes to seeking agreement to the scope of particular aspects of the duty of fair presentation.'**
>
> *Paul Lewis, Partner at Herbert Smith Freehills*

Checklist for Airmic members – reasonable search	
Start early for each renewal cycle.	*Sufficient time needs to be given to consider a reasonable search with the broker and insurer, to carry it out and to give the insurer time to ask follow-up questions before providing a quote.*
Propose an interpretation of reasonable search to the insurer and broker before commencing the search, outlining parameters, scope and limitations.	*Propose a process of reasonable search to the insurer and consider their feedback and suggestions on the scope and detail of the search.*
Consider who the policy covers, in terms of both organisations e.g. subsidiaries and individuals e.g. retired directors and officers.	*Insureds should discuss with the insurer who are the 'knowledgeable persons' and agree a formal process for collecting information from them.*
Identify all contact points with the broker, across all divisions.	*Seek clarity and assurance on how all information is collated, stored and disclosed.*
Document and evidence the reasonable search.	*Once agreed, the reasonable search should be carried out in full, and documented. This includes follow-up questions and responses, to create a full audit trail of disclosure.*
Review any additional IT technology needed for undertaking and evidencing a reasonable search.	*Consider the benefits of risk management and insurance software. It is worth noting that the implementation time for such software (and all other data collection processes) can be significant.*

02 The duty of fair presentation of the risk

2.4 Fair Presentation – clear and accessible manner

A fair presentation of the risk is one -
(b) which makes that disclosure in a manner which would be reasonably clear and accessible to a prudent insurer

Section 3(3)(b), Insurance Act 2015

The Act adds an additional duty on the insured, for the benefit of the insurer, to present the disclosure in a clear and accessible manner. This duty applies whether a disclosure is made on paper or online. Insurers have historically reported a huge variety in terms of content, scope and structure of insurance disclosures.

The requirement aims to discourage 'data-dumping'

The clear and accessible requirement aims to combat overly brief, overly large and cryptic submissions. Data dumping is a practice whereby a policyholder provides a huge amount of information on the basis of avoiding non-disclosure.

Airmic recommends that policyholders clearly structure, signpost and index their submissions to ensure they are easy to navigate and highlight key information and changes. Large insureds that use data rooms will need to take extra care not to overload these with poorly organised files as this will most likely fail to comply with the clear and accessible provision of the Act. Insureds that use data rooms must also ensure that the contents of them at inception are secured and archived for traceability in the event of a disagreement some years later and that additions or amendments mid term or on renewals are similarly traceable.

Impact on internal data collection

Policyholders should consider how this requirement impacts their data collection processes and systems for collecting, storing and accessing information. This can be a time consuming and difficult task as information collected from the business is often provided in a form that is not immediately useful to the insurer.

A fair presentation of the risk requires disclosure, without misrepresentation, of every material circumstance that the insured knows or ought to know

1	2	3	4	5	6
Includes the actual knowledge of senior management	Includes the actual knowledge of individuals responsible for insurance, including information held by the broker	Includes information that should be reasonably revealed by a reasonable search	Information must be presented in a clear and accessible manner	Need not include information considered 'insurer knowledge'	Failing achievement of 1 to 3, sufficient information must be provided to put a prudent insurer on notice that it needs to make further enquiries to reveal those material circumstances

Use of technology

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.

   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.

Airmic is concerned that there may be 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 also 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.

In *Young v Royal and Sun Alliance Insurance Plc* [2020] CSIH 25, the insured provided its disclosure to the insurer by way of a market presentation created using the broker's electronic software. One of the responses provided to a question was entered incorrectly and so material information was not provided to the insurer. The court found that the insurer was entitled to avoid the policy. This case illustrates that while the use of electronic platforms may assist with efficiency in the gathering of information for presentation to insurers, they need to be prepared with a clear understanding of the duty of fair presentation to avoid the risk of an insured inadvertently failing to discharge its duty.

Checklist for Airmic members – clear and accessible manner	
Contact the broker and insurer early in the renewal process.	*Any necessary technology and process changes can take some time to incorporate into the business. An insurer may ask for information to be presented in a more accessible way once a submission has been made, so policyholders will need plenty of time to respond to questions.*
Be wary of relying on previous year's content and format.	*Ask your insurer which information is of most use to them and make sure that this is highlighted within the submission. Ask for clarity on how a disclosure can be structured to make it easily navigable.*
Incorporate signposting, indexing and sub sections to aid navigation of the disclosure.	*As data dumping is no longer acceptable, take advantage of your broker's expertise on disclosure presentations and what makes a good submission.*
Make full use of exception reporting.	*Comment on the relevance of each piece of information and highlight where something is special or 'abnormal' to your organisation, compared to similar risks. If there was a specific reason why a particular cover was purchased, ensure that this is flagged.*
Avoid pointing towards the organisation's website.	*Marketing literature is unlikely to fulfil the insurance requirements, and there is little control over whether the information on the website changes and therefore there is no traceable audit trail.*
Agree with the broker and insurer how changes to information will be updated.	*Flag to the insurer which information is likely to change, and record any changes in a clear manner. Beware of removing any data as a result of a change, as this may prevent the creation of a suitable 'audit trail' for the disclosure.*
Ensure any data room is secured and archived for future reference	*It is important that the contents of any data room are secured at inception and archived in the event of a disagreement at a later time. Any additions or amendments mid term should also be traceable.*

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.

02 The duty of fair presentation of the risk

A fair presentation of the risk requires disclosure, without misrepresentation, of every material circumstance that the insured knows or ought to know

2.5 Fair Presentation – insurer knowledge

In the absence of enquiry, [the duty] does not require, the insured to disclose a circumstance if -
(a) it diminishes the risk
(b) the insurer knows it
(c) the insurer ought to know it
(d) the insurer is presumed to know it
(e) it is something as to which the insurer waives

Section 3(5), Insurance Act 2015

The Act provides detail on '*insurer knowledge*', which describes the information the insured does not have to disclose in order to achieve fair presentation:

- information held by the insurer and accessible to the individual(s) underwriting the risk, including any insurer agent, e.g. a coverholder
- information that an employee of the insurer or any of its agents knows and ought to have passed on to the individual(s) underwriting the risk
- information that an insurer underwriting the risk in question reasonably would be expected to know in the ordinary course of business
- common knowledge.

However, Airmic members should not rely on this provision to limit their disclosure for the following reasons:

1. An insurer's knowledge can and does vary widely, and therefore the scope of information known by any individual underwriter cannot be guaranteed.
2. The Act advises that information must be 'held by' the insurer and be 'readily available' to the underwriter(s) in question. Therefore, the systems and processes used within a particular insurer are critical. Again, these can vary widely between different insurers.
3. Insurers cannot be expected to be 'experts' in a particular industry

It is wise for members to assume that their insurer has no prior knowledge of their business.

Checklist for Airmic members – insurer knowledge	
Do not presume that the insurer has any prior knowledge of the insured business.	*Prepare a defined list of subject matters and knowledge that the insurer holds about the business.*
Meet with the insurer at an early stage for each renewal cycle.	*Review the information they hold and identify the additional information they require.*
Understand the structure of and the relationships within the insurer.	*Clarify how information obtained by any employee of an insurer or any its agents is collated and shared across the insurer as a whole.*
Be extra cautious.	*If in doubt, ask the insurer whether a particular circumstance is known or must be disclosed. If still in doubt, disclose.*
Where one insurer is looking at two separate lines of business, ensure that full disclosure is made to both of the underwriters.	*Ask insurers which information is shared, but as a default, assume that nothing is shared.*
Take additional care when changing an insurer.	*Do not assume that any information held by a previous insurer would be held by a new insurer. Clarify with the broker how information on previous claims, risk control / loss adjustor surveys, etc. would be passed on.*

02 The duty of fair presentation of the risk

2.6 Fair Presentation – sufficient information to put a prudent insurer on notice

Failing that, disclosure which gives the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances

Section 3(4)(b), Insurance Act 2015

The Act provides insureds with a fall-back position if they fail to disclose all the material information which they know or ought to know. Thus, the insured can satisfy the duty of fair presentation by providing sufficient information to put a prudent insurer on notice that it needs to make further enquiries to reveal that information. It was hoped that this 'second limb' of disclosure would prevent insurers from taking a passive role during the disclosure process, as they are required to ask questions where there is any uncertainty about the risk.

Although the requirement can provide some additional protection for the insured, it is important that policyholders don't rely on this to give an overly brief description of the risk.

The submission must still be made in a clear and accessible manner, with appropriate signposts for the insurer to identify where further questions may be required. Insurance contracts are based on utmost good faith, and the insured will not have satisfied the duty of fair presentation if they deliberately hold back information from the insurer. In particular, where a policyholder is aware that information may be more limited, e.g. for a specific overseas territory, this limitation should be flagged to the insurer.

From a practical perspective, a clear statement by a policyholder of what it has done and what it has not done can assist in putting an insurer on notice to ask questions. If the insured makes clear it has not sought information from a particular source because it is unreasonable or impracticable to obtain reliable answers, an underwriter that wishes to know something from that source will find it difficult to ignore the statement and then criticise the insured's efforts later.

This fall-back position may, in some cases, lead to an increased number of follow-up questions from the insurer post initial disclosure and subsequently increase the length of the disclosure process. Policyholders should take control and look to agree a process of disclosure, including a formal protocol for handling follow-up questions, with their insurer before they begin collecting any disclosure information.

A fair presentation of the risk requires disclosure, without misrepresentation, of every material circumstance that the insured knows or ought to know

1	2	3	4	5	6
Includes the actual knowledge of senior management	Includes the actual knowledge of individuals responsible for insurance, including information held by the broker	Includes information that should be reasonably revealed by a reasonable search	Information must be presented in a clear and accessible manner	Need not include information considered 'insurer knowledge'	Failing achievement of 1 to 3, sufficient information must be provided to put a prudent insurer on notice that it needs to make further enquiries to reveal those material circumstances

Use of technology

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.

All of these electronic records must be secured at inception and archived so that they can be traced and retrieved if necessary at a future date.

Checklist for Airmic members – sufficient information to put a prudent insurer on notice	
Agree a full disclosure policy with the insurer before commencing data collection.	*This should include a formal process and timescale for receiving and responding to insurer questions.*
Start early in each renewal cycle.	*Policyholders should be prepared for the insurer to ask more questions after reviewing the disclosure, which could increase the timescale for placement and renewal.*
Document all communications, recording all questions, responses and to whom these are made.	*Where questions are asked by the insurer, either directly or via the broker, record the question, response and any follow-up communication.*
Review systems and processes.	*A robust technical system will be required to ensure all follow-up questions are handled and recorded appropriately. System changes can take some time to implement.*
Share information across all insurers.	*If one insurer within the programme requests clarity for further information, share the question and response with all insurers, including the captive if applicable.*

03 Insurer remedies for a breach of the Duty of Fair Presentation

The Marine Insurance Act 1906 was criticised for allowing the insurer the sole remedy of avoiding the policy from its inception in the event of material non-disclosure or misrepresentation. The Act introduced a series of 'proportionate remedies'.

Proportionate remedies

Where a breach is not considered deliberate or reckless the insurer can:

- avoid the policy and return the premium, where it can prove it would not have entered the contract
- treat the policy as if it included different terms, where it can prove it would have entered the contract, but on different terms and/or
- 'reduce proportionately' (as per the Act) any claims, where it can prove it would have entered the contract, but at a higher premium

On this last point, some policyholders and insurers consider it preferable for the insured to pay the additional premium that would have been charged, rather than face a reduced claim. If a policyholder wants to consider contracting out of the remedy that provides for the proportionate reduction in claims, they should take care to consider which approach is more appropriate for them in light of claims frequency and, critically, severity.

The law on inducement has not changed under the Act. Therefore, in order for the insurer to have a remedy for any breach by the insured of the duty of fair presentation, the insurer must show that it would have acted differently if the insured had not failed to make a fair presentation; that is, that the insurer would not have entered into the contract or variation at all, or would only have done so on different terms.

Fraudulent claims

The Act provides clarity over the remedies for the insurer in the event of a fraudulent claim by the insured.

- Where the insured has committed a fraud in relation to a claim:
  - the insurer will have no liability to pay the claim
  - the insurer can recover any payments already made in relation to the fraudulent claim
  - the insurer can terminate the contract from the time of fraud, and refuse to pay claims for losses occurring after the fraud
  - the insurer does remain liable for all claims for losses suffered before the fraud;
  - the insurer can retain premiums already paid.
- In group policies the above applies, but only with regards to the fraudulent claimant: therefore, innocent members of the group policy are not prejudiced.

Alternative remedies

In some markets for some classes of policy, insurers have been willing to alter these remedies to differentiate themselves. The following approaches have been seen:

- Requiring payment of additional premium, rather than reducing the claim proportionately in the event of a breach of the duty of fair presentation

  This 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 limitation on an insurer's remedies 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.

04 The impact of the Act on policy terms

The Act brought in a number of changes to the terms and operation of insurance policies, primarily regarding the operation of warranties.

Warranties: 'Suspensive conditions'

The Act amends the previous rules where even minor breaches of warranties unrelated to the loss could provide the insurer with a defence to a claim.

- Under the Act, warranties are now 'suspensive conditions' meaning that the insurer's liability will be suspended while the insured is in breach of the warranty. The insurer will not be liable for any loss which occurs or is attributable to something happening while the insured is in breach of warranty.

- Once the breach is remedied, assuming it can be, (including where an insured takes an action later than a time limit stated in a warranty as long as the risk to which the warranty relates becomes essentially the same as that contemplated by the parties), the liability of the insurer is restored.

- "Basis of contract" clauses were abolished by the Act. Therefore, any warranties in the policy must be expressly agreed as a warranty between the insured and the insurer.

Conditions precedent

Whilst not directly impacted by the Act (save for the impact of Section 11, see below), Airmic has noted that the use of of conditions precedent to liability has increased since the Act came into force. This has been reflected in members reporting an increased incidence of claims being declined for breach of notification clauses, which are still commonly expressed by insurers as conditions precedent to liability.

Conditions and conditions precedent: A quick reminder

In an insurance context, a condition is a contractual term obliging an insured either to act in a particular way, or a contingency upon which the validity of a policy or a claim may depend. Whilst the nature and types of insurance conditions may vary widely, they typically relate to the commencement of the risk, the conduct of the insured during the currency of the policy and the procedure to be observed for making and advancing claims under the policy.

Identifying conditions precedent

Identifying a condition precedent is not necessarily straightforward. While insurers should and often do use the words "condition precedent" to identify such a provision, in fact a clause in a policy may be held by the courts to be a condition precedent to liability based on the construction of the clause and in the absence of identifying words. For example in the well-known case of *HLB Kidsons (A Firm) v Lloyd's Underwriters* [2008] EWCA Civ 1206, the Court of Appeal held that a clause dealing with notification of circumstances to a "claims made" professional indemnity liability policy was in fact a condition precedent to liability even in the absence of the words condition precedent. The relevant clause (which should not be used if possible) provided that:

"The Assured shall give to the Underwriters notice in writing as soon as practicable of any circumstance of which they shall become aware during the period specified in the Schedule which may give rise to a loss or claim against them. Such notice having been given any loss or claim to which that circumstance has given rise which is subsequently made after expiration of the period specified in the Schedule shall be deemed for the purposes of this insurance to have been made during the subsistence hereof"

The Court of Appeal held that the words "such notice having been given" operated as a condition precedent to liability because, if the notice had not been given in the way prescribed in the previous sentence, the deeming provisions did not operate to link claims made outside the policy period (and, therefore, outside the insuring clause) back to the earlier notification of circumstances.

Conditions precedent to the attachment of cover

Airmic recognises that, in certain circumstances, conditions precedent may be used for legitimate reasons, particular in relation to the attachment of cover.

For example, the insurer of property may require the insured to obtain an up to date survey of the property and to comply with certain specific requirements set out in the survey if cover is to attach. The insurer may require confirmation that certain information or statements be entirely accurate as a condition precedent to the attachment of the risk. To see an example of a policy clause adopting this approach, see LMA5253 the Critical Information clause (set out below), in which an insurer seeking to incorporate this clause in its policy identifies a limited number of matters which are regarded as critical to the underwriting of the risk.

LMA5253

"It is a condition precedent to the insurer's liability under this insurance contract that the following matters are true and accurate at the time of inception of the contract"

The result of LMA5253 would be that if, upon inception of the risk, any of the matters contained in the Critical Information clause were found not to be true, the insurer would have no liability under the policy.

Airmic recognises that in particular circumstances (but not as a matter of course), the complete accuracy of certain information provided pre-contract will be legitimate underwriting concerns. The danger of clauses such as LMA5253 is that, if misused, they can constitute an attempt by an insurer to re-introduce basis clauses, when these have been abolished by the Act and are void in any contract of (re)insurance underwritten after the Act came into force.

Conditions precedent to liability

The conditions precedent used most commonly by insurers, particularly (but not exclusively) in liability policies and specialty risks, are conditions precedent to liability to make or pay a claim (or part of a claim). Conditions precedent may deal with at least the following situations (and possibly others not listed):

- To notify a claim within a specified timescale ie 7 days or as soon as practicable;
- To provide assistance to the insurer in the conduct of the claim generally, or to comply with the insurer's requests for information (without any limitation as to their scope, necessity or reasonableness);
- To seek consent to incurring defence costs in the face of a third party claim, often before any legal costs are even incurred (which takes no account of the need to respond quickly to unexpected claims);

- Not to make admissions of liability or to settle a third party claim without the insurer's prior approval;

- To submit a proof of loss (in a first party claim) within a specified time period or in a specified form;

- To commence proceedings (suit) against the insurer within a specified period (often shorter than the limitation period under the general law) in the event that there is a coverage dispute with the insurer.

All of these are used by insurers in relation to the conduct of the insured during the policy period. The remedy for an insured's breach may be to bar the claim entirely, or all claims under the policy, or to entitle the insurer to decline some part of the indemnity that would otherwise be payable.

Sweeper clauses

That the use of conditions precedent to liability is on the increase, is not least due to the re-emergence in some policy wordings of the use of "sweeper" clauses. These are terms usually appearing in the general conditions or claims conditions of the policy and make compliance with everything that the policy requires to be done by the insured a condition precedent to the insurer's liability to pay a claim. This development can circumvent effects of certain provisions of the Act (for example, by using a sweeper clause to re-characterise all policy terms, including warranties, as conditions precedent to guard against the changes made to warranties by section 10 of the Act or by requiring that the provision of accurate information on certain matters at inception is a condition precedent to the insurer's liability under the policy in response to the abolition of basis clauses by section 9 of the Act).

Sweeper clauses (an example of which is set out below) can be legally effective and convert policy terms which are bare conditions and do not identify themselves as conditions precedent to liability into conditions precedent to liability. Airmic considers "sweeper" clauses to be fundamentally unfair and encourages members to resist them where possible.

Example sweeper clause

"It is a condition precedent to any liability on the part of the Insurer under this Policy that the terms hereof so far as they relate to anything to be done or complied with by the Insured are duly and faithfully observed and fulfilled by the Insured and by any other person who may be entitled to be indemnified under this Policy."

A potential pitfall for the unwary

What is almost always the case, however, is that the remedy for breach of a condition precedent to liability is severe in its effect. It provides the insurer with an ability to decline the claim in response to what is often inadvertant conduct on the part of the insured in circumstances that don't prejudice the insurer. The most commonly seen example is late notification in which claims have been rejected by an insurer on the basis that claims were notified late, often inadvertently or by trivial periods of time, which caused the insurer no prejudice.

By contrast, if the same provisions were expressed as bare conditions, the only remedy available to the insurer in the event of breach would be damages for the insured's breach. However, there are few reported cases in which an insurer has been awarded damages for breach of a policy condition, since it is rare that breach of a policy condition (particularly those relating to claims co-operation) will give rise to a quantifiable loss.

One of the few recoded cases where insurers have been awarded damages for breach of a bare condition is *Milton Keynes Borough Council v Nulty* [2011] EWHC 2847. In this case the insured delayed their notification of a fire under a public liability policy for 18 months. The court held that, while the insured's negligence was the proximate cause of the fire on the balance of probabilities (with the result that insurers were liable under the policy), insurers had been prejudiced by the late notification. In particular, they had not been involved in the post-fire investigations and, thus, had not had the opportunity to take contemporaneous witness accounts. As a result, they lost the chance to investigate alternative causes of the fire. Damages representing this loss of a chance were assessed (albeit arbitrarily) at 15% of the claim.

In *Milton Furniture Ltd v Brit Insurance Ltd* [2014] EWHC 965 the court was of the view that a breach of a condition which required the assured to keep an alarm maintenance contract in force would have justified an award of damages in circumstances where a fire (which might have otherwise been limited in its effect) caused significant damage. However, in the end, the provision was held to be a condition precedent to liability absolving the insurers from liability altogether, so it was unnecessary for the court to decide what loss was caused by the insured's breach.

Members should seek to remove conditions precedent to liability where possible. While an insurer may suggest that the draconian remedy of a condition precedent to liability operates as a deterrent to insureds ignoring their policy obligations at the expense of insurers, Airmic believes that its members take seriously their obligations under their policies and that the deterrent is unwarranted. Further, if an insurer has suffered genuine prejudice, a bare condition would provide a remedy in damages. If they cannot prove prejudice reflected in money terms, Airmic does not believe the indemnity afforded to its members should be reduced.

In Airmic's view conditions precedent to liability give rise to fundamentally different considerations to conditions precedent to the attachment of cover which, while onerous, can serve a legitimate purpose during underwriting if used sparingly and specifically.

Conditions precedent to the insurer's liability

Most conditions precedent to liability are concerned with some aspect of the claims process and the insured's behaviour. Generally speaking, a failure to comply with a condition precedent to liability will prevent the insured from making the claim to which the breach relates, or to recovering an indemnity for a particular element of the claim such as defence costs, regardless of whether the insurer has suffered any prejudice as a result of the breach. If the condition precedent does not relate to a specific claim, but is of general application, a breach may suspend the insured's right to make any claim until they have complied with the obligation. By far the most common conditions precedent to liability to pay the claim are notification clauses setting out what the insured must do and within what timeframe to notify the insurer in the event of a claim. Other common conditions precedent to liability may concern cooperation by the insured with the insurer in the conduct of the defence of a liability claim, seeking advance permission to incurring defence costs and making no admissions of liability without the insurer's consent.

Conditions precedent to the attachment of cover

Some policies will make compliance with a particular action, such as the payment of premium or the carrying out of a particular survey, a condition precedent to the attachment of cover under the policy. If a condition precedent of this sort is not complied with, the insurer never comes on risk.

Bare conditions

These are usually concerned with the insured's conduct during the currency of the policy. Breach of a bare condition does not entitle the insurer to avoid the claim. The insurer is entitled to damages (as the remedy for the insured's breach of the condition) for any loss suffered as a consequence of the insured's breach. However in practice it is often difficult for the insurer to show that an insured's breach has caused prejudice capable of being expressed in money terms.

Section 11 of the Act

Section 11 of the Act provides that in the event of a claim, an insurer cannot avoid liability based on the breach of any warranty or any term where the breach could not have increased the risk of the loss which actually occurred in the circumstances. However, this only applies to "risk mitigation terms" (terms which tend to reduce the risk of loss of a particular kind or at a particular location or time) and does not apply to terms which define the risk as a whole. This does offer a certain amount of protection to policyholders from, for example, arbitrary consequences of a breach of some conditions precedent to liability.

However, there are many policy terms frequently expressed to be a condition precedent to liability which will not meet these qualifying criteria. It may be difficult to argue that a notification clause or obligation to cooperate with insurers meets those criteria, leaving the insurer in breach of such a clause without relief from section 11.

Market clauses

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

Appendix 1 Suggested timeline for insurance placement / renewal

Action	Days before inception
1. Evaluate the insurance needs of the business	**210 days**
• Review renewal plans to allow further time for information gathering and responding to insurer enquiries	
2. Meet with your insurer and broker to establish disclosure processes	**180 days**
• Discuss and agree information requirements of insurer • Clarify what constitutes 'insurer knowledge' with the individual underwriter(s) • Propose lists of senior management, individuals responsible for insurance and a process of reasonable search to the insurer, and consider feedback	
3. Compile exposure and loss data to achieve full disclosure	**150 days**
• Collect information agreed in stage 2. Document the information collected, who it is collected from and how it is collected. • Ensure that broker knowledge is incorporated into the presentation	
4. Discuss with underwriters to ensure understanding	**120 days**
• Ensure that insurance presentations are adequately presented, ordered and sign-posted • Record any insurer questions and the responses made	
5. Legal and professional review of suggested wordings	**90 days**
• Ensure any changes to the wording are noted and understood • Ensure that any wordings that contract out of the Act are identified and understood, as these may introduce disadvantageous terms	
6. Discussion, negotiation and testing, including scenario testing	**60 days**
• Cross-check the policy coverage against the improved risk understanding that arises from greater analysis of the business risks	
7. Formal agreement of all parties of the final terms and conditions	**45 days**
8. Ensure accurate and timely policy documentation issuance	**30 days**
9. Ensure compliance with regulatory, tax and warranty requirements	**15 days**

This guide is part of the EXPLAINED series of Airmic Guides:
www.airmic.com/technical/library

airmic

EXPLAINED GUIDES

Marlow House
1a Lloyd's Avenue
London
EC3N 3AA

Tel: +44 207 680 3088
Fax: +44 207 702 3752
Email: enquiries@airmic.com
Web: www.airmic.com

EXP-0004-0921