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SHOOK
HARDY & BACON

IS YOUR COMPANY INSURED THROUGH THE LONDON MARKET?

As from August 2016, the Insurance Act 2015 will alter the landscape of insurance and reinsurance contracts placed through the London market or governed by English law. Market practices will change significantly and businesses should start preparing for the new reforms now.

Key changes and practical guidance as to how to navigate the new Act are set out below.

1. A new duty of fair presentation

Businesses currently have a pre-contractual duty of utmost good faith. In practice, this means that when obtaining a policy a business has to disclose every circumstance that it knows or ought to know regarding the insured risk, which would influence the insurer when writing the risk. As there is often uncertainty surrounding the factors that may influence an insurer, this commonly leads to a substantial amount of (often irrelevant) documentation being provided to insurers in an unorganized manner.

The new provisions should streamline this process by requiring an insured to either disclose every material circumstance that the insured **knows or ought to know (on the basis of a "reasonable search");** or give the **insurer sufficient information** to put it on notice that it needs to make further inquiries. Knowledge is limited to what is known to individuals who are (i) part of the insured's senior management or (ii) responsible for the insured's insurance.

Information now also needs to be presented "fairly" to the insurer. Firstly, this means that it should be disclosed in a reasonably clear and accessible manner. Secondly, the insured should ensure that (i) every material representation as to a matter of fact is substantially correct and (ii) every material representation as to a matter of expectation or belief is made in good faith.

Shook, Hardy & Bacon lawyers think globally in everything we do. We have been entrusted by many of the world's leading companies to help them preserve their ability to manufacture, market and sell products in key markets worldwide in the face of increasing regulation, legislation and litigation threats.

From risk mitigation, regulatory and intellectual property strategies to creative dispute resolution tactics, Shook lawyers offer comprehensive, cost-effective solutions at all stages of your product's life cycle.

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An insured does not need to disclose a circumstance if (i) it diminishes the risk; (ii) it is known or ought to be known by the insurer; (iii) the insurer is presumed to know it; (iv) or it is something that the insurer waives.

How will this affect you?

The process of obtaining or renewing a policy is likely to take longer than previously, particularly the first time of renewal after the Act comes into force. Both the insurer and the insured may be uncertain as to the nature and extent of a reasonable search and the levels of information that should be disclosed. In any event, insureds should be prepared to carry out broader internal investigations and to make more thorough inquiries of external consultants.

Insurers may well pursue the *"further inquiries"* with some vigor. Adequate time is needed to undertake reasonable searches and respond to insurers' questions well before the policy is due to commence.

Additional care must also be taken to ensure that relevant documentation is identified and presented in a coherent manner; the days of the "document dump" are over.

Key actions to take now include:

- Reviewing how internal disclosure processes are carried out. Ensure that those responsible for procuring insurance disclose all matters they will be presumed to know.
- Maintaining records of the name and roles of individuals responsible for arranging insurance cover, as matters within their knowledge will need to be disclosed.
- Ensuring senior management are actively involved in any disclosures.
- Evaluating the steps taken to obtain information from internal and external sources.
- Keeping records to demonstrate that reasonable searches have been made.
- Responding fully to further inquiries from your insurer.
- Confirming with insurers in writing the extent of their presumed knowledge.

2. Remedies for breach of fair presentation

Currently, any pre-contract non-disclosure of material information, however caused, gives an insurer the right to avoid the entire policy from its outset.

This rather draconian practice will be somewhat tempered by the new Act. As from August 2016, the remedy available to insurers has to be proportionate and will depend on (i) how the breach occurred and (ii) what effect it would have had on the underwriting decisions. Unless the insurer can prove the breach was deliberate or reckless, it will not retain a right to avoid the entire policy from the outset. Remedies for breaches which were not reckless or deliberate will depend on how the breach altered the underwriter's decision making when writing the risk (if at all) and include imposing additional exclusions or reducing cover.

How will this affect you?

Insureds can be comforted that minor breaches will no longer necessarily lead to the entire policy being avoided. Maintaining comprehensive records of the searches undertaken and the inquiries made in the pre-contract stage will make it more difficult for the insurers to avoid policies altogether.

3. Warranties

Currently most UK Insurance contracts include "basis of contract" clauses. These have the effect of turning any representations made by the insured in the pre-contract phase into contractual warranties. This allows the insurer to avoid paying out on a claim if any statement on the proposal form is inaccurate (even if the statement is minor and immaterial to a claim).

Under the new Act, "basis of contract" clauses are prohibited for all business contracts. Instead, the liability of the insurer will be suspended until the breach of warranty is remedied. Once the breach is remedied, cover can continue.

In addition, from August 2016 the insurer cannot exclude, limit or discharge its liability when a claim is made if the insured can show that any non-compliance with a warranty did not increase the risk of the loss which occurred.

How will this affect you?

This is a positive development for insureds as it gives them more protection against claims being denied on the basis of breach of warranty. Of course, the optimum approach for insureds is to ensure that any representations made in the pre-contract stage are accurate. Where breaches of warranty are identified, however, this should be documented, remedial steps undertaken and the completion date noted and confirmed with the insurer.

4. Fraudulent claims

Currently, in the event of fraud, policyholders forfeit their entire claim and insurers can void the entire policy from the outset.

Under the new Act, insurers can only avoid a policy or claim from the date upon which a fraudulent event occurred. Any claims that arose out of circumstances before a fraudulent act will still be covered. Insurers have the right to recover sums paid in respect of a fraudulent claim from the person who committed the relevant act.

In respect of group policies, if one company in a group behaves in a fraudulent manner, this will not affect cover of the innocent entities.

How will this affect you?

This is a positive development for insured businesses; particularly those in a group structure. However, if a fraud is discovered it is vital that steps are taken to investigate when this took place and ensure that insurers are aware of the position. We would advise businesses to also review their Directors and Officers cover in respect of coverage for fraud.

5. Contracting out

If any of the provisions of the new Act are to be excluded from the insurance contract, the insurer must take sufficient steps to draw the disadvantageous term to the insured's attention, before the contract is entered into or the variation agreed. In addition the insurer must ensure that the disadvantageous term is clear and unambiguous as to its effect.

Generally, the Act is more favorable to insureds than insurers, so a business should only contract out of the provisions with good reason and on the basis of legal advice.

The choice of a lawyer is an important decision and should not be based solely upon advertisements.