Weightmans

Legal Update

The Insurance Act

Introduction

This is the third in a series of updates from the Weightmans Market Affairs Group which aim to raise awareness of the changes facing the insurance industry in relation to commercial insurance contracts following the enactment of the Insurance Act 2015 ('the Act') the main provisions of which come into force on 12 August 2016.

In our previous publications we have provided an overview of the Act and considered the new duty of fair presentation. If you've missed our previous publications on the Act, you can read them here. In this update we will consider the remedies that will be available to insurers when this new duty is breached and some areas where problems might be encountered.

The remedies for breach

The Act provides an insurer with remedies against an insured for what is termed a "qualifying breach" ('breach') of the duty of fair presentation if it can be shown that, but for the breach, the insurer would not have entered into the contract of insurance at all or would have only done so on different terms. The Act separates qualifying breaches into two categories, those which are (a) deliberate or reckless, or (b) neither deliberate nor reckless. A breach is deliberate or reckless if the insured either knew, or did not care whether or not it was in breach of the duty of fair presentation. The Act also provides that it is for the insurer to prove that a breach was deliberate or reckless.

The remedies available to insurers in the event of a breach are set out in Schedule 1 of the Act (details of which can be found here) and depend on various factors including whether the breach was deliberate, reckless or neither, whether the breach occurred at inception or variation and whether the insurer would not have contracted on any terms or only on different terms. The remedies available include avoiding the contract, treating the contract as having been entered into on different terms and reducing claims payments by a percentage (set by a formula in the Act).

Areas for awareness

As with any change in legislation, there are inevitably going to be areas where disputes are likely to arise. It is easy to envisage disputes that are fuelled by the potentially sizeable premiums in commercial insurance and the fact that the return of these premiums very much depends on whether the breach was deliberate, reckless, or neither.

With the Act placing the burden of proof on the insurer it is paramount that insurers take care to obtain and safely retain evidence of any breach as well as the intention of the insured.

As set out above, the Act creates remedies which allow the insurer to reduce its liability to pay claims by a set percentage. As part of the formula used to establish the percentage reduction, the insurer must determine the policy premium that would have been charged but for the misrepresentation. We may, therefore, see situations where insurers' pricing and underwriting models could be open to challenge.

Another area for awareness is section 151 of the *Road Traffic Act 1988* ('RTA') which imposes a liability on an insurer to pay a third party claim contingent on the third party already having obtained a judgment against the insured which remains unsatisfied. This contingent liability remains regardless of the proportionate percentage remedy. Therefore, if insurers would be entitled to a 100% reduction on the claim, then they will need to consider the need for declaration proceedings under section 152 of the RTA. Where the proportionate reduction available is less than 100% insurers will need to preserve their right of recovery against their insured.

It is also worth remembering that the Financial Ombudsman Service ('FOS') has jurisdiction to hear complaints in commercial matters where the turnover of the insured is less than £1 million. We therefore await, with interest, the approach that will be taken to the new provisions by the FOS bearing in mind their *"fair and reasonable"* power.

There will inevitably be a period where the new terms and principles are tested in the courts or in arbitration before we arrive at a position where the full meaning, impact and ramifications of the new provisions are understood.

Accordingly, insurers will need to take great care when dealing with claims to ensure that evidence is properly assessed and given appropriate weight, that the correct principles are applied and that their decisions will stand up to scrutiny. Insurers will be keen to avoid any accusations that they are not treating customers fairly or are failing to handle complaints correctly. Equally, they will want to ensure that they take all reasonably practicable steps to ensure that their position is protected as far as possible.

With the main provisions of the Act coming into force in just over twelve months it is advisable for insurers to begin their preparations sooner rather than later. Insurers can do this by reviewing their customer-facing documentation and their internal processes to ensure that they comply with the provisions of the Act and utilise the same terminology. Insurers will also need to ensure that there is full cooperation and information sharing across all areas of their business to ensure that accurate and fully informed decisions can be taken at all stages from cradle to grave.

What next?

In our next update, the Weightmans Market Affairs Group will look at the provisions in the Act relating to warranties and other contractual terms. Should you wish to discuss the Act and its effects in more detail, or would like assistance with your preparations, please do not hesitate to get in touch.

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