MARSH

HERBERT SMITH FREEHILLS

INSURANCE ACT 2015
WARRANTIES AND OTHER TERMS
WEBCAST, 14 APRIL 2016

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED.

MARSH & McLENNAN COMPANIES

Agenda

1. Classification of terms.
2. What changes will the Act bring about?
3. Issues to consider.

Tim Pritchard
UK & Ireland Corporate Placement Leader, Marsh

Today's Presenters

Siân French
Coverage Consultant and Senior Vice President
FINPRO UK, Marsh

Paul Lewis
Partner
Herbert Smith Freehills LLP

PART 1

CLASSIFICATION OF TERMS

Warranties

Conditions precedent

Bare conditions

Classification of Terms

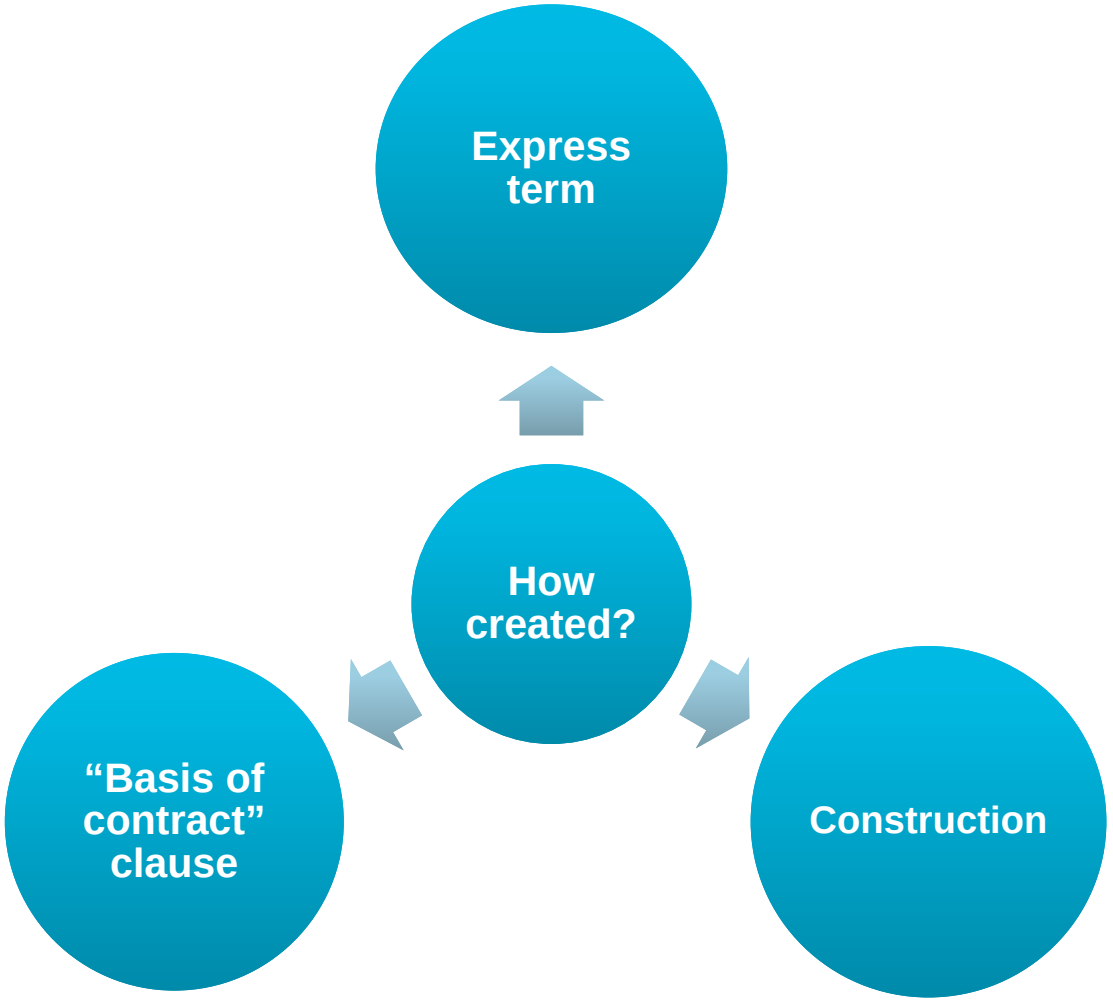
Why is it important?

- Classification of term determines remedy available to insurer in the event of breach.
- Not just about labels given to terms, also about construction.

Classification of Terms – Warranties

What is a warranty?

- Term requiring exact compliance, whether or not material to the risk.
- No particular form of words is required to create a warranty.



Classification of Terms – Warranties

Remedy for breach – current law

- ***Any*** departure constitutes a breach.
- Insurer is automatically and permanently discharged from liability from the date of the breach.
- Even if the breach is irrelevant, is remedied, or has no causal connection with the loss.

Classification of Terms – Warranties

Example

- Property policy provides: *"The insured warrants that it will maintain a sprinkler system at the insured property".*
- Property is flooded on 1 February.
- Investigations establish that sprinkler system was not maintained from 1 January.
- Insurers off risk from 1 January.
- No cover for loss/damage caused by flood.

Classification of Terms – Warranties

“Basis of contract” clauses

What is a basis clause?

- A declaration in a proposal form, policy, or other documentation that certain representations made by the insured are warranted to be true and accurate.
- *For example: “Whereas the Insured, as defined herein, have made to Insurers a written submission containing particulars and statements which it is hereby agreed are the basis of this Policy and are to be considered as incorporated herein”.*

Classification of Terms – Warranties

“Basis of contract” clauses

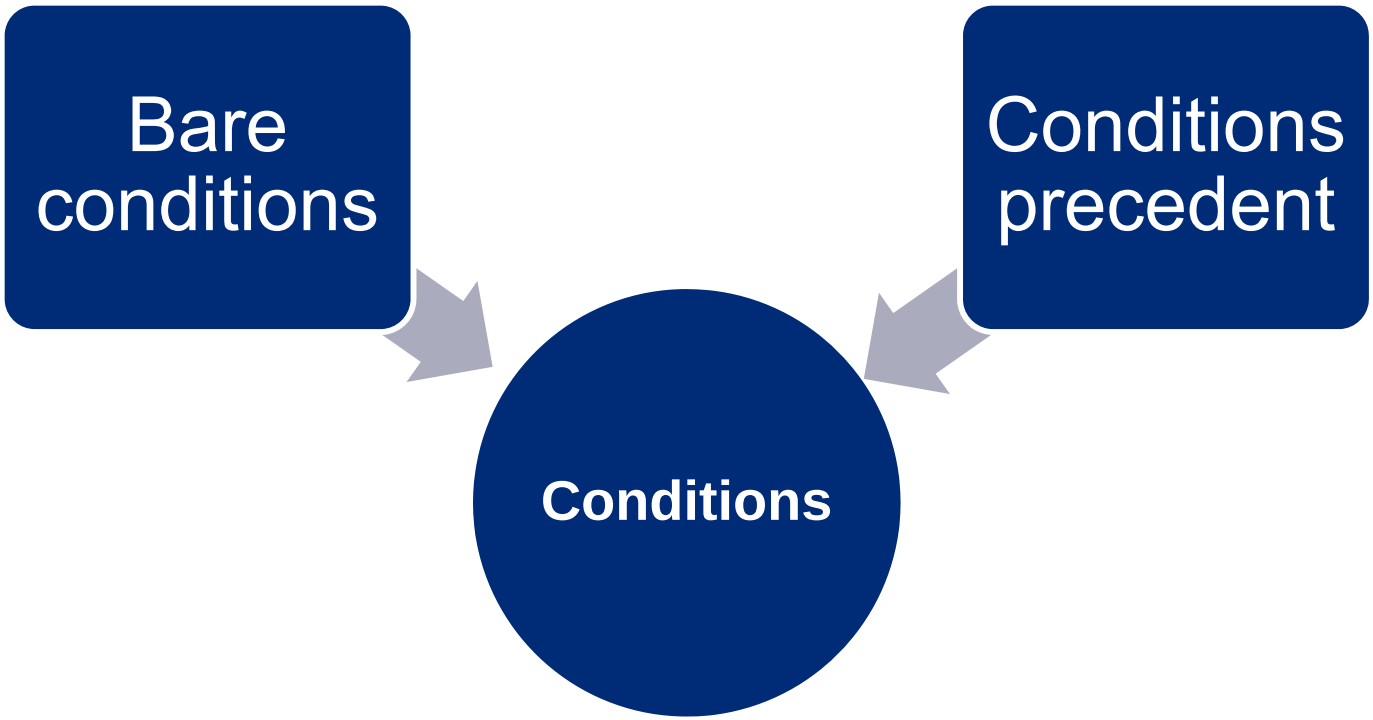
What is effect of a basis clause?

- Converts insured’s pre-contractual representations into warranties.
- Insurer’s remedy for breach: automatic and permanent discharge of liability from the date of breach, i.e. the policy never takes effect.

Classification of Terms – Conditions

What is a condition?

- An obligation on the insured to act in a particular way; or
- A contingency upon which the validity of the policy or and claim may depend.
- Current position: remedies available irrespective of cause of loss.



Classification of Terms – Conditions Precedent

What is a condition precedent?

- To insurer coming on risk – breach means cover never incepts.
  For example: payment of premium.

- To payment of a claim – breach means insurer can decline particular claim (but will not impact the cover going forward).
  For example: notification provisions.

How created?

- Labelled as "condition precedent“.
- Consequences of a breach of condition spelt out.
- Sweeping up clause – beware.

Classification of Terms – Conditions Precedent

Example 1

- Professional indemnity policy provides: "*It is a condition precedent of this policy that any Claim shall be notified within 28 days of the Insured becoming aware of it*".
- This is a condition precedent to liability to cover for the particular claim.
- Failure to comply means no cover for the claim notified late, irrespective of whether insurer suffers prejudice.
- Policy remains valid and intact for future claims.

Classification of Terms – Conditions Precedent

Example 2

- Policy provides: "*No claim under this policy shall be payable unless the terms of this condition have been complied with*".
- Consequences of a breach of the condition are spelt out.
- Failure to comply means no cover for the claim .
- Policy remains valid and intact for future claims.

Classification of Terms – Conditions Precedent

Example 3

- Policy provides: "*The due observance and fulfilment of the terms and conditions of this policy by you in so far as they relate to anything to be done or complied with by you will be a condition precedent to our liability to make any payment under this policy*".
- Sweep up clause.

Classification of Terms – Conditions

What is a bare condition?

- Deals with conduct of insured during currency of policy.
- Breach will be remedied in damages if insurer can show prejudice.
- No right to avoid policy.

Classification of Terms – Conditions

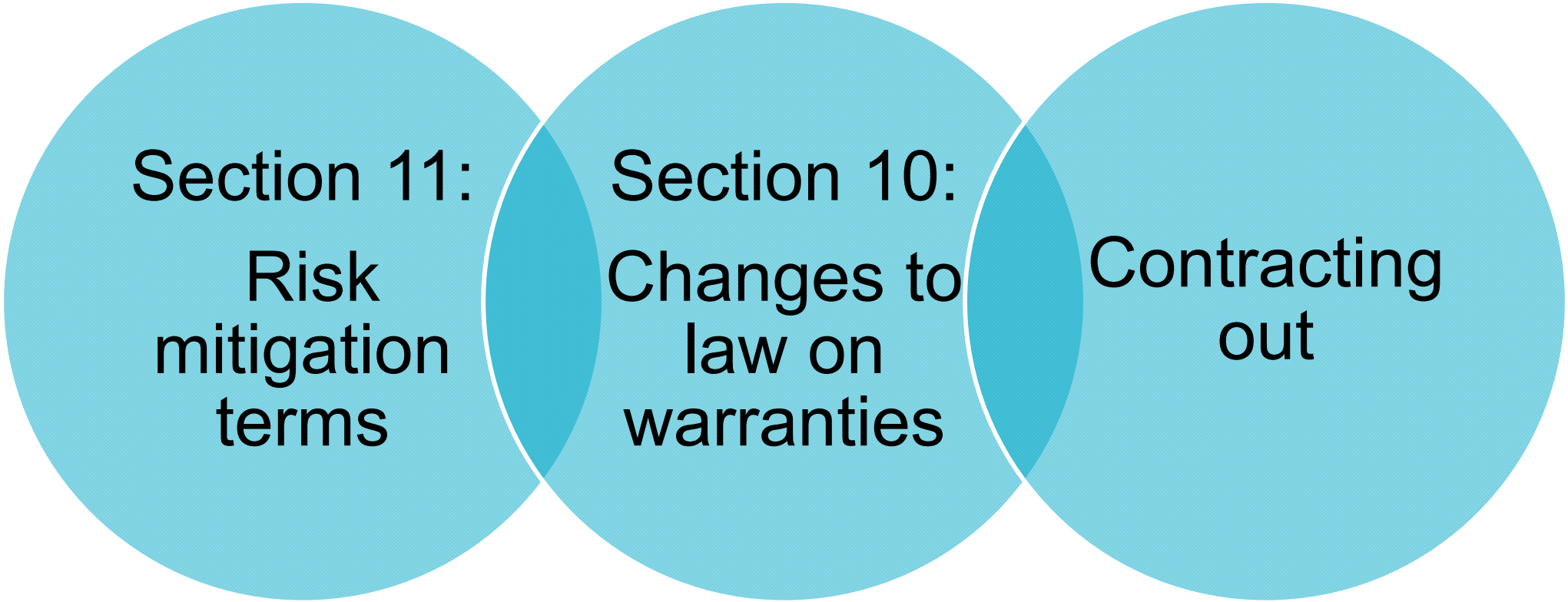
Example:

- *“The insured shall, at its own cost, render all reasonable assistance to and co-operate with the insurer.”*
- If the insured fails to co-operate, then insurer may claim damages if it has suffered a loss.
- Difficult in practice for insurers to show they have suffered prejudice.

PART 2

WHAT CHANGES WILL THE ACT BRING ABOUT?

What Changes Will the Act Bring About?



Section 11 – Risk Mitigation Terms

- Aim is to prevent insurers relying on breach of term which is unconnected to the actual loss that has taken place.

- Applies to **all terms** (including warranties and conditions precedent) which would tend to reduce the risk of loss of a particular kind, at a particular location or at a particular time (i.e. “risk mitigation terms”).

- Insurers can no longer rely on breach of such a term to avoid paying a claim “***if the breach could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred***”.

- Burden on the insured to show that the breach could not have increased the risk of loss which actually occurred in the circumstances.

- NB: new law only applies to “risk mitigation terms”, not to terms which define the risk as a whole.

Section 11 – Risk Mitigation Terms

Example

- Property policy includes a condition precedent requiring sprinkler to be operational at all times/a warranty that the insured will maintain a sprinkler.
- Sprinkler breaks and insured fails to have it repaired.
- Fire at property – insurer does **not** have to pay as failure to have operational sprinkler (i.e. breach of term) increased risk of loss that occurred.
- Flood at property – **insurer pays** as having sprinkler would not have made any difference.

Potential difficulties with new law

- Determining which terms fall within the scope of this provision.
- Will the insured be able to show that the breach could not have increased the risk of loss?
- Application to exclusions?

Section 10 – Changes to the law on Warranties

- Warranties become suspensive conditions.

- Automatic termination of cover no longer the sole remedy for breach.

- Cover is suspended for the period the insured is in breach.

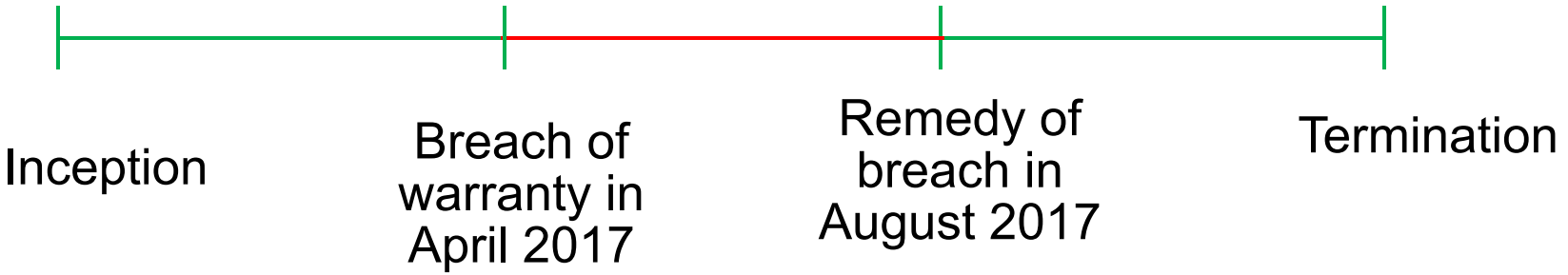
- Insurer has no liability during the “suspended” period for:
  - Any loss occurring; and/or
  - Any loss which is attributable to something happening during the “suspended” period.

- “Basis of contract” clauses abolished.

Section 10 – Changes to the law on Warranties

Example

- Warranties will operate as “suspensive” conditions.



- Insurer has no liability for losses in the period April 2017 to August 2017.
- Insurer remains liable for losses before April 2017.
- Insurer remains liable for losses after August 2017 unless the losses are attributable to something happening between April and August 2017.

Section 10 – Changes to the law on Warranties

When is breach remedied?

Time-specific warranty	Requires something to be done by a particular ascertainable time	For example, installation of a burglar alarm by 1 April	Remedied when the risk becomes essentially the same as that originally contemplated by the parties	For example, if the burglar alarm system is installed on 15 April
Other warranties	Non-time specific	For example, warranted that a vessel will sail with 20 crew and vessel sets sails with 18	Remedied when the insured ceases to be in breach	For example, at the moment two additional crew are picked up and crew is increased to 20

Section 10 – Changes to the law on Warranties

What if a warranty cannot be remedied?

- For example, a warranty relating to a duty of confidentiality cannot be remedied once confidentiality has been compromised.
- Liability remains suspended for the rest of the policy term.
- Resist, where possible, warranties that cannot be remedied.

Interplay between sections 10 and 11

- What if a warranty is breached and an unconnected loss occurs during period when cover is suspended?
- Starting point: No cover regardless of whether breach had causal connection to loss (see section 10).
- However, if warranty was a risk mitigation term, insurers unable to rely on breach if breach could not have increased the risk of the loss which actually occurred in circumstances in which it occurred (see section 11).

Contracting Out

- No restriction on the parties' ability to exclude the terms of the Act…
- …other than the prohibition on basis clauses.
- Any "disadvantageous term" which would put the policyholder in a worse position than it would be under the Act must meet the "transparency requirements".

	Transparency Requirements
# 1	Take sufficient steps to draw the disadvantageous term to the insured's (or its broker's) attention, before the contract is entered into or the variation agreed.
# 2	Term must be clear and unambiguous as to its effect.

Contracting Out

Example

- Contracting out language reads: "*Section 10 of the Insurance Act 2015 is excluded in its entirety*".
- Transparency requirements not met – term not clear and unambiguous as to its effect.
- Contrast the following contracting out language: "*Section 10 of the Insurance Act 2015 is excluded in its entirety. As a result, if the insured fails to exactly comply with any warranty in the policy, the insurer is irrevocably discharged from liability from the date of the breach of warranty. Accordingly, the insured cannot avail itself of the defence that it has remedied the breach of warranty before any loss has occurred*".

Insurer Responses to the Act

- A number of insurers have said that they will comply with the "*spirit of the Act*" in advance of August 2016.
- Some insurers are using clauses to bring in certain provisions of the Act prior to August 2016 – Be careful: some clauses are not identical to the Act and less advantageous.
- Beware of insurers contracting out of some aspects of the Act – Lloyd's Market Association (LMA) has issued a number of clauses which aim to contract out of certain aspects of the Act, including:
  - Proportionate remedies – revert to sole remedy of avoidance.
  - New law on warranties – current remedy preserved (automatic and permanent discharge from liability).
  - Section 11 – insurer able to rely on breach of term which could not have increased the risk of loss which actually occurred in circumstances in which it occurred.

PART 3

ISSUES TO CONSIDER

Review your Wordings

- Crucial in order to take full advantage of the Act.

- Insurers are looking carefully at their wordings and you should too. Watch out for:

  - Insurers changing warranties to conditions precedent (no ability to remedy breach of condition precedent).
  - Insurers using exclusions more extensively.
  - Insurers including conditions precedent to liability that certain matters are true and accurate.
  - Insurers contracting out of certain aspects of the Act (noted earlier).
  - Insurers using clauses to bring in certain provisions of the Act prior to August 2016 which are not identical to the Act and less advantageous (noted earlier).

Review your Wordings

- Remember wordings issues flagged in previous webinars, such as:

  - Defining who falls within the definition of "senior management“.
  - Defining scope of reasonable search by reference to information held by particular entities.
  - Protect, and ensure fit for purpose, innocent non-disclosure clauses.
  - Using enhanced language to address the new regime of proportionate remedies.

How Will the Act Affect your Wording?

Warranties

- Can still be included, and strict compliance is still required – only the insurer's remedy for breach that has changed.
- Try to remove any warranties that cannot be remedied.
- Note all warranties and record compliance with them.
- If a breach of warranty occurs, record date breach remedied.

Risk mitigation terms

- Identify, and try to agree with insurers, which policy terms are "risk mitigation" terms and those which "define the risk as a whole".

Contracting out

- Be aware of and understand implications of insurers contracting out.

Be Aware of What the Act Is not Changing

Conditions precedent

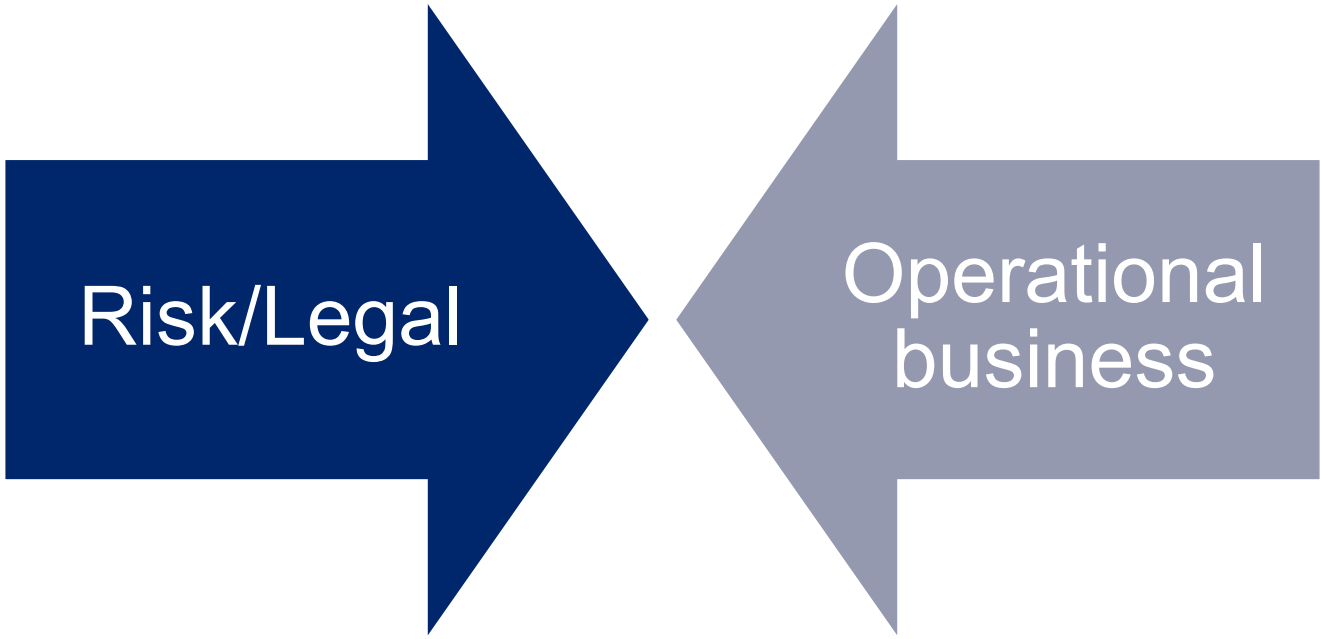
- No changes to conditions precedent (and bare conditions), save for risk mitigation terms.

- Condition precedents can still be included, for example, for notification – not caught by section 11.

- Take opportunity to improve notification provisions by ensuring:
  - Triggered only by knowledge of certain class(es) of individual within the insured (not insured generally).
  - Reasonable period to notify rather than short, specified time limit.
  - Clear threshold for notification clause to be triggered.

- “Sweep up” clauses can still be included – avoid.

Ensure Risk/Legal and Business Are Linked up



To maximise effectiveness of cover

Ensure Risk/Legal and Business Are linked up

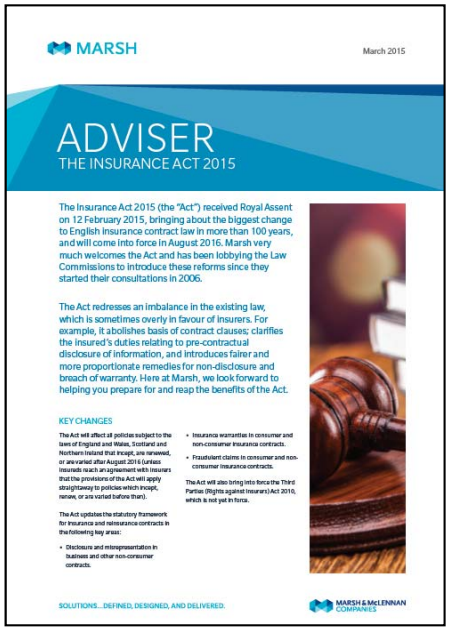
- Ensure systems are in place that reflect requirements of the policy, for example:
  - To record compliance with warranties.
  - To identify (and then remedy) any breaches of warranty and record date breach remedied.
  - Claims reporting systems.

- Ensure key operational personnel understand what they must do under the terms of the policy, for example:
  - Identifying and complying with any warranties and conditions precedent.
  - Obligations in relation to ongoing provision of information or changes to risk insured.

Insurance Act 2015
Warranties and Other Terms

Questions?

Insurance Act 2015
Warranties and Other Terms


MARSH March 2015

ADVISER
THE INSURANCE ACT 2015

The Insurance Act 2015 (the "Act") received Royal Assent on 12 February 2015, bringing about the biggest change to English insurance contract law in more than 100 years, and will come into force in August 2016. Marsh very much welcomes the Act and has been lobbying the Law Commissions to introduce these reforms since they started their consultations in 2006.

The Act redresses an imbalance in the existing law, which is sometimes overly in favour of insurers. For example, it abolishes basis of contract clauses; clarifies the insured's duties relating to pre-contractual disclosure of information, and introduces fairer and more proportionate remedies for non-disclosure and breach of warranty. Here at Marsh, we look forward to helping you prepare for and reap the benefits of the Act.

KEY CHANGES

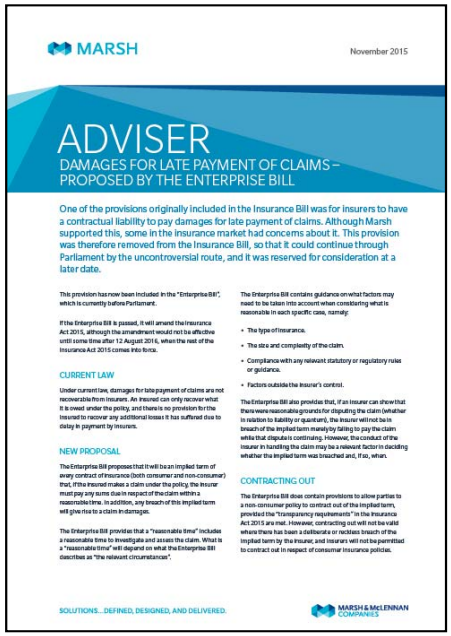
The Act will affect all policies subject to the laws of England and Wales, Scotland and Northern Ireland that incept, are renewed, or are varied after August 2016 (unless insureds reach an agreement with insurers that the provisions of the Act will apply straightaway to policies which incept, renew, or are varied before then).

The Act updates the statutory framework for insurance and reinsurance contracts in the following key areas:

- Disclosure and misrepresentation in business and other non-consumer contracts.
- Insurance warranties in consumer and non-consumer insurance contracts.
- Fraudulent claims in consumer and non-consumer insurance contracts.

The Act will also bring into force the Third Parties (Rights against Insurers) Act 2010, which is not yet in force.

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED. MARSH & McLENNAN COMPANIES


MARSH November 2015

ADVISER
DAMAGES FOR LATE PAYMENT OF CLAIMS – PROPOSED BY THE ENTERPRISE BILL

One of the provisions originally included in the Insurance Bill was for insurers to have a contractual liability to pay damages for late payment of claims. Although Marsh supported this, some in the insurance market had concerns about it. This provision was therefore removed from the Insurance Bill, so that it could continue through Parliament by the uncontroversial route, and it was reserved for consideration at a later date.

This provision has now been included in the "Enterprise Bill", which is currently before Parliament.

If the Enterprise Bill is passed, it will amend the Insurance Act 2015, although the amendment would not be effective until some time after 12 August 2016, when the rest of the Insurance Act 2015 comes into force.

CURRENT LAW

Under current law, damages for late payment of claims are not recoverable from insurers. An insured can only recover what it is owed under the policy, and there is no provision for the insured to recover any additional losses it has suffered due to delay in payment by insurers.

NEW PROPOSAL

The Enterprise Bill proposes that it will be an implied term of every contract of insurance (both consumer and non-consumer) that, if the insured makes a claim under the policy, the insurer must pay any sums due in respect of the claim within a reasonable time. In addition, any breach of this implied term will give rise to a claim in damages.

The Enterprise Bill provides that a "reasonable time" includes a reasonable time to investigate and assess the claim. What is a "reasonable time" will depend on what the Enterprise Bill describes as "the relevant circumstances".

The Enterprise Bill contains guidance on what factors may need to be taken into account when considering what is reasonable in each specific case, namely:

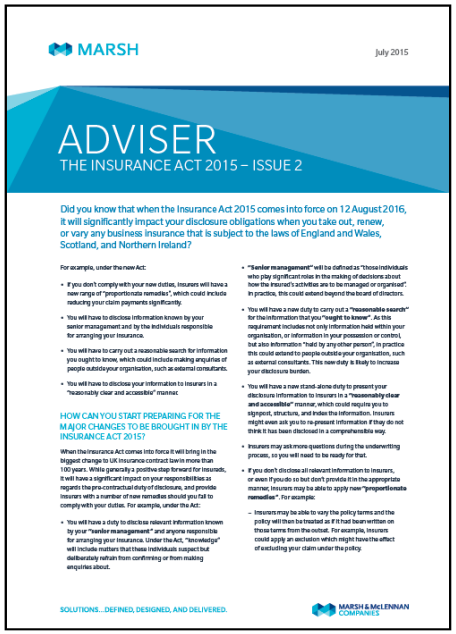
- The type of insurance.
- The size and complexity of the claim.
- Compliance with any relevant statutory or regulatory rules or guidance.
- Factors outside the insurer's control.

The Enterprise Bill also provides that, if an insurer can show that there were reasonable grounds for disputing the claim (whether in relation to liability or quantum), the insurer will not be in breach of the implied term merely by failing to pay the claim while that dispute is continuing. However, the conduct of the insurer in handling the claim may be a relevant factor in deciding whether the implied term was breached and, if so, when.

CONTRACTING OUT

The Enterprise Bill does contain provisions to allow parties to a non-consumer policy to contract out of the implied term, provided the "transparency requirements" in the Insurance Act 2015 are met. However, contracting out will not be valid where there has been a deliberate or reckless breach of the implied term by the insurer, and insurers will not be permitted to contract out in respect of consumer insurance policies.

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED. MARSH & McLENNAN COMPANIES


MARSH July 2015

ADVISER
THE INSURANCE ACT 2015 – ISSUE 2

Did you know that when the Insurance Act 2015 comes into force on 12 August 2016, it will significantly impact your disclosure obligations when you take out, renew, or vary any business insurance that is subject to the laws of England and Wales, Scotland, and Northern Ireland?

For example, under the new Act:

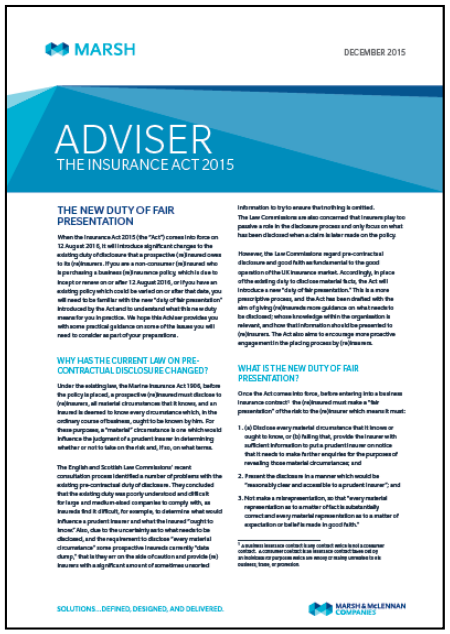
- If you don't comply with your new duties, insurers will have a new range of "proportionate remedies", which could include reducing your claim payments significantly.
- You will have to disclose information known by your senior management and by the individuals responsible for arranging your insurance.
- You will have to carry out a reasonable search for information you ought to know, which could include making enquiries of people outside your organisation, such as external consultants.
- You will have to disclose your information to insurers in a "reasonably clear and accessible" manner.
- "Senior management" will be defined as "those individuals who play significant roles in the making of decisions about how the insured's activities are to be managed or organised". In practice, this could extend beyond the board of directors.
- You will have a new duty to carry out a "reasonable search" for the information that you "ought to know". At this requirement includes not only information held within your organisation, or information in your possession or control, but also information "held by any other person", in practice this could extend to people outside your organisation, such as external consultants. This new duty is likely to increase your disclosure burden.
- You will have a new stand-alone duty to present your disclosure information to insurers in a "reasonably clear and accessible" manner, which could require you to signpost, structure, and index the information. Insurers might even ask you to re-present information if they do not think it has been disclosed in a comprehensible way.
- Insurers may ask more questions during the underwriting process, so you will need to be ready for that.
- If you don't disclose all relevant information to insurers, or even if you do so but don't provide it in the appropriate manner, insurers may be able to apply new "proportionate remedies". For example:
  - Insurers may be able to vary the policy terms and the policy will then be treated as if it had been written on those terms from the outset. For example, insurers could apply an exclusion which might have the effect of excluding your claim under the policy.

HOW CAN YOU START PREPARING FOR THE MAJOR CHANGES TO BE BROUGHT IN BY THE INSURANCE ACT 2015?

When the Insurance Act comes into force it will bring in the biggest change to UK insurance contract law in more than 100 years. While generally a positive step forward for insureds, it will have a significant impact on your responsibilities as regards the pre-contractual duty of disclosure, and provide insurers with a number of new remedies should you fail to comply with your duties. For example, under the Act:

- You will have a duty to disclose relevant information known by your "senior management" and anyone responsible for arranging your insurance. Under the Act, "knowledge" will include matters that these individuals suspect but deliberately refrain from confirming or from making enquiries about.

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED. MARSH & McLENNAN COMPANIES


MARSH DECEMBER 2015

ADVISER
THE INSURANCE ACT 2015

THE NEW DUTY OF FAIR PRESENTATION

When the Insurance Act 2015 (the "Act") comes into force on 12 August 2016, it will introduce significant changes to the existing duty of disclosure that a prospective (re)insured owes to its (re)insurers. If you are a non-consumer (re)insured who is purchasing a business (re)insurance policy which is due to incept or renew on or after 12 August 2016, or if you have an existing policy which could be varied on or after that date, you will need to be familiar with the new "duty of fair presentation" introduced by the Act and to understand what this new duty means for you in practice. We hope this Adviser provides you with some practical guidance on some of the issues you will need to consider as part of your preparations.

WHY HAS THE CURRENT LAW ON PRE-CONTRACTUAL DISCLOSURE CHANGED?

Under the existing law, the Marine Insurance Act 1906, before the policy is placed, a prospective (re)insured must disclose to (re)insurers, all material circumstances that it knows, and an insured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. For these purposes, a "material" circumstance is one which would influence the judgment of a prudent insurer in determining whether or not to take on the risk and, if so, on what terms.

The English and Scottish Law Commissions' recent consultation process identified a number of problems with the existing pre-contractual duty of disclosure. They concluded that the existing duty was poorly understood and difficult for large and medium-sized companies to comply with, as insureds find it difficult, for example, to determine what would influence a prudent insurer and what the insured "ought to know." Also, due to the uncertainty as to what needs to be disclosed, and the requirement to disclose "every material circumstance" some prospective insureds currently "data dump," that is they err on the side of caution and provide (re) insurers with a significant amount of sometimes unsorted information to try to ensure that nothing is omitted. The Law Commissions are also concerned that insurers play too passive a role in the disclosure process and only focus on what has been disclosed when a claim is later made on the policy.

However, the Law Commissions regard pre-contractual disclosure and good faith as fundamental to the good operation of the UK insurance market. Accordingly, in place of the existing duty to disclose material facts, the Act will introduce a new "duty of fair presentation." This is a more prescriptive process, and the Act has been drafted with the aim of giving (re)insureds more guidance on what needs to be disclosed, whose knowledge within the organisation is relevant, and how that information should be presented to (re)insurers. The Act also aims to encourage more proactive engagement in the placing process by (re)insureds.

WHAT IS THE NEW DUTY OF FAIR PRESENTATION?

Once the Act comes into force, before entering into a business insurance contract[1] the (re)insured must make a "fair presentation" of the risk to the (re)insurer which means it must:

1. (a) Disclose every material circumstance that it knows or ought to know, or (b) failing that, provide the insurer with sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purposes of revealing those material circumstances; and
2. Present the disclosure in a manner which would be "reasonably clear and accessible to a prudent insurer"; and
3. Not make a misrepresentation, as that "every material representation as to a matter of fact is substantially correct and every material representation as to a matter of expectation or belief is made in good faith."

[1] A business insurance contract is any contract entered into that is not a consumer contract. A consumer contract is an insurance contract entered into by an individual for purposes entirely or mainly outside his trade, business or profession.

SOLUTIONS...DEFINED, DESIGNED, AND DELIVERED. MARSH & McLENNAN COMPANIES

Visit marsh.com/uk to access our bulletins and webcast replays on the Insurance Act.

HERBERT
SMITH
FREEHILLS

This PowerPoint™ presentation is based on sources we believe reliable and should be understood to be general risk management and insurance information only,.

The information contained herein is based on sources we believe reliable and should be understood to be general risk management and insurance information only. The information is not intended to be taken as advice with respect to any individual situation and cannot be relied upon as such.

Statements concerning legal, tax or accounting matters should be understood to be general observations based solely on our experience as insurance brokers and risk consultants and should not be relied upon as legal, tax or accounting advice, which we are not authorised to provide.

In the United Kingdom, Marsh Ltd is authorised and regulated by the Financial Conduct Authority.