THE INSURANCE ACT 2015

GUIDANCE NOTE

Innovation Broking

Introduction

The Insurance Act, implemented from 12 August 2016, seeks to update and modernise an antiquated area of law, regarded as out of line with modern business practices and the richness of information now available.

It intends to provide a neutral framework that is fair to both customer and insurer.

It looks to ensure that sharp practices, or the concealment of material information, find no support in the law whether they concern a risk or how an insurance policy is expected to work.

It aims to encourage dialogue and promote industry practices which support the understanding of risk.

It retains a central place for the key principle of good faith on which the industry has always depended.

Although the Act directly addresses the parties to the insurance contract (the client and insurer), its focus is on the transfer of risk information and communication of how insurance policies work. In practice the broker is at the coal face of most of the Act's impact. The Act introduces a number of important changes. The two most important changes directly affect how an insurance policy is arranged.

First, the Act redefines the client duty of disclosure as one requiring a "fair presentation" of risk, with additional guidelines around how a risk needs to be investigated and described to meet the new standard.

Secondly, the Act amends the way in which warranties and conditions operate in insurance policies. The insurer has a responsibility to explain this to clients in order to treat them fairly.

Fair Presentation

The most obvious change in the Act, the new duty of fair presentation, is a more structured framework for disclosure that includes far greater specificity about necessary knowledge, enquiries and presentation of risk information.

How can brokers help?

Senior Management is defined in the Act as *'individuals who play significant roles in making decisions about how the insured's activities are to be managed or organised.'*

The words "to be" in the definition are significant. They imply a higher level of management or oversight than those managing or organising the business on a day to day basis.

Depending on the circumstances this may include individual investors, non-executive directors, shadow directors, SME director family members or individuals employed by parent companies. Clients will be required to think through where the line should be drawn.

It should be noted that even where individuals are not considered to be Senior Management for the purpose of fair presentation, there is still a separate duty to make reasonable enquiries of relevant individuals excluded from the definition.

What is the role of good faith?

Although the specific remedy of avoidance for breach of the duty of good faith is replaced, good faith is still likely to be required to fulfil the new duty of fair presentation.

An example of a simple voluntary disclosure statement: "the insured has had no claims in the last five years". Even if this statement may be sufficient to put insurers on notice that there could have been a claim six years prior, the broker or the client should perhaps volunteer this additional claims information. Failing to do so can introduce uncertainty as to whether the insurer has waived its rights in requesting data only for a defined period or whether the customer or broker may have acted in bad faith – with any legal answer dependant on the facts.

Another "good faith" example is whether it needs to be disclosed should insurers decline to quote. Again there is no single solution: if an insurer's reasons are clearly documented and based on a material risk concern, disclosing that concern is likely to be prudent; if declinature is based purely on commercial grounds then it is of no consequence.

INSURED'S KNOWLEDGE

What MUST be actively disclosed

Knowledge of senior management →

Knowledge of the insurance team, including brokers →

Information which would be revealed by a reasonable search →

A fair presentation of the risk requires clear and accessible disclosure without material misrepresentation of:

Every material circumstance which the insured knows/ought to know

Or failing that:

Sufficient information to put a prudent insurer on notice that it needs to make further enquiries to reveal those material circumstances

INSURER'S KNOWLEDGE

NOT required to be disclosed

← Information held by the insurer and accessible to the underwriter relevant to the risk

← What an insurer writing this risk would reasonably be expected to know

← Common knowledge

Warranties and Conditions

How has the burden of proof changed regarding a breach of policy?

Historically, the burden of proof has generally rested with the insurer (unless stated otherwise) to establish either that a breach of policy condition/warranty has occurred, or that an exclusion applied. That basic position remains but the new regime is more complicated:

Under Section 10 of the Act, **the effect of a breach of warranty is now to suspend liability rather than to discharge the insurer from all liability** under the policy. Therefore, in practical terms it will often fall to the client to prove that a breach has been rectified.

Section 11 of the Act helps clients by creating a limitation to prevent risk mitigation terms being applied where they are irrelevant, for example a breach relating to fire extinguishers being used to avoid an unrelated flood claim.

→ *However, it is now up to the clients and their broker to establish not just that a breach did not affect loss but also that it could not have increased the risk of loss in the circumstances concerned. This is a potentially onerous evidential burden and opens up a new area of dispute*

It would be wise for brokers to ensure that clients understand that the protection offered by Section 11 (Terms not relevant to the actual loss) does not extend to all policy terms. There are two important exceptions:

→ *Terms which define a risk as a whole, although this is a potential grey area that is likely to become clearer as case law develops (and may apply differently for a single line policy than for a cross-class one that covers many types of risk)*

→ *Terms which govern post-loss behaviour, for example an inconsequential delay in notification of a claim, in breach of the requirements of a condition precedent to liability, could still be used by an insurer to decline a claim*

Is there a new requirement to disclose breaches of risk mitigation terms?

A feature of the 1906 Marine Insurance Act was the lack of any duty to disclose facts which were relevant only to the insured's ability to comply with a warranty. Since the breach of warranty would anyway discharge all insurer liability, disclosure of facts relating to a breach of warranty by the customer was generally not required.

The Act makes **warranties suspensory** (i.e. the insurer is again liable once the breach is remedied) which is obviously of benefit to clients. However, facts relevant to the insured's propensity to breach a warranty (or, indeed, any condition tending to mitigate risk) may now be material for the purpose of fair presentation – such as significant or repeated instances of breaching important risk management obligations in the policy (from waste handling to security or fire protection system maintenance).

The safest approach would be for the client to monitor its compliance with risk mitigation terms and disclose all material failures to comply with them. This approach is in line with the overall objectives of the Act but could require disclosure relating to a large number of obligations depending on policy detail. This is a demanding departure from current practices.

Overview

From a client perspective, the Insurance Act is a balance between providing the legal basis for fairer claims outcomes in return for a fair presentation of the risk.

Although the outgoing duty to disclose every material fact was demanding, the industry actually developed much more limited expectations. But for the clients this came with the risk of an unfair and disproportionate impact on claims if that limited risk information later proved inadequate. The duty of fair presentation aims to tackle this problem head on. The core question, is: what do we need to do differently?

The whole concept of fair presentation requires the client to work through what is reasonable within the context of its own organisation. Where and by whom activities are undertaken or information is held and how responsibilities are divided all affect what enquiries are necessary or reasonable to undertake. The broker can advise on how to go about doing so, but cannot definitively set the boundaries.

The duty of fair presentation is made up of various constituents, including maintaining the existing duties of "material accuracy" (of facts) and "good faith" (as regards expectations or beliefs), but there are two newly defined areas where clients are most likely to ask questions:

1. What are the boundaries of "reasonable search"?

2. How can we ensure information is presented in a "clear and accessible" manner?

The table overleaf summarises some potential steps that clients can take to protect themselves

Client Action	Conducting a reasonable search	Clear and accessible presentation
Good Practice	Know what risks are insured and tailor search to find information relevant to those risks Document who and what is involved in gathering and checking risk information Updating guidance to individuals responsible for providing information relating to their responsibilities under the IA 2015	Consistent indexing and signposting - pointing insurers to what is relevant to them Not just about improving presentation standards but also emphasising known risk concerns (e.g. a trend arising from uninsured minor incidents)
Added Value	Reassessing the adequacy of sources consulted in the light of how business information is held Clarifying what 'sign-off' realistically involves for both operations and management/the board (to ensure full approval of accuracy and completeness) Reviewing where search should be broadened a) insured parties and/or b) relevant third party knowledge (consultants, contractors and agents, including the insurance broker)	Providing bespoke supporting guidance and summaries to help insurers though all wider risk context documents provided, e.g. websites, risk management policies Ongoing appraisal of operations throughout the year to identify and flag any changed or unusual risk factors on a consistent basis
Market Leaders	Explicitly agreeing senior management definitions and search limitations with insurers Automating 'sign-off' within the IT systems used for information gathering, e.g. though Enterprise Risk Management or bespoke tools Running investigative enquiries or analysis into complex aspects of risk beyond the traditional dataset	Designing additional checkpoints to stress-test clarity and completeness with a wider internal audience Highlighting specific gaps or weakness in risk information for insurer approval

Key Conclusions & Client Implementation

Timing

Implementing procedures will take more time; some important considerations

- Commence renewal exercise a month or more earlier than "normal"
- Once processes established, timescales should be extended to allow for additional review and sign-off of risk information and to record the enquiries made. For larger businesses it could require starting as much as five or six months prior to renewal

Broker Partnership

The fair presentation standard makes clear that responsibility for insurance disclosure must involve customer and broker working together. This requires:

- Seeking to establish clarity on respective broker and customer responsibilities around risk information
- Ensuring that broker processes are clearly understood by the client, and that they are properly recorded both where the broker interacts with the wider business and throughout the broker's dealings with insurers

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