INSURANCE BILL

The Bill will give effect to some of the recommendations made by the Law Commission and the Scottish Law Commission in their joint report, *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment,* published in July 2014.

Insurance contract law was developed in the eighteenth and nineteenth centuries, and codified in the Marine Insurance Act 1906 (which has been held to apply to all insurance). It is now considerably out-of-date.

The two Law Commissions have been carrying out a long-running project to update the law. Their first draft Bill became the Consumer Insurance (Disclosure and Representations) Act 2012, which removes the duty of consumers to volunteer information to the insurer. This Bill updates three further aspects:

- the duty of business policyholders to disclose information to the insurer;
- the law of warranties; and
- insurers' remedies for fraudulent claims.

The Bill also corrects a technical flaw in the Third Parties (Rights against Insurers) Act 2010, so that it can be introduced.

The Bill is the result of lengthy consultation and has broad-based support. It extends to the whole of the United Kingdom.

The Explanatory Notes published with the Bill give a fuller description of its contents. An impact assessment for the Bill has been placed in the Libraries of both Houses.

THE BUSINESS INSURED'S DUTY OF DISCLOSURE

The current law

Section 18 of the Marine Insurance Act 1906 places an onerous duty on a business policyholder to tell the insurer "every material circumstance" which it "knows or ought to know" before concluding a contract. A material circumstance is defined as "every circumstance which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk".

If the policyholder fails to do this, the insurer may "avoid" the contract and refuse all claims. This harsh remedy may over-protect insurers against minor failures.

The courts have attempted to ameliorate the severity of the law by developing the concept of "fair presentation of the risk". Case law suggests that insurers should ask questions where the insured's presentation points to the need for more information. However, there is a tension between the case law and the words of section 18.

Problems with the present law

The duty of disclosure in the insurance context has been criticised for many years.[1] In particular:

- It is poorly understood – and often appears so onerous that some policyholders do not know how to go about complying with it. As a result, they may "dump" large quantities of unsorted information on the insurer.

- Some medium to large companies in particular find it difficult to judge what the company "knows or ought to know" to satisfy the 1906 Act test. A company may employ several thousand employees, yet the law provides little guidance about whose knowledge is relevant.

- The statute appears to allow insurers to play a passive role, without asking questions about relevant issues. This has been stated to encourage "underwriting at claims stage", where insurers ask questions only when a claim arises, and then use that information to threaten refusal of the claim.

- Avoidance of the contract by an insurer is an "all or nothing" remedy, which leads to adversarial disputes. It allows insurers to refuse the whole claim even if, had they known the full information, they would still have accepted the risk but at a slightly higher premium.

The reforms in Part 2

Part 2 of the Bill reframes the current law of disclosure and misrepresentation as a "duty of fair presentation". It makes changes in six areas.

- Clause 3(3)(b) requires policyholders to present the risk in a clear and accessible way, rather than "dump" data on the insurer.

- Clause 3(4)(b) confirms that insurers should ask questions where they receive sufficient information to put them on notice that further information is required.

- Clause 4 gives businesses greater guidance on what a business "knows or ought to know". Only the knowledge of the business's senior management and procurement team is automatically attributed to the business, but under clause 4(4) a business must make a reasonable search of available information.

- Clause 3(5) and clause 5 clarify the exceptions to the duty of disclosure, including circumstances which the insurer knows or ought to know.

- Clause 7(4) provides more guidance to businesses by giving examples of what circumstances might be material;

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1 For example, by the Law Reform Committee in 1957, by the Law Commission in 1980, and by the British Insurance Law Association in 2002.

- Clause 8 and Schedule 1 replace the insurer's sole remedy of avoidance of the insurance contract with more proportionate remedies, such as the ability to reduce proportionately the amount to be paid on a claim or to treat the contract as if it had been entered into on different terms.

THE LAW OF WARRANTIES

A warranty is a promise made by the policyholder to the insurer. If the policyholder breaks it, the consequences can be severe.

In particular, section 34(2) of the Marine Insurance Act 1906 states that once a warranty is breached, the policyholder "cannot avail himself of the defence that the breach has been remedied, and the warranty complied with, before loss". This means that if a policyholder agrees to keep "a working burglar alarm at all times" and the alarm breaks, the insurer may (in principle) refuse all claims, even if the alarm is repaired and in working order at the time of the loss.

A further problem is that statements made by prospective policyholders on insurance proposal forms may be converted into warranties, using obscure words that are not always readily understandable. For example, if a business signs a statement on a proposal form that their answers form the "basis of the contract", the insurer may (in principle) refuse a claim for any mistake on the form, no matter how trivial.

The reforms in Part 3

- Clause 9 abolishes "basis of the contract" clauses, which automatically convert statements on an insurance proposal form into warranties. These have already been abolished in consumer insurance and the Bill does the same for business insurance. If insurers wish to include warranties in an insurance contract, they must do so specifically.

- Clause 10 provides that breach of warranty suspends rather than discharges the insurer's liability, meaning that insurance coverage may be restored if and when the breach is remedied.

INSURERS' REMEDIES FOR FRAUDULENT CLAIMS

Clear sanctions are needed to deter policyholders from acting fraudulently. Although insurance fraud is a criminal offence, prosecutions are relatively rare, meaning that the civil law plays an important part. However, the law is this area is convoluted. There is tension between the common law rule that the fraudster forfeits the fraudulent claim, and the statutory rule which allows the insurer to avoid the whole contract from the outset if the insured breaches the duty of good faith.

The reforms in Part 4

Clause 11 sets out clear remedies. It states that the insurer:

- has no liability to pay the fraudulent claim; and

- is entitled to refuse all claims arising after the fraud; but
- remains liable for legitimate losses *before* the fraud.

Clause 12 makes special provisions for group insurance. Where fraud is committed by a member of the group, the insurer has remedies against the fraudster but the claims of other group members remain unaffected.

GOOD FAITH

Section 17 of the Marine Insurance Act 1906 states that insurance is based on “utmost good faith”, and if that is not observed, the contract may be avoided. The remedy of avoidance has been severely criticised as being overly harsh and favouring the insurer over the insured.

Clause 13 abolishes the remedy of avoidance for breach of good faith. Good faith itself remains as an interpretive principle.

CONTRACTING OUT

Clauses 16-19 provide that business parties are able to contract out of the provisions of this Act, provided they do so in a transparent way. Clause 16 requires the insurer to takes sufficient steps to draw a disadvantageous term to the insured’s attention. However, the provisions of the Act that apply to consumers are mandatory, and as such, contracting out in the consumer context is prohibited.

THIRD PARTIES (RIGHTS AGAINST INSURERS) ACT 2010

This Act was designed to simplify the procedure by which third parties may claim against insurers when the insured is insolvent or dissolved. It would, for example, remove around two months from the time taken by mesothelioma victims to claim against dissolved companies.

Unfortunately the 2010 Act proved technically defective as it does not cover the full range of insolvent and dissolved insureds - and many new forms of insolvency have been introduced since it received Royal Assent. Clause 17 of the Bill adds a power to amend the list of insureds covered by the Act. Schedule 2 makes some further additions.