

INSURANCE ACT 2015 PROPORTIONATE REMEDIES

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Agenda

1. Changes the Insurance Act 2015 will bring about.
2. Practical examples.
3. Issues to consider.



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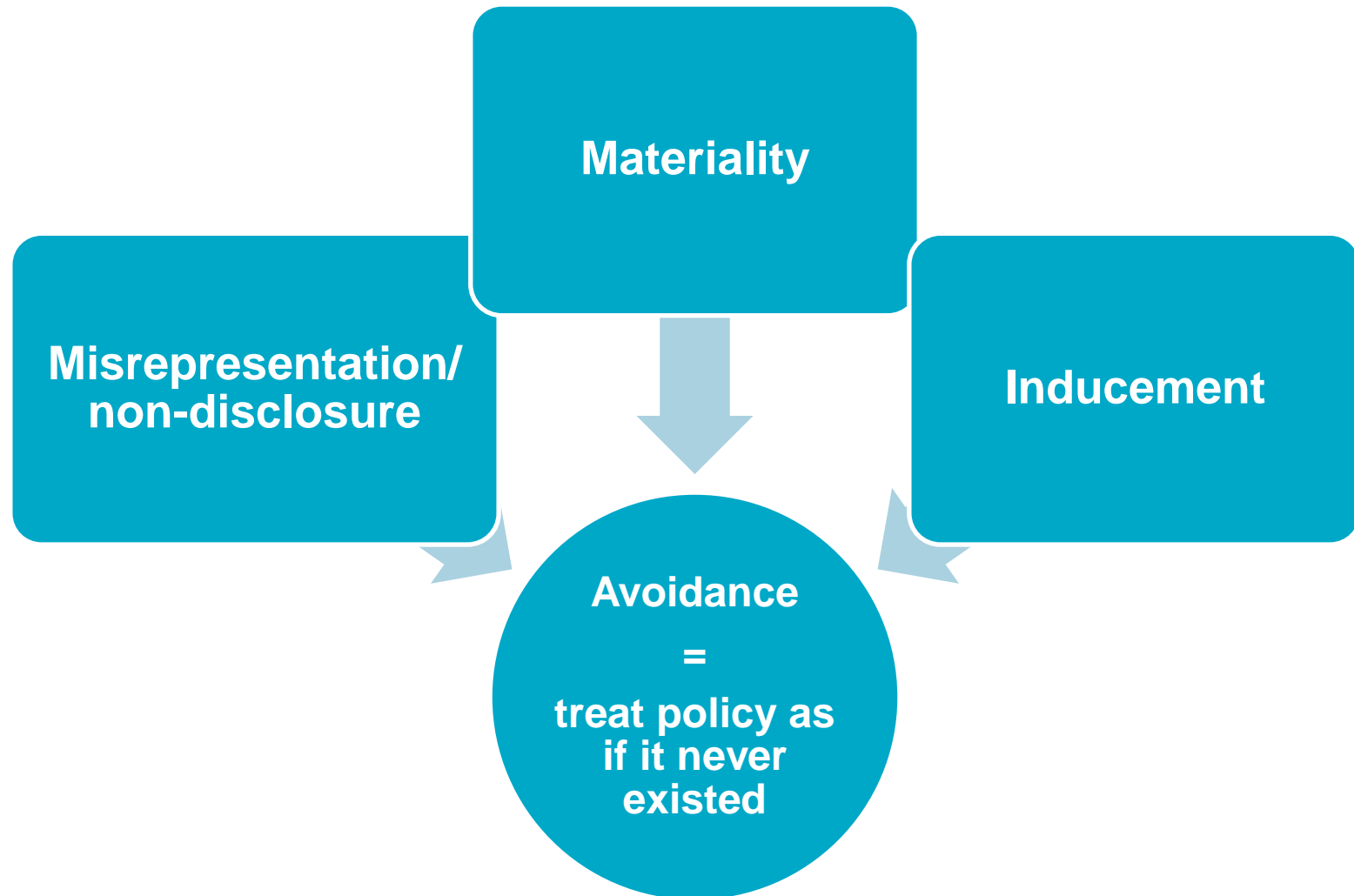


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PART 1

WHAT CHANGES WILL THE INSURANCE ACT 2015 BRING ABOUT?

Current Law



Current Law

“a blot on English insurance law”

Mr Justice Leggatt in *Involnert Management v Aprilgrange Ltd* [2015]

- Law Commission: overly harsh, sole, inflexible remedy.
- Considered insurer-friendly.
- Query how much relied on in practice?

Insurance Act 2015 – new Proportionate Remedies

Breach of Duty of Fair Presentation in Relation to **Contract/Policy**

- For deliberate/reckless breaches: **avoidance of contract** (no return of premium).
- For other types of breach (i.e. not deliberate/reckless):
 - If the insurer would not have entered into the contract on any terms: **avoidance of the contract** but insurer must return premium.
 - If the insurer would have entered into the contract but on different terms: (not relating to premium) **contract may be treated as if it included those terms from the outset.**
 - If the insurer would have entered into the contract but would have charged a higher premium: **the amount paid on claim may be “*reduced proportionately*”.**

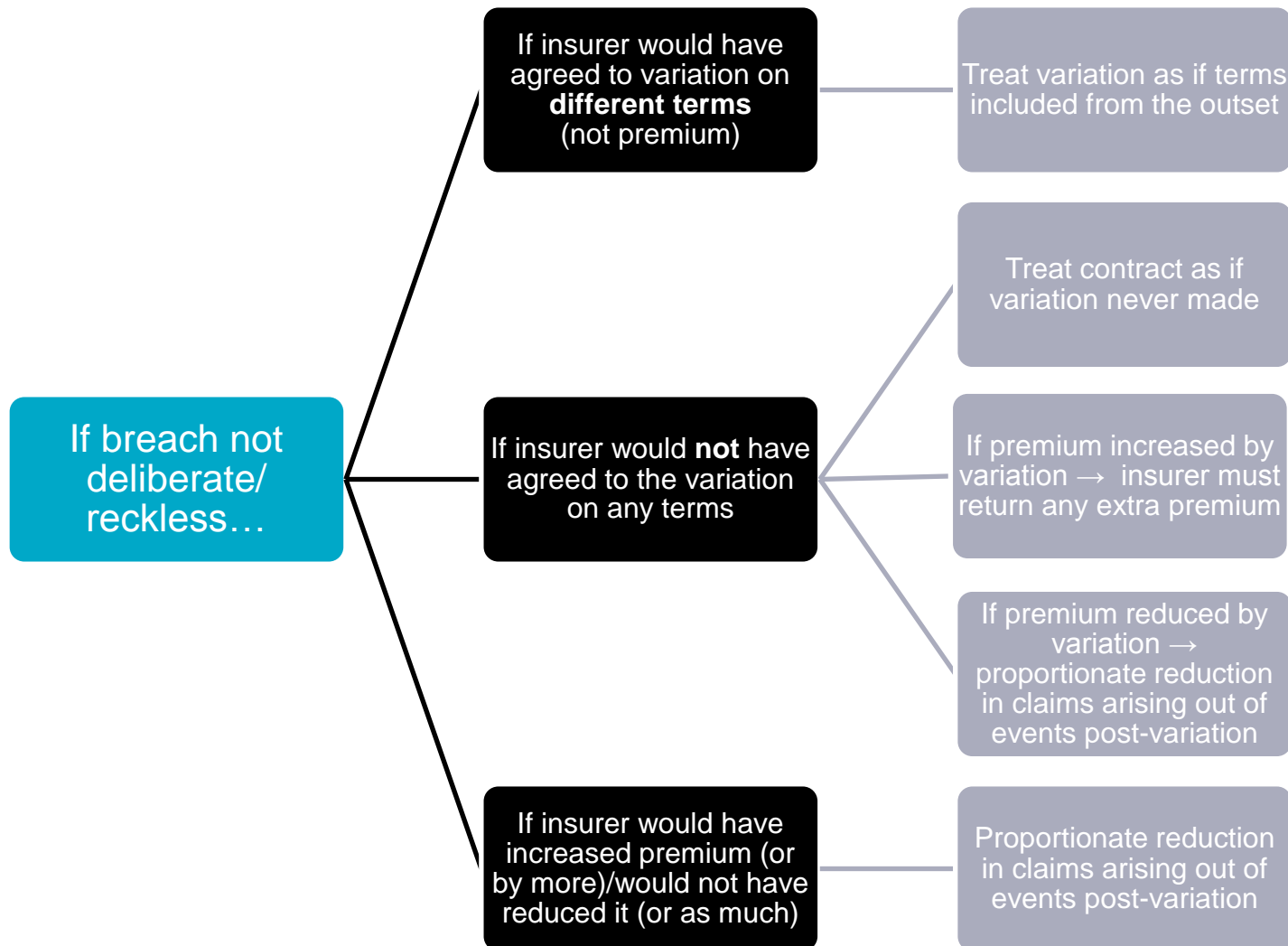
Insurance Act 2015 – New Proportionate Remedies

Breach of Duty of Fair Presentation in Relation to **Variation**

- For deliberate/reckless breaches: **contract terminated** from time variation made (not just variation) and no return of premium.
- For other types of breach (i.e. not deliberate/reckless): similar proportionate remedies exist (see next slide).

Insurance Act 2015 – New Proportionate Remedies

Breach of Duty of Fair Presentation in Relation to **Variation**



PART 2

PRACTICAL EXAMPLES

Proportionate Remedies – Practical Examples

Insurer would have entered into the contract but included an exclusion

- Policy treated as if it included the exclusion from the outset.
- Could affect claim under consideration.
- Previously settled claims may be unravelled if subject to the exclusion.

Proportionate Remedies – Practical Examples

Example:

- Property policy covering commercial premises which have suffered subsidence in the past.
- Without being deliberate or reckless, the insured fails to disclose this matter to the insurer.
- If the insurer had been aware of the history of subsidence at the property, it would have included an exclusion on loss or damage caused to the property by subsidence.
- Any claim would be treated as if the policy included the exclusion from the outset **AND** the insured would have to reimburse the insurer for prior claims payments relating to subsidence damage that pre-date the insurer's discovery of the breach of duty of fair presentation.

Proportionate Remedies – Practical Examples

Insurer would have charged more premium

- Claim payment “reduced proportionately” as per formula in Act.
- Insurer need only pay “X%”, where “X%” is calculated as follows:

$$X = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100$$

Example 1:

- Insurer argues it would have charged GBP4 million premium instead of GBP3 million.
- Insurer need only pay 75% of the claim.
- No link needed between the claim and premium.
- Insurer cannot also charge additional premium.
- Potentially significant impact on claim payments.

Proportionate Remedies – Practical Examples

Insurer would have charged more premium – example two

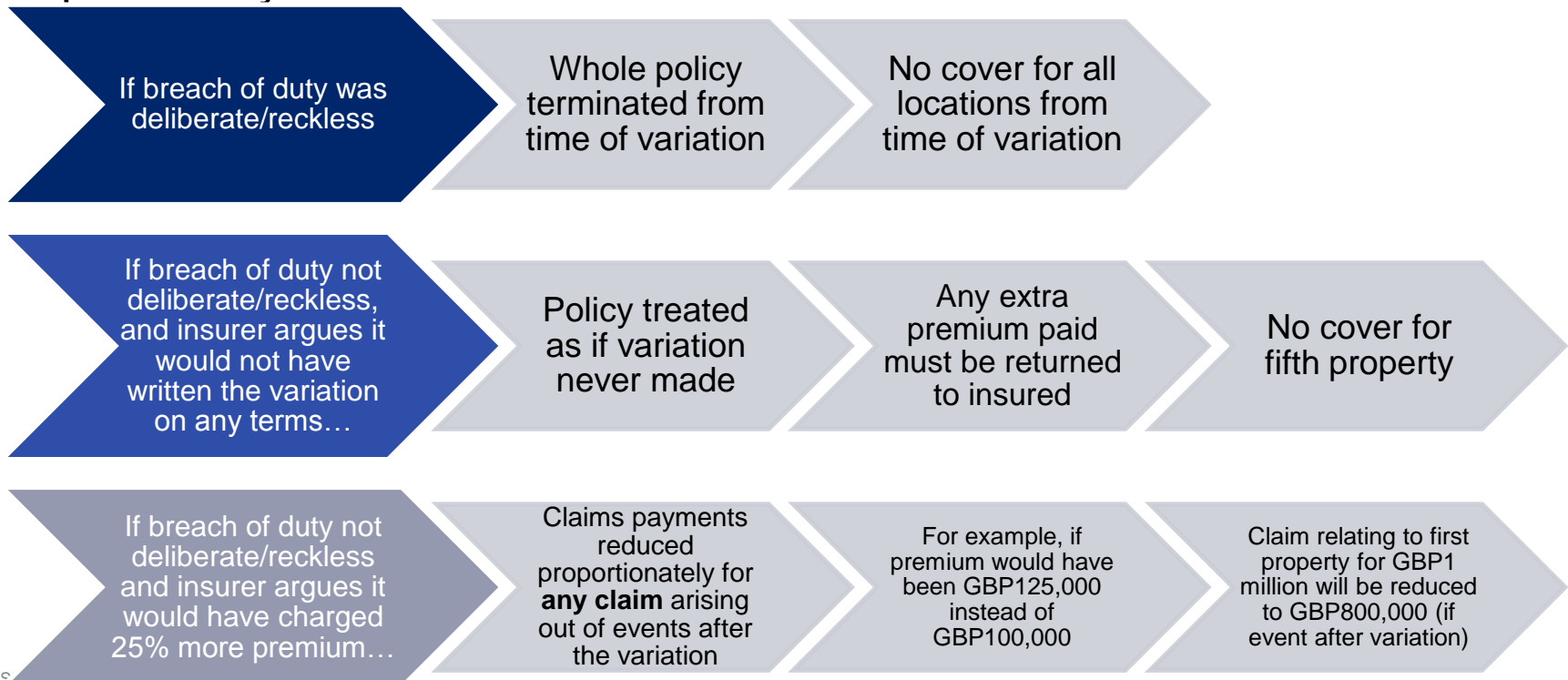
- Firm of architects has a liability policy with GBP10 million limit including defence costs.
- Insured fails to disclose that it had started working on projects in the Middle East (without being deliberate or reckless).
- Insurer argues it would have doubled the premium from GBP100,000 to GBP200,000 if it had known about Middle Eastern projects.
- Insurer need only pay 50% of what it would otherwise be under an obligation to pay under the terms of the contract.
 - **Defence costs** – If insured incurs GBP1 million of defence costs in relation to **any claim** (could be unrelated to Middle East project) – can only recover GBP500,000.
 - Consider impact on claims control?

Proportionate Remedies – Practical Examples

Variations

Example:

- Property policy covers four locations and policy varied to add fifth location.
- Insured fails to disclose fifth location which was burgled twice in previous year.



Proportionate Remedies – Practical Examples

Involnert Management v Aprilgrange Ltd [2015]

- Luxury yacht insured for EUR13 million, in fact worth EUR7-8 million.
- Yacht destroyed by fire.
- Insurers allowed to avoid policy for non-disclosure of true value.
- Court found that insurers would have agreed to insure the yacht for the lower sum of EUR8 million had all material circumstances been disclosed.
- The proportionate remedies in the Insurance Act 2015 would have allowed the insured to recover the lower sum of EUR8 million.

Proportionate Remedies – Practical Examples

Involnert Management v Aprilgrange Ltd [2015]

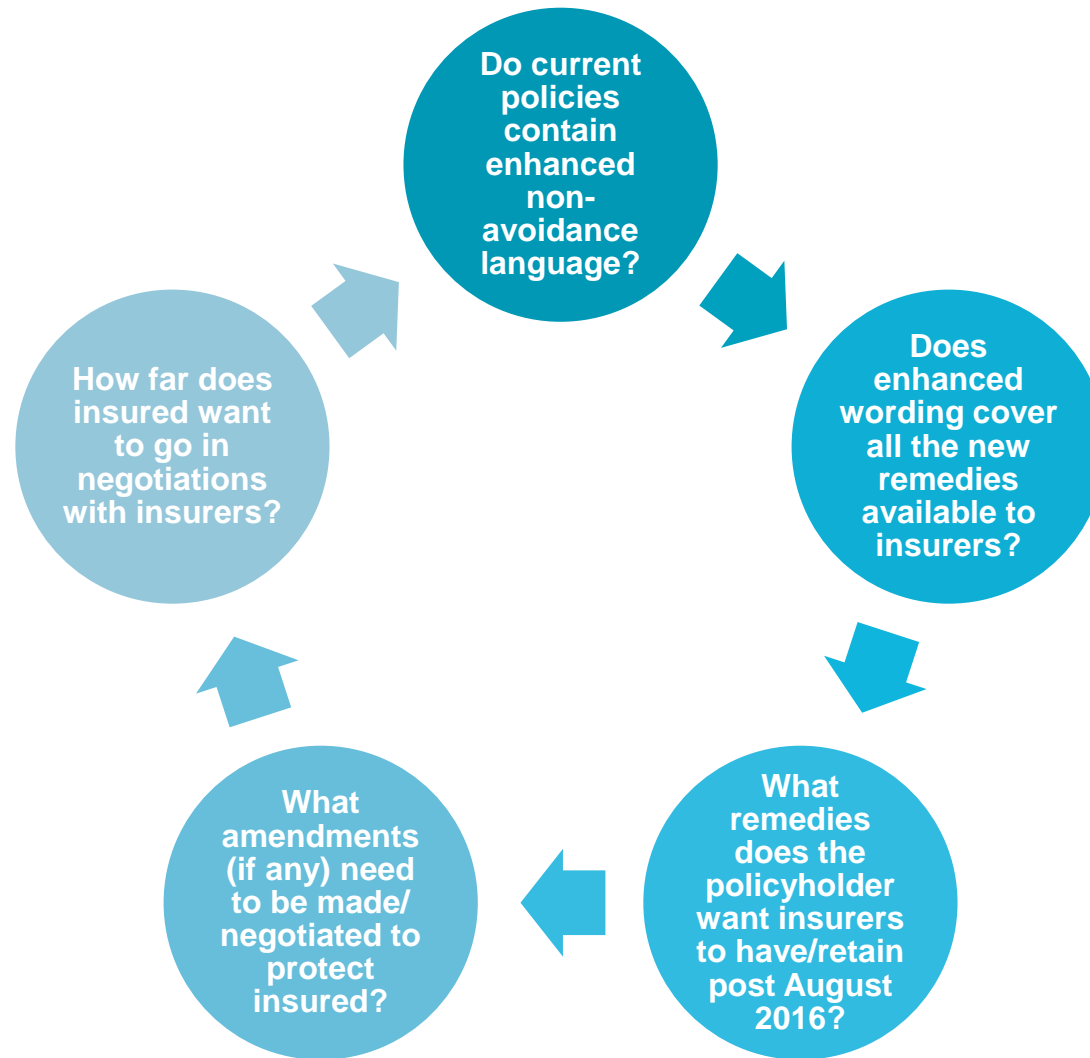
"The consequence of the insured's breach of the duty of disclosure was therefore to induce the Insurers to insure the Yacht for €13m instead of €8m. The just result in these circumstances would be to treat the insurance as valid in a reduced amount of €8m. Such a result will be achieved in cases to which the new Insurance Act 2015 applies when the Act comes into force. Until then, however, it remains a blot on English insurance law that in a case of the present kind the insurer is permitted to avoid liability altogether. That is the law even though it puts the insurer in a better position as a result of the insured's innocent failure to make full disclosure than the insurer would have been in if full disclosure had been given."

Mr Justice Leggatt

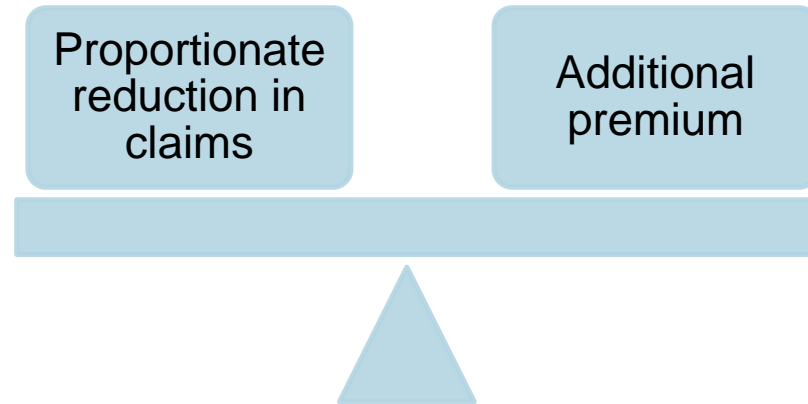
PART 3

ISSUES TO CONSIDER

Current Wordings



Proportionate Reduction Versus Additional Premium



- In the event insurers can show they would have charged an additional premium, would policyholder prefer to pay that additional premium rather than face a proportionate reduction in the claim?
- Discuss with your broker.

Proving the Hypothetical

- Insurer's remedy depends on what the actual insurer can show he would have done had the duty of fair presentation not been breached.
- Burden is on the **insurer** to show what it would have done.
- Impact on litigation:
 - What will be the role (if any) of expert evidence?
 - What will the court's approach be to the admission of evidence of other underwriting decisions?
 - Cost implications.
- Role of broker

Proving the Hypothetical Example

- Property policy covering a factory where fireworks are stored.
- Insured breaches duty of fair presentation by failing to disclose that fireworks are stored at the property.
- The property is severely damaged by flooding.
- The insured's breach was neither deliberate nor reckless.
- The insurer was generally willing to insure properties at which fireworks were stored, although would have inserted an exclusion for loss or damage caused by fireworks.

Proving the Hypothetical

Example Continued: Which Proportionate Remedy Could Apply?

- Insurer cannot avoid the policy because it cannot prove it would not have written the policy at all.
- If insurer can show it would have inserted an exclusion for loss or damage caused by fireworks, this will not assist in this scenario.
- Likely to be difficult for insurer to show that if he was told about the fireworks he would have imposed an exclusion for loss caused by flood.
- If insurer can show he would have charged a higher premium (which may not be straightforward) – insurer will have remedy of proportionate reduction in claim.

Proving the Hypothetical

Example: *Axa Versicherung AG v Arab Insurance Group* [2015]

Indication of how courts are likely to assess hypothetical scenarios of what an insurer would have done.

- ✓ Non-disclosure – failure to disclose historical loss statistics.
- ✓ Material.
- ✗ Inducement – despite the underwriter’s evidence that if he had been given a fair presentation of the risk he would have declined it.

Court’s reasons:

- Inducement not established on the balance of probabilities.
- Underwriter’s evidence was necessarily hypothetical.
- Underwriter considered reinsured to be high quality and keen to support.
- Broker could have explained poor results and underwriter would have listened.

Proving the hypothetical

Example: *Axa Versicherung AG v Arab Insurance Group* [2015]

- “*A healthy scepticism is appropriate in evaluating such evidence*” – Mr Justice Males.
- Reminder of the heavy burden on (re)insurers when it comes to proving what the underwriter would have done had it known about the non-disclosed facts.

Claims Handling Issues

- Will insurers be more inclined to argue points going forward?
- In a **subscription market**, risk of different insurers arguing different remedies – do you want to limit the remedies available to insurers?
- Response of **excess layer policies** where underlying contracts only paying a proportion of limits – market does address similar situations currently.
- How will proportionate reduction in claim payments affect the claims control of insurers in **liability policies**?
- In the **reinsurance** context, risk to reinsureds/captives where remedies in insurance and reinsurance not back to back.

Proportionate Remedies – Practical Tips

What Can You Do Now?

- Work with your broker to check current wordings to protect/re-negotiate enhanced non-avoidance language.
- Consider limiting the number of remedies open to insurers.
- Consider with your broker whether you want to try and agree with insurers to pay additional premium as opposed to taking a proportionate reduction in claims payments.
- Consider with your broker whether any amendments are necessary to excess layer policies.
- **Best advice:** ensure robust process to duty of fair presentation at outset.

Insurance Act 2015

Proportionate Remedies

Questions?



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