Reforms to UK insurance law: overview of key changes

David Hertzell
BLM

The UK insurance industry is the largest in Europe and the third largest in the world. Insurance is a major UK export and its importance is recognised in the government's Insurance Growth Action Plan published in December 2013. The development of insurance in London is also crucial to wider economic growth in the UK and internationally.

The size of the UK insurance market means that English insurance law has had a worldwide influence. However, despite this success, insurance law has been criticised during the second half of the 20th century. Mainly based on the Marine Insurance Act 1906, UK insurance law has consistently been described as archaic, unclear and unfair. This has resulted in reform initiatives from both regulators and the insurance market itself. For more information on the origins of UK insurance law and attempts to reform it see box, Historical background.

A series of insurance law reforms has recently been introduced in the UK following an extensive consultation carried out by the Law Commission and the Scottish Law Commission (see box, The Law Commissions reform project). These reforms resulted in the adoption of three new Acts of Parliament and represent the first major overhaul of UK insurance law since the Marine Insurance Act 1906.

This article provides an overview of the main changes introduced by the:
- Third Parties (Rights against Insurers) Act 2010.

The three Acts were enacted following the Law Commissions' procedure for uncontroversial bills. Generally, this procedure takes up less parliamentary time and allows desirable law reforms which are not perceived as high political priorities to be adopted more quickly.

THE THIRD PARTIES (RIGHTS AGAINST INSURERS) ACT 2010

The Third Parties Act 2010 was based on an earlier consultation and improved the mechanisms by which a party with a claim against an insolvent insurer can recover compensation from the relevant insurer. It updates an earlier piece of legislation with the same name dating from 1930. It will be brought into force by regulations made under the Insurance Act 2015. It is not directly concerned with the contractual arrangements agreed between the insured and the insurer. However, as a general principle, the third party will have no better right against the insurer than the insolvent insured would have had.

THE CONSUMER INSURANCE (DISCLOSURE AND REPRESENTATIONS) ACT 2012

The Consumer Insurance (Disclosure and Representations) Act (CIDRA) 2012 applies to consumer insurance and sets out what happens if a consumer gives incorrect information to their insurer. CIDRA also deals with group insurance in which the proceeds of the policy may be paid to beneficiaries who are not the insured (for example, a policy taken out by an employer for the benefit of its employees). CIDRA came into force in April 2013.

CIDRA only applies to consumer insurance contracts. These are defined as insurance bought by individuals for purposes wholly or mainly unrelated to their trade, business or profession. This definition deliberately follows the general approach of European law. The definition of insurance is left to the common law.

CIDRA follows the practice of the Financial Ombudsman Service (FOS) and abolishes the consumer's duty to volunteer information (often referred to as the duty of disclosure and fundamental to the Marine Insurance Act 1906). Instead, the insurer must ask appropriate questions and the consumer must answer them honestly and carefully. CIDRA imposes on the consumer a duty to take reasonable care not to make a misrepresentation. This also applies when a policy is varied or renewed. The standard applied is objective, being that of the reasonable consumer taking into account all relevant circumstances (such as the type of insurance and how it was sold). The particular characteristics of the individual consumer are only relevant if the insurer knew, or ought to have known about them.

Where the consumer gives incorrect information, CIDRA distinguishes between three types of misrepresentation:
- Reasonable.
- Careless.
- Deliberate or reckless.

Misrepresentations that are careless or deliberate and reckless are described as "qualifying misrepresentations" for which the insurer will be compensated if it can show that it would have acted differently had it known the true facts. There is no remedy if the consumer's misrepresentation was reasonable.

For a misrepresentation to be deliberate or reckless, the insurer must show that the consumer both:
- Knew that the statement was untrue or misleading, or did not care whether it was or not.
- Knew that the matter was relevant to the insurer or did not care whether it was or not.

Two presumptions assist the insurer:
- The consumer is presumed to have the knowledge of a reasonable consumer.
If the insurer asks a clear question, the subject matter of the question is presumed to be relevant.

If the misrepresentation is deliberate or reckless (essentially fraudulent), the insurer may avoid the policy and can generally keep the premium.

If the misrepresentation is careless, the insurer's remedy depends on what it would have done had proper information been provided:
- If the insurer would have declined the risk altogether, it can avoid the policy and refuse any claim but should return the premium.
- If the insurer would have written the policy on different terms then those terms apply from inception. These terms may include different limits or exclusion clauses.
- If the insurer would have charged a higher premium, any claim can be reduced pro rata to the underpayment.

These provisions represent a very considerable change to the Marine Insurance Act 1906 under which the only applicable remedy is the possibility for insurers to avoid the entire policy, regardless of the circumstances of the misrepresentation.

In addition, CIDRA provides that misrepresentations by a beneficiary under a group scheme will affect that individual but not the other members of the scheme. It abolishes "basis clauses" which incorporate all representations as insurance warranties. In contrast, the Marine Insurance Act 1906 provides that breach of a warranty automatically discharges the policy, regardless of whether it is relevant to the risk insured.

Finally, CIDRA gives some guidance on whether an intermediary is acting as the agent of the policyholder or of the insurer when the policy is being agreed.

Since CIDRA came into force, research carried out by the Chartered Insurance Institute and confirmed by discussion with the FOS indicates that consumer disputes involving questions of misrepresentation have become rarer. Instead, disputes arise over the wording and extent of the cover provided.

**THE INSURANCE ACT 2015**

The Insurance Act 2015 will come into force in August 2016. It regulates both business and consumer insurance and covers the following topics:

- The pre-contract duty of disclosure for all non-consumer insureds: it introduces the new duty to make a "fair presentation" of the risk.
- The insurer's remedies for breach of the duty of fair presentation.
- Basis of the contract clauses.
- Remedies for breach of warranty.
- "Irrelevant" risk mitigation clauses.
- The insurer's remedies for fraud.
- Contracting on different terms.

The Insurance Act 2015 retains some provisions of the Marine Insurance Act 1906, codifies some of the developments that have occurred since 1906 and introduces new legal concepts. The key provisions are the introduction of the new duty to make a fair presentation, the provision on warranties and similar terms risk mitigation clauses, and insurers' remedies for fraud.

The Insurance Act 2015 is a default scheme for business and non-consumer insureds. However, as it is based on best practice and was widely supported by the market, it is unlikely that insurers will wish to contract out of it on a regular basis. It may however be appropriate to do so if the risk insured is very specific or complex. In addition, the new regime is probably not appropriate for many reinsurance contracts. If the insurer wishes to contract on different terms and a term is "disadvantageous" to the insured, the insurer must:

- Take sufficient steps to bring the term to the insured's attention.
- Ensure that the term is clear and unambiguous.

This is a deliberately flexible test. For example, what is sufficient in a sophisticated market with well informed and advised parties will not be adequate if the insured is a small business buying cover online.

**Duty of disclosure**

The Law Commissions retained the obligation to volunteer relevant information for all insureds who are not consumers (duty of disclosure). However, the Insurance Act 2015 also includes new provisions relevant to the duty of disclosure. The duty to make a fair presentation of the risk incorporates both the law on non-disclosure and representation. The duty also includes waiver provisions similar to those of the Marine Insurance Act 1906. An insured will have complied with the duty to make a fair presentation if it has provided enough information to put the underwriter on notice to ask further questions. Additionally, the Act gives some guidance on how information must be disclosed and who must provide it. The new duty recognises that gathering information in large organisations involves a lot of processes and aims to recognise the impact of Information Technology (IT).

The duty of disclosure deals with both the substance of the information provided and its form. The insured must:

- Disclose all "material circumstances" which it knows or ought to know.
- Failing that, provide sufficient information to put the underwriter on notice to ask further questions.

The insured cannot comply with its obligation through merely providing information on every possible fact and circumstance. A fair presentation of a complex risk requires adequate signposting to draw the underwriter's attention to the relevant facts.

The insured:

- Knows information known by its senior management.
- Knows information known by the persons arranging the insurance.
- Ought to know information that would reasonably have been revealed through a reasonable search.

"Senior management" is defined as the persons who "play significant roles in the making of decisions about how the insured's activities are to be managed or organised". Senior management will often be the board of a company. However, the definition is wider as some insureds will not be companies. The individuals arranging the insurance can include, for example, the insured's risk manager or broker (although a broker is not obliged to disclose confidential information obtained through a business relationship unconnected to the relevant contract of insurance).

The Marine Insurance Act 1906 included some limitations to the insured's duty of disclosure which have been maintained by the Insurance Act 2015. An insured does not have to disclose information if the insurer knows it, ought to know it or is presumed to know it. The insurer knows what is actually known to its underwriter or their agent. The insurer ought to know both:

- Information that should have been passed on to the underwriter (for example, by a surveyor or the claims department).
- Information that the insurer holds in its systems provided that it is "readily available" to the underwriter.

global.practicallaw.com/insurance-guide
The insurer is presumed to know information that underwriters writing the relevant class of business should know. The Commissions did not think that the law should protect the naïve or poorly trained underwriter. Instead the Commissions sought to reinforce good professional standards.

If the insured fails to make a fair presentation, the insurer always has a remedy provided that it can show that it would have acted differently had it known the truth. If the insured is deliberate or reckless, the insurer can avoid the policy and keep the premium. If the insurer would not have written the risk then again it can avoid the policy but must return the premium. For all other breaches of the duty of fair presentation, the following applies:

- If the insurer would have imposed additional terms or limits, these are imposed from inception.
- If the insurer would have charged a higher premium, the claim is reduced pro rata.

Although the duty of fair presentation is based on the existing law, policyholders and their brokers would be wise to review their existing practices, for example:

- Processes for gathering information.
- Whether there is a reasonable search and how this is documented.
- Whether discussions with the board or senior management are adequate.
- Whether discussions between the insured and their broker are adequate.

Insurers will also have to review their processes and address the following questions:

- Are underwriters sufficiently well trained and knowledgeable to ask the right questions? Insurers are expected to have a reasonable degree of knowledge about the type of business they are underwriting.
- Is knowledge properly passed across the organisation?
- Is communication with an agent or surveyor sufficient?
- Are communications between the claims departments and underwriting adequate?
- What is held in the insurer's systems and can underwriters access what they need?
- What evidence will there be on what underwriters might have done if a fair presentation had been made?

Warranties and fraud

The provisions on warranties and fraud of the Insurance Act 2015 apply to both business and consumers. The new act follows CIDRA and abolishes basis of contract clauses (see above, The Consumer Insurance (Disclosure and Representations) Act 2012). Any term that seeks to turn information provided when the policy was purchased into an insurance warranty will have no effect. However, the new Act does not define "warranty" and existing definitions will continue to apply.

In the case of a breach of warranty, the policy will be suspended while the insured is in breach but will be restored once the breach is remedied. For example, if an insured is obliged to inspect an alarm system but fails to do so, cover is suspended until the inspection is carried out.

Warranties and terms that seek to mitigate risk will not be effective if the insured can show that non-compliance "would not have increased the risk of the loss which actually occurred in the circumstance in which it occurred". A risk mitigation term is one that "tends to reduce the risk of" loss of a particular kind, at a particular location or particular time. It is not a term that defines the risk as a whole such as an age requirement in a motor policy. For example, a sprinkler warranty will apply if there is a fire, but not if the property suffers a loss by flood from an adjacent river.

These changes are a departure from the current law under which a warranty discharges the insurer from any liability under the policy from the date of breach, regardless of whether there is a connection between the breach of warranty and the loss that occurred.

If the insured makes a fraudulent claim, the entire claim is forfeit (including any honest part of the claim) and the insurer can keep the premium. The insurer will remain liable for any genuine claims before the fraud, but has the option to terminate the policy from the date of the fraud.
HISTORICAL BACKGROUND

Origins of UK insurance law

The origins of UK insurance law lie with the practices developed by merchants in the City of London which led up to the leading case of Carter v Boehm (1766) 3 Burr. 1905 in 1776. The case concerned the goods of Roger Carter who was the governor of Fort Marlborough in Sumatra. The goods were lost when the French invaded Sumatra during the Seven Years’ War. In a leading judgment, Lord Mansfield laid out the principles of insurance contracts and the parties’ obligations on the purchase of insurance. These principles were further developed during the 19th century and codified into the Marine Insurance Act 1906. This Act has remained the fundamental law of insurance until the recent changes.

The law protected the fledgling insurance industry. The insured was obliged to disclose everything that a prudent underwriter may want to know. Failure to do so allowed the underwriter to avoid the policy and refuse all claims. If the underwriter imposed warranties, then these had to be strictly complied with. Breach meant that the policy was discharged, whether or not the breach had any relevance to the actual loss.

The economic and social context in which Lord Mansfield decided Carter v Boehm was very different to that which evolved over the second half of the 20th century and continues to date. At the time, insurance was essentially a commercial arrangement between knowledgeable businessmen. The range of products on offer was very limited and the market was dominated by marine insurance. Communications were slow and poor. There was very limited ability to store or process information. Underwriters were vulnerable and needed to be protected by the law. It was legitimate to claim that all the relevant knowledge was held by the insured and that the underwriter was a passive participant when the insurance contract was agreed.

Changes to the insurance market

Much has changed since World War II. Like most western economies, the UK is dominated by consumer activity. Communications across the globe are now instantaneous and information is widely available. Insurers, brokers and policyholders have the ability to store, analyse and process data in ways that could not have been foreseen even a few years ago. Improvements in IT have allowed businesses to span the globe and to grow to sizes that were previously unthinkable. In addition, the range of insurance products on offer and the risks that are insured are now much wider and more diverse.

The law has the ability to develop to keep pace with change through the development of new precedents. Court decisions can reflect contemporary social and economic conditions, and apply existing legal principles to new facts and situations in a way that produces an acceptable outcome. This occurred to an extent with insurance law. However, courts have only partially been able to do this because:

- The pace of change of the insurance market has been extremely rapid.
- The Marine Insurance Act 1906 is drafted in clear and straightforward terms, which limit the ability of judges to develop the law.

In addition, in recent years, consumer disputes have generally been resolved by the FOS, and many commercial disputes through arbitration. Neither of these mechanisms produces new legal precedents.

Attempts to reform UK insurance law

Both regulators and insurers recognised the need to reform UK insurance law. Possible reforms were proposed by the:

- UK Law Reform Committee in 1957.
- English Law Commission in 1980.

The insurance industry also agreed a series of guides and codes to overcome the issues outlined above. In addition, in 1981, insurers set up the voluntary Insurance Ombudsman Bureau (IOB). The regulators also produced rules that differed from the Marine Insurance Act 1906. In 2000, the Financial Services and Markets Act replaced the IOB with the FOS. The FOS is not a voluntary scheme and has statutory powers. The Ombudsman is not required to follow the law and can make decisions based on what is fair and reasonable in all the circumstances of the case. Over the years, the FOS developed a framework to resolve consumer disputes that owed little to the Marine Insurance Act 2006.

While well intentioned, these initiatives had an unfortunate effect. The outcome of a dispute depended on who decided it and on whether the policyholder was classified as a consumer, small business or larger business. The law governing the formation of insurance contracts and disputes differed from the rules that the (then) Financial Services Authority (FSA) applied in a regulatory context. This created confusion, generated costs and undermined the certainty that English law traditionally provides. Some commentators claimed that the disparity between the various rules undermined trust in insurance, particularly for consumers.
THE LAW COMMISSIONS REFORM PROJECT

General background
In 2002, a subcommittee of the British Insurance Law Association consisting of judges, lawyers, brokers, insurers and loss adjusters declared itself “satisfied that there is a need for reform” and supported a review by the Law Commission. In 2006, the Law Commissions (for England and Wales) and the Scottish Law Commission started their review of UK insurance law.

The Commissions reached the early conclusion that the attempts by the market to resolve problems without reforming the Marine Insurance Act 1906 had failed. However, they also recognised that these attempts included good ideas and confirmed the concerns of the market itself. The solutions on which reforms could be based were therefore likely to come from the market.

The Law Commissions carried out an intensive round of consultation which lasted eight years. The Commissions attended numerous market and individual meetings, and participated in many seminars. The Commissions’ review involved the following steps:

- First, the Commissions issued a scoping study confirming the areas of insurance law in need of reform.
- This was followed by a series of individual Issues Papers on specific topics.
- Three formal consultation papers developing the Issue Papers’ themes and the market responses were then published.
- Finally, two final reports were adopted: one dealing exclusively with consumer issues and the other with a range of topics.

Basis for reforming insurance law
The final reform proposals were based on the following broad conclusions:

- The market for consumer insurance has developed in a different way to business insurance, for example:
  - the insurance products are different, and are sold in different ways and by different insurers;
  - social policy more often has an impact on consumer insurance;
  - brokers, who could provide guidance to consumers, are less frequently involved in the consumer insurance market;
  - the risk pools for business insurance are generally smaller and potentially more volatile than those for consumer risks;
  - businesses cover a much wider range of risk exposures. Insurers are less likely to know the details of business risk than they are for consumer risk, which by its nature and volume is more predictable.

- The reform of the Marine Insurance Act 1906 should then distinguish between consumer and business insurance. However, common solutions should also be adopted, where possible.

- The impact of IT on the insurance market is considerable. The availability of data means that the perceived asymmetry of information between insurer and insured that had shaped the Marine Insurance Act 1906 has become much less relevant (see box, Historical background: Origins of UK insurance law).

- The Marine Insurance Act 1906 remains more relevant for business insurance. Some of its principles have stood the test of time (although others clearly have not). The Act has given rise to many legal precedents and certain provisions have acquired clear and settled meanings. Where possible, valid principles and accepted definitions should be maintained by any new legislation.

- The consumer reforms should set up a mandatory regime, whereas the business insurance reforms should provide a default regime (that is, the parties should be able to contract on different terms if they wish to do so). This is particularly important in the UK where a major part of commercial insurance is international, and the relationship between the insurer and insured may be distant.

- It was clear from the market response to consultation that only one business regime was required. This means that the law should cover both small businesses and complex reinsurance placements and international companies.

- No proposed reforms should be included in the final legislation unless there was very strong support from all participants to the insurance market.

- The reforms should apply throughout the UK.

Late payment reform
One recommendation from the Law Commission that was not included in the Insurance Act 2015 related to compensation for late payment of a valid insurance claim. In England and Wales (but not in Scotland), each time an insured loss occurs the insurer is considered to be in breach of contract. Payment of an indemnity under the policy is therefore treated as damages for breach on contract and not as debt. As English law will not award further damages on existing damages, the policyholder is unable to claim compensation for any loss caused by the insurer failing to pay their claim. This rule does not apply to life insurance and is not followed by the Financial Ombudsman Service in consumer cases.

The Law Commissions proposed a new obligation upon insurers to pay claims within a reasonable time. The definition of “reasonable” would take into account the insurer’s need to investigate and assess the claim. It would also depend on the circumstances of the loss, the type of policy and delays caused beyond the insurer’s control including delay by the policyholder. Generally, it takes longer to deal with a large foreign loss than a small domestic claim. The Commissions recognised that an insurer is custodian of the insurance fund on behalf of all policyholders and should only pay genuine losses.

Whilst the majority of those consulted by the Law Commissions believed the current rule on late payment required reform, those parts of the insurance market that wrote a lot of business from the US feared the introduction of “bad faith” style litigation. In the circumstances, the House of Lords considered the reform to be too controversial for the Law Commissions’ bill procedure. However, it was agreed that the proposal would be reintroduced in a government bill. This occurred in late 2015 as the Law Commissions’ reform proposal forms part of the Enterprise Bill with an amendment to limit the time in which claims for delay can be brought. Assuming the Enterprise Act is passed, the new rule will amend the Insurance Act 2015 and will come into force one year after Royal Assent.
**Professional qualifications.** Former Law Commissioner for Commercial and Common Law

**Areas of practice.** Insurance, reinsurance and coverage; policy development. David has been the leading force on the implementation of commercial insurance contract reform. He is working with BLM partners to inform, educate and prepare the firm’s customers in advance of the implementation of the Insurance Act 2015.

**Professional associations/memberships**
- President of the British Insurance Law Association.
- Chair of the CII Professional Standards Board.
- Member of the Airmic board.
- Previously sat on the audit and risk committee of the Judicial Appointments Committee.
- Chair of the government task force on insurance fraud.