

Financial institutions  
Energy  
Infrastructure, mining and commodities  
Transport  
Technology and innovation  
Life sciences and healthcare

---



# Proposed Reform of the United Kingdom Marine Insurance Act

Vanessa Rochester, PhD  
Norton Rose Fulbright  
2 December 2014

# Overview

## Insurance Bill

- Introduced into Parliament on 17 July 2014
- Special fast-track procedure
- Currently before a special public committee House of Lords, who is meeting today, 2<sup>nd</sup> December.
- Sets out the proposed new regime in 3 main areas:
  - Disclosure and misrepresentation in non-consumer insurance
  - Insurance warranties (including basis of the contract clauses)
  - Insurers' remedies for fraudulent claims
- Applies to insurance and reinsurance
- Aimed at ensuring a better balance of interests between insureds and insurers
- Why is it of interest to Canada?



## Lloyd's coffee house



# The case for reform

- The Marine Insurance Act 1906 (“MIA”) codified principles developed by the English Courts in the 18<sup>th</sup> and 19<sup>th</sup> Centuries
- Introduced to protect a fledgling insurance industry - insurer friendly and outdated
- Does not reflect:
  - diversity of the modern insurance market
  - changes in practice
  - the information revolution



Marine Insurance Act 1906

1906 CHAPTER 41 6 Edw 7

# Pre-contractual obligations



## Duty of disclosure – current law

- Utmost good faith
- Requires disclosure of all “material” circumstances known or deemed to be known by the insured
- Same duty applies to insured’s agent (e.g. broker)
- A circumstance is material if it would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk.
- Inducement of actual insurer is required
- Only remedy for breach – avoidance of the policy

# Criticisms of the duty of disclosure

Duty of disclosure is poorly understood and one-sided

Duty on insured is unduly wide

Data dumping


Underwriting at the claims stage

Single remedy of avoidance

Lead to disputes

# Duty of disclosure - Reform

Law Commission has set out 3 aims:



Clarify how  
insureds are  
expected to  
present a risk

Encourage  
insurers to assist  
insureds to  
understand what  
must be  
disclosed

New system of  
proportionate  
remedies



# Fair presentation of the risk – First Element

Statutory obligation on the insured will be to make a fair presentation of the risk

A fair presentation of the risk is one that meets the following 3 criteria:

## First element

### Substance:

1. First limb: duty to disclose every material circumstance which the insured knows or ought to know; or
2. Second limb: failing that, sufficient information to put a prudent insurer on notice that it needs to make further enquiries in order to reveal those material circumstances

Additional guidance re. “material circumstance” (non-exhaustive):

- Special or unusual facts which increase the risk
- Particular concerns leading to the purchase of insurance
- Anything which those concerned with the class of insurance and field of activity in question would generally understand as something that should be disclosed (i.e. what the market would expect)

# Fair presentation of the risk – First Element

## Knowledge of the Insured – “*knows or ought to know*”

- Corporate insured “knows” only what is known to:
  - Senior management team (i.e. board members or those who play a significant role in the decision making process of the business)
  - Those responsible for placing the insurance (i.e. risk manager and/or broker)
- An insured “ought” to know:
  - There is a positive duty on the insured to conduct a “reasonable” search for information available within the organization and held by others (i.e. agents)
- “Knowledge” does not include:
  - Confidential information held by the insured’s agent (i.e. broker) acquired through a relationship with someone other than the insured.

# Fair presentation of the risk – First Element

**BUT – the Insured does not have to disclose a circumstance if:**

- The Insurer knows it, ought to know it, is presumed to know it, or waives information concerning it, or it diminishes the risk.

**Knowledge of the Insurer – “*knows it*” or “*ought to know it*” or “*presumed to know it*”**

- Known:
  - information known to the underwriter personally or any employee or agent involved in the underwriting decision
- Ought to have known:
  - employees or agents of the underwriter who have knowledge and ought to have passed it on (i.e. claims department, reports by surveyors or medical experts)
- Presumed to have known:
  - Things which are common knowledge
  - Things which an insurer offering insurance of the class in question would reasonably be expected to know in the ordinary course of business

# Fair presentation of the risk - Reform

## Second element

### Form

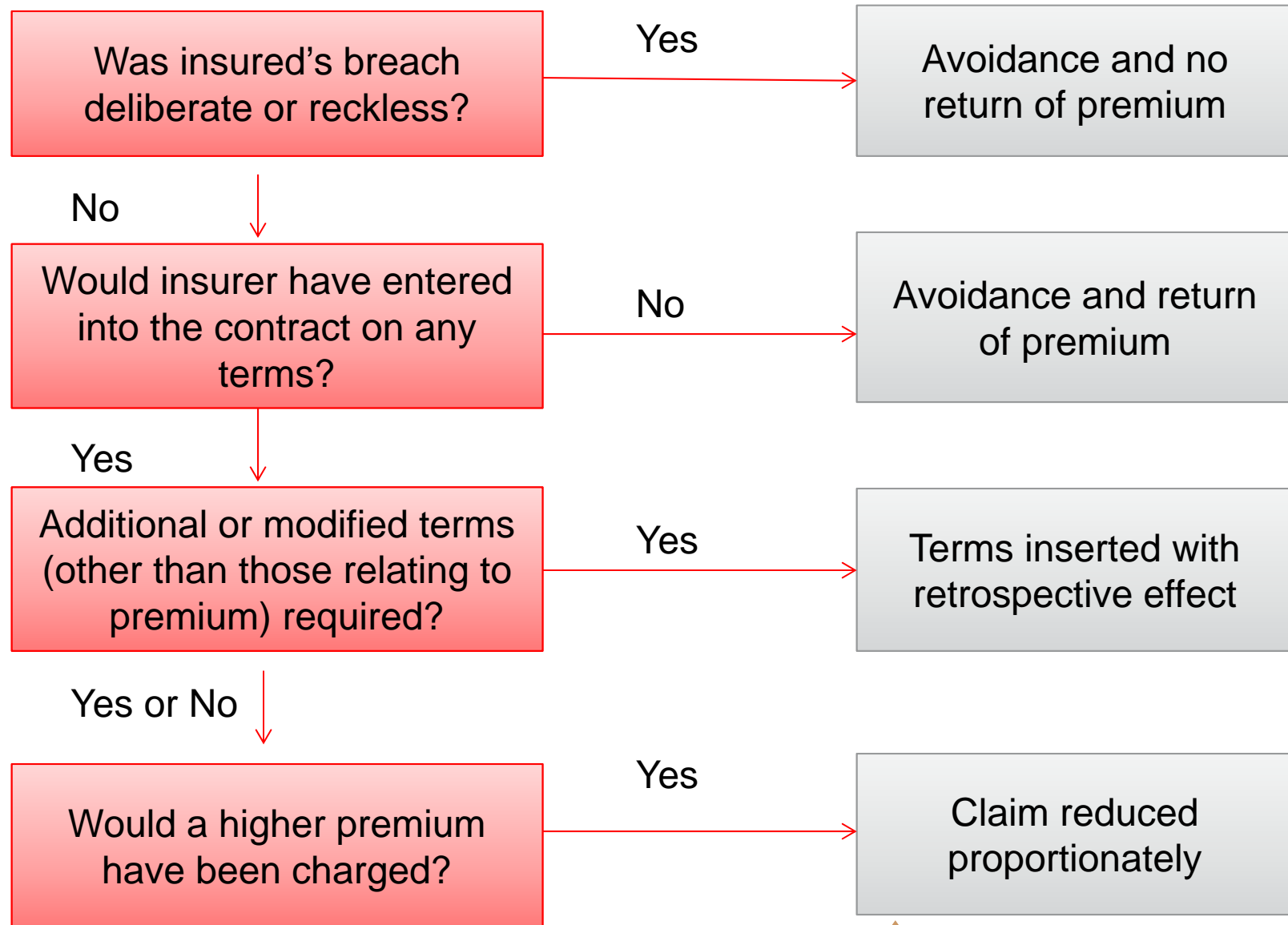
- Additional requirement for insured to disclose information in a manner which is reasonably clear and accessible to a prudent insurer
- Targets “data dumps”

## Third element

### Material representations

- Duty not to make misrepresentations:
  - Every material representation as a matter of fact is substantially correct
  - Every material representation as a matter of expectation or belief is made in good faith

# Default remedies for non-disclosure or misrepresentation



# Warranties



# Warranties - Current law

## Summary of key characteristics

1. Must be a term of the contract

2. Exact compliance required

3. Matter warranted need not be material to the risk

4. Breach leads to insurers being automatically discharged from liability **even if:**

Loss has no connection with the breach;

Breach is remedied before the loss; or

Breach is minor

# Warranties – Draconian impact of the law

## *De Hahn v Hartley (1786)*

- Policy of insurance was taken out on a vessel sailing from Liverpool to the British West Indies
- Warranty that the vessel would leave Liverpool with “50 hands or upwards”
- Vessel set sail with only 46 hands
- 6 hours later, the vessel picked up a further 6 crew members in Anglesey
- Weeks later off the coast of Africa the vessel (still with 52 hands) was captured and lost
- Held: Breach of warranty - claim not covered. It was irrelevant that the breach had been remedied within 6 hours and before the vessel had left the relatively safe waters around Britain



## “Basis of the contract” clauses

- Converts pre-contractual information supplied by the insured in a proposal form into contractual warranties
- Insurer discharged from liability if any inaccuracy in answers given, even if they are immaterial
- Already abolished in respect of consumer insurance

# Warranties - Reform

Main proposals:

Abolish 'basis of the contract' clauses

Abolish existing statutory remedy for breach i.e. automatic discharge of liability

New default remedy: breach suspends rather than discharges insurers from liability

Remedy of breach by insured prior to loss puts insurers back on risk

# Suspension of Liability / Remedy of the Breach

- What to do about time limits?
  - i.e. condition survey within 30 days
  - remedied if *“the risk to which the warranty relates later becomes essentially the same as that originally contemplated by the parties”*
- What to do if a time limit is critical for an insurer?
  - Don’t leave it to the background law, set out the remedy (i.e. state in the policy if do not comply then cover will terminate on 30<sup>th</sup> day).
- Causation?
  - caused a debate about remoteness

# Warranties

What is staying the same?

Exact compliance required

No requirement for breach to relate to loss



# Fraud – Current law

## Types of fraud

- Pure fraud
- Exaggerated claims
- Fraudulent devices

## Effect of fraud

- *Galloway v Guardian Royal Exchange (UK) Ltd* [1997] All ER (D)14

## Legal uncertainty

- Common law rule of forfeiture; or
- Remedy of avoidance for breach of the duty of utmost good faith
- (i.e. forfeit the fraudulent claim vs. avoid the whole contract for breach of good faith (incl. genuine claims))

## Fraud – Current law

The Commissions have identified a number of unresolved issues, including:

1. Does a fraudulent claim affect a previous claim made under the same policy?
2. Does a fraudulent claim affect subsequent claims made before the insurer has taken action to terminate the policy?



# Fraud - Proposals

## Common law rule of forfeiture put on a statutory footing

- Insurer not liable to pay insurance claim to which the fraud relates
- Can recover monies already paid out on a claim which is later discovered to be fraudulent

## Forfeiture of subsequent claims

- Insurers have the option to treat the contract as if it had been terminated at the time of the fraudulent act
- Must give notice of their election to do so to the insured
- Insurers may then refuse to pay claims relating to 'relevant events' occurring after the time of the fraudulent act and need not return any premium paid
- A relevant event is any event that would trigger the insurer's liability under the particular policy e.g. loss or damage which is insured or a notification of claim in a 'claims made' policy.



# Fraud - Proposals

## No avoidance of previous valid claims

- Insurer remains liable in respect of claims in relation to relevant events that took place before the date of the fraudulent act.
- A 'relevant event' may include, for example:
  - Occurrence of a loss
  - Making a claim
  - Notification of a potential claim

# **ADDITIONAL POINTS TO NOTE AND ONGOING ISSUES**

# Points to note

## Contracting out

- Provisions of the Bill are intended to provide **default rules**
- Non-consumer insurance: parties are free to agree alternative regimes provided that the insurer satisfies **2 transparency requirements**
  1. Must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into
  2. Disadvantageous term must be clear and unambiguous as to its effect

## Exception

- Basis of the contract clauses

## Good Faith

- Avoidance as a result of the breach of duty of good faith – removed!
- Will remain an interpretive principle

# Ongoing issues

2 controversial areas removed from the Bill:

1. Effect of a breach of warranty where the loss is unrelated to the breach
  - Law Commission wanted a relationship between a breach of a term and the type of loss it covered.
2. Remedies for late payment of a claim by the insurer:

## Current law:

- Property insurance: insurer is in breach of contract from the date of the loss and the cause of action against the insurer arises on that date
- No remedy for late payment of claim e.g. *Sprung v Royal Insurance*

## Proposed changes:

- Draft Bill provided for payment of damages once insurer had had a reasonable amount of time to investigate a claim and could not show reasonable grounds for disputing the claim

= Law Commission – wishes to continue to work with stakeholders to reform these two areas.

# General implications

# Pre-contractual information

## Insurers

- Change in emphasis in relation to duty of disclosure – required to play a more active role in the pre-contractual negotiations
- Need to make further enquiries based on the information provided if a prudent underwriter would make such enquiries
- Consider working with insureds to develop guidance and protocols regarding what a standard presentation of the risk should include
- Effective information sharing between the underwriting and claims teams required
- Insurers need to evidence that they have:
  - carried out a reasonable search of information available within their organisation
  - a reasonable level of knowledge relating to the class of business in question
- Awareness that avoidance is no longer the sole statutory remedy
- Arguably – more effective proportionate remedies?

# Pre-contractual information

## Insureds

- Change in emphasis from disclosure to making a fair presentation
- More active and considered approach is required when deciding what information should be given to the insurer
- Need to structure and signpost their presentation in a clear and accessible way i.e. no “data dumping”
- Required to seek out information about their business by undertaking a reasonable search and by making enquiries of their staff and agents (including brokers)
- “Draconian” remedy of avoidance restricted – proportionate remedies introduced

# Pre-contractual information

## Brokers

- No longer a separate statutory duty on agents to disclose information to the insurer when effecting insurance on the insured's behalf
- However, the broker's knowledge is likely to be within the definition of the insured's knowledge, the broker being responsible for the insured's insurance
- No need to disclose confidential information held on behalf of other clients



# Warranties & Fraud

## Warranties

### Insurers

- Warranties must be clearly set out in the policy
- Breach of warranty is only suspensory
- Consider setting out the consequence of the breach in the policy wording

### Insureds

- Breach of warranty is no longer fatal to a claim however liability is suspended
- Strict compliance still applies and currently no requirement for breach to relate to the type of loss

## Fraud

- Greater certainty for all parties regarding the remedies available to insurers in the case of fraud by an insured

# Next Steps & Future Work

## Insurance Bill

- Must complete the process before the House of Lords, move through the House of Commons and receive Royal Assent before the next general election to be held on 7 May 2015
- Parliament will be dissolved on 30 March 2015

## Law Commission

- Further work on (a) damages for late payment and (b) link between the breach and the loss – which were excluded from the Bill.

### • Report in 2015:

- Insurable interest;
- Broker's liability for premiums;
- Requirement for a formal marine policy

# Any questions?





**NORTON ROSE FULBRIGHT**