The Insurance Act 2015 (the ‘2015 Act’), which is due to come into effect in the United Kingdom on 12 August 2016, will bring about the most significant changes to insurance contract law in the UK for over 100 years. The Act will apply to all contracts of insurance concluded after 12 August 2016 that are governed by English Law, as well as to variations to existing contracts of insurance which are concluded after 12 August 2016.

The current law in the UK is based on common law developed over the 18th and 19th centuries, which was codified in the Marine Insurance Act 1906 (the ‘1906 Act’). While the name of the 1906 Act would suggest that it applies only to marine insurance, in practice, it has been applied to all areas of commercial insurance on the basis that it reflects the common law applicable generally, which just happens to have derived mainly from maritime case law.

The 1906 Act was drafted at a time when the insurance industry was in its infancy, and when policy makers were concerned to nullify the possibility of exploitation by insureds. Consequently, it confers wide-ranging rights upon insurers to refuse claims or to treat their liability as discharged, where such remedy seems, at least to the modern eye, disproportionate to the breach committed by the insured.

The Law Commission began a review of insurance law in 2006, and submitted its recommendations as to non-consumer insurance law in 2014. In essence, the Law Commission found that the 1906 Act was in many respects no longer fit for purpose – the commercial insurance market had developed into a highly sophisticated field, such that the rigidity of the 1906 Act, notably in its treatment of disclosure and remedies for breach of the duty of disclosure, were no longer appropriate. These recommendations were accepted by Parliament, resulting in the adoption of the 2015 Act, which amends certain provisions of the 1906 Act but does not have the effect of repealing it in its entirety.

The 2015 Act has as its central aim the creation of a fairer balance between the interests of the insurer and the insured. Importantly, however, the 2015 Act provides only a default regime, much of which can be contracted out of. Indeed, in its 2014 report the Law Commission expressly acknowledged that “in some sophisticated markets, including the marine insurance market, we expect contracting out will be more widespread.” Insurers are able to contract on terms which exclude the provisions of the 2015 Act, save in relation to two areas. First, under Section 9(2) of the 2015 Act, a representation made by an insured prior to contract may not be treated as a warranty by means of a provision in the contract, such as a “basis of contract” clause. What this means is that insurers may no longer rely on such a provision to avoid liability at all, and instead must establish that a representation relates to a specific warranty, the breach of which would then give rise to a proportionate remedy. Secondly, Section 13A of the 2015 Act implies into contracts of non-consumer insurance a term requiring the reimbursement of claims within a reasonable time. The 2015 Act does not permit contracting out of this implied term to avoid liability for deliberate or reckless failure to reimburse an insured’s claim within a reasonable time.

It should be noted that certain of the proposals put forward by the Law Commission, notably concerning broker’s liability for insurance premium and a statutory definition of “insurable interest”, were not included in the Act. It is likely that there will be further reform of the law to address these issues in due course.

The 2015 Act – key features

The 2015 Act introduces new provisions in three broad areas: disclosure obligations, warranties and the treatment of fraudulent claims.

(i) Disclosure obligations

Section 17 of the 1906 Act states: “A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed by either party, the contract may be avoided by the other party”. Section 16 places a duty on the insured to disclose to the insurer “every material circumstance which the insured knows or ought to know” before the contract is entered into. Under section 18(2), a material circumstance is defined as “every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk”.

The only remedy available to the insurer for breach of disclosure obligations under the 1906 Act was avoidance of the contract - the contract being treated as if it never existed, and the insurer entitled to refuse all claims made under it. This reflected the intention of lawmakers to protect the interests of the insurer as much as possible. The 2015 Act introduces the new concept of an obligation to make a “fair presentation of the risk” (Sections 3 – 7).

Section 3(4) of the 2015 Act provides that:

“the disclosure required is as follows:

(a) disclosure of every material circumstance which the insured knows or ought to know; or
(b) 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 purposes of revealing those material circumstances."

Section 3(4)(b) highlights the greater role required of the insurer.

(ii) Knowledge

The insured’s knowledge

The insured must disclose to the insurer all material circumstances which it knows, or ought to know. Under Section 4(6) of the 2015 Act an insured “ought to know” information that would be revealed by a reasonable search of information available to it.

Knowledge would be deemed to be knowledge of the insured if it is:

- known to the senior management of the insured or the person responsible for insurance placement, or
- known to the broker.
The anticipated effect of the above, along with the revised duty of disclosure under Section 3(4) is that there will be more focussed disclosure, and less ‘data dumping’, i.e. presentation of large volumes of material without regard for what is material and what is not. Indeed the Law Commission has indicated that this could amount to a deliberate breach of the duty to make fair presentation.

(iii) The Insurer’s knowledge

Section 5 of the 2015 Act sets out the tests for what the insurer “knows”, “ought to know” and “is presumed to know”.

The insurer “knows” what is known to the individuals who decide on behalf of the insurer whether to accept the risk in question. The knowledge of the insurer’s claims department may also be deemed to be knowledge of the insurer. Combined with the option given to the insurer under Section 3(4) to disclose only that which would put the insurer on notice of the need to make further enquiry, this means that the insurer will need to take a proactive role in the disclosure process.

The insurers knowledge will include that which “an insurer offering insurance of the class in question to insureds in the field of activity in question would reasonably be expected to know”, in other words, general knowledge.

(iv) General points concerning knowledge

Section 6 of the 2015 Act contains general provisions regarding knowledge:

“Knowledge” includes not only actual knowledge, but also what is often referred to as “blind eye” knowledge – matters which the individual suspects but deliberately chooses to ignore, such as an adverse development to a claim likely to impact on the claim reserve. Failure to disclose such knowledge could also amount to a deliberate breach of the duty to make fair presentation.

(v) Warranties

In the treatment of warranties, the main changes introduced under the new Act are as follows:

Section 9 - “basis of contract” clauses, which convert all statements made by an insured when applying for insurance into warranties, are deemed to be of no effect. This is one of the two sections of the new Act which insurers cannot contract out of.

Section 10 - breaches of warranty will suspend, rather than discharge, an insurer’s liability. There will be no liability for losses which arise whilst an insured is in breach, but once that breach is remedied, cover will be reinstated.

Section 11 - warranties or other terms, except those which affect the risk as a whole, will not discharge the insurer from liability where the insured can prove that the relevant breach would not have increased the risk of the loss which actually occurred.

(vi) Remedies for breach of the duty of fair presentation

The remedy of avoidance under the 1905 Act for a breach of disclosure obligations is abolished in the 2015 Act and replaced with a proportionate system of remedies for breach of the duty to make a fair presentation. These proportionate remedies operate on the basis of establishing whether, had the insurer received a fair presentation, he would have either:

a. not entered into the contract at all;
b. entered into the contract but on different terms (but would not have altered the premium charged); or
c. entered into the contract but with a higher premium.

If any of the above criteria are met the breach will be a ‘qualifying’ breach, and the available remedy will depend on whether or not the breach is either deliberate or reckless (i.e. the insurer knew it was in breach or did not care whether it was in breach). If it is the insurer would have the remedy of avoidance of the contract from inception and be able to retain the premium paid by the insured. The Law Commission helpfully provides the following guidance on what might be construed as a deliberate breach of the duty of fair presentation:

‘(1) failing to disclose a circumstance which the insured knows to be material;
(2) making a data dump or otherwise presenting risk in a particular way in order to conceal certain information (as in the case where a summary is misleading); or
(3) intentionally misrepresenting a material representation, either in the initial presentation or by knowingly giving a false response to an insurer enquiry’.

In so far as what may be construed as reckless, this is not defined in the Act, so its meaning will likely be subject to existing case law – “making a statement without caring whether it is true or false.” (Derry v Peek (1889) LR 14 App Cas 337)

Where a qualifying breach is not deliberated or reckless, the available remedy under the Act would have the objective of putting the parties in the position they would have been in had a fair presentation been made.

If the insurer is able to establish, on the balance of probabilities, that he would not have written the risk at all, the remedy will be avoidance from inception, with the premium being returned to the insured.

If the insurer would nevertheless have written the risk but on different terms, the contract will remain but those different contractual terms will be implied into the contract from inception, which in turn could impact upon claims which had been covered by the insurer prior to the breach of duty having been discovered.

If the insurer would have charged a higher premium to write the same risks, the remedy will be for the contract to continue in force but for the amount of any claims reimbursement to be reduced by the same proportion as the premium actually paid bears to the premium that would have been charged but for the breach of duty. By way of example, if the insurer would have charged £10,000 but only charged £5,000, then the claim reimbursement would be reduced by half.

P&I Clubs and the 2015 Act

Eight of the Clubs in the International Group (“the IG”) are affected by the 2015 Act because their Rules are subject to English law. Accordingly and in the interest of continuity across the wider IG, the consensus amongst the eight IG Clubs is to contract out of certain aspects of the Act, and to adopt those which clarify certain aspects of the law which are presently uncertain.

(i) Non-disclosure/fair presentation of the risk

The new duty to make fair presentation of the risk is perceived to be generally favourable to insureds. In particular the insured’s obligation can be discharged not only by disclosure of all material facts, but also by sufficient disclosure overall to put a prudent insurer on notice that further enquiries are required. In turn a greater burden will be placed on insurers to ensure that relevant material is requested and considered. Similarly the provisions in Sections 4 and 6 in respect of what an insured or its agents knows, or is deemed to know, for the purposes of discharging his obligations, are said to make the duty on the insured less onerous. In the P&I world, the relationship between a Club and its Member is a close one. Both are sophisticated market participants and entry or renewal discussions are detailed and focused. A fair presentation and a professional assessment of the risk are of mutual benefit to both owners and Club and what both would aspire to. Accordingly the Clubs have amended the fair presentation and knowledge regimes in Sections 9 - 7 of the 2015 Act. At the same time
recognising the importance across the IG Clubs of proper disclosure, the more diluted provisions in Section 8 of the 2015 Act in relation to remedies for breach are contracted out of, so as to retain the remedy of avoidance of the policy for failure to make a fair presentation of the risk.

(ii) Warranties
So far as concerns warranties or other conditions of cover, for example the warranty or condition that the Member will comply with any requirement of Class, the existing practice is that cover is suspended during the period of breach, so that the Member will not be entitled to any recovery from the Club in respect of any claim arising during that period, except at the discretion of the Directors of the Club. Bearing in mind the mutual nature of the cover provided by the IG clubs, the importance attached to matters such as compliance with Class and the availability of the Directors’ discretion in appropriate cases, existing practice is to be maintained. Accordingly the Clubs have contracted out of Sections 10 and 11.

(iii) Fraudulent claims
The current law allows an insurer to avoid a fraudulent claim at common law and, under Section 17 of the 1906 Act, avoid the policy, allowing the insurer to recover sums paid out previously under a non-fraudulent claim.

Under Section 12 of the 2015 Act, where the insured makes a fraudulent claim, the insurer is not liable to pay that claim and may recover any sums paid to the insured in respect of that claim. The insurer may also treat the contract as having been terminated with effect from the time of the fraudulent act.

Under Section 13, where an insurance contract confers benefits on third persons who are not parties to the insurance contract, the submission of a fraudulent claim by such a third person will not affect the rights of the parties to the contract. The Clubs provide cover to persons who are affiliated to or associated with the Member but not entered in the Club. In the event that a fraudulent claim were submitted by such an affiliate or associate of a Member, it is felt that for consistency such fraud should have the same impact on the Member as that provided by Section 12 of the new Act, namely the right to decline payment/recover sums paid and to terminate the cover. The clubs have, however, contracted out of Section 13, so that conduct of one party which is sufficient to bar that party’s recovery would bar rights of recovery of the others under the same entry.

Members who have questions concerning the insurance Act 2015 are advised to direct their enquiries to their usual contacts with the Managers.

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