SFS INSURANCE FOR INDEPENDENT SCHOOLS

The Insurance Act 2015

The Insurance Act 2015 (the "Act") received Royal assent on 12th February 2015 and comes into force on 12th August 2016. It applies to all classes of non-consumer insurance and reinsurance and in part to consumer insurances. The Act will also bring into force the Third Party (rights against Insurers) Act 2010, which is not yet in force.

The legislation is seeking to create a new and fairer balance between policyholder and insurer. The main provisions of the Act give effect, with some modifications, to the recommendations made in July 2014 by the Law Commission and Scottish Law Commission.

The changes will have a significant impact on how insureds and insurers approach policies, creating new duties for insurers and policyholders to comply with.

Key Changes

The Act will affect all policies subject to the laws of England and Wales, Scotland and Northern Ireland that incept, are renewed, or are varied after August 2016 (unless Insured's reach an agreement with insurers that the provisions of the Act will apply straight away to policies which incept, renew, or are varied before then).

The Act updates the statutory framework for insurance and reinsurance contracts in the following key areas:

- Duty of Disclosure and misrepresentation, both before a contract incepts and when amended, in business and other non-consumer contracts
- Insurance Warranties (including basis of contract clauses) in business and other non-consumer contracts
- Fraudulent claims in consumer and non-consumer insurance contracts
- Good faith
- Amendments to the Third Parties (Rights Against Insurers) Act 2010

Disclosure

Under the Act the insured has a duty to make a "fair presentation of the risk" to the insurer.

This means that the insured must:

- Disclose every material circumstance which it knows or ought to know; or
- Failing that, the insured must give the insurer sufficient information to put a prudent insurer on notice that it needs to make further enquiries for the purpose of revealing those material circumstances.

The insured must also:

- Make the disclosure "in a manner which would be reasonably clear and accessible to a prudent insurer"; and
- Must not make misrepresentations.

Under the Act a business that is insured would be expected to know what is known to the insured's **senior management** and **individuals responsible for the insured's insurance** (which includes any employee who assists in the collection of data, or who negotiates the terms of the insurance and risk managers).

The Act also states an insured **ought to know** what would have been revealed by a **reasonable search** of information available to the insured.

The Act states that the broker's independent duty of disclosure is abolished, but the broker's knowledge is attributed to the insured.

Importantly, the Act introduces an entirely new system of proportionate remedies where the duty to make a fair presentation has been breached. The remedy of avoidance for a breach of the duty of utmost good faith is abolished, although the ability to avoid will be retained in some cases where the insured breaches the duty to make a fair presentation in relation to disclosure/misrepresentation.

The Remedies for **Material Non-Disclosure or Misrepresentation** are as summarised below:

Avoidance - Deliberate or Reckless Breaches
If a qualifying breach was deliberate or reckless, the insurer:

a) May avoid the contract and refuse all claims, and
b) Need not return any of the premiums paid.

For example, an insured deliberately conceals material and known information from its risk presentation and does not provide sufficient information to put the insurer on enquiry, making it an unfair presentation. This entitles avoidance but with no obligation to return premium.

Proportionate Remedies - Non-Deliberate or Non-Reckless Breaches
In all other cases (even where the insured has made an innocent mistake), the following proportionate remedies will apply, all being based on what the insurer would have done had it known the true facts:

1. If the insurer would not have entered into the contract on any terms - the insurer may avoid the contract and refuse all claims but must in that event return the premiums paid.

2. If the insurer would have entered into the contract but on different terms (other than terms relating to the premium) the contract is to be treated as if it had been entered into on those different terms if the insurer so requires, even if the insured would never have accepted such terms.

SFS

3. In addition, if the insurer would have entered into the contract but would have charged a higher premium (whether the terms relating to matters other than the premium would have been the same or different) - the insurer may reduce proportionately the amount to be paid on a claim.

In sub-paragraph (3) above, 'reduce proportionately' means that the insurer need only pay on the claim X% of what it would otherwise have been under the terms of the contract (or, if applicable, under the different terms provided for by virtue of paragraph 2, because 2 and 3 can apply together). The calculation is as follows:

$$X = \frac{\text{Premium actually charged}}{\text{Higher Premium}} \times 100$$

Insurance Warranties and Other Terms

Under the current law, breach of a warranty in an insurance contract means the insurer is automatically discharged from liability completely from that point onwards, even if the breach is remedied.

An insurer may avoid liability even if the breached term was entirely unrelated to the type of loss occurring which was actually suffered (for example, a warranty to maintain a working burglar alarm would be unconnected with a flood to the insured premises caused by extreme weather conditions).

Under the new Act breaches of warranty can be cured, all warranties will become 'suspensive conditions'. What this means is that cover is suspended for the period during which the warranty is not complied with. Furthermore, this means that an insurer will be liable for losses that take place after a breach of warranty has been remedied, assuming that a remedy is possible.

If, for example, an insured breaches a warranty that roof structures will be inspected every three months, that breach will be 'remedied' if the roof is inspected after four months, and so coverage will be suspended for only one month in these circumstances. A loss resulting from a cause that would have been prevented if an inspection had taken place will not be covered if it occurred in that one month suspensory period.

Under the Act all "Basis of Contract Clauses" are completely abolished.

Remedies for Fraudulent Claims

The Act provides the insurer with clear statutory remedies when a policyholder submits a fraudulent claim. If a claim is tainted by fraud, the policyholder forfeits the whole claim, they cannot recover the part of the claim that would genuinely have been payable.

The Act also provides that the insurer may refuse any claim arising after the fraudulent act and can serve notice that it is treating the contract as terminated from the date the offence was committed. However, previous valid claims arising prior to the fraudulent act are unaffected.

The insurer need not return premium following notice of termination based upon the submission of a fraudulent claim.

The Act makes special provision for situations in which a member of a group insurance policy (i.e. a policy arranged by one insured for a number of insureds, such as a Group of companies) makes a fraudulent claim.
Where this happens, the insurer will have a remedy against the fraudulent member but it will not affect the other members or the insurance policy as a whole – cover will remain in place for the other 'innocent' beneficiaries. If an insurer wants to contract out of this

provision, it must comply with the transparency requirements to bring that to the attention of the group company beneficiaries.

Good Faith

The Act removes the remedy of avoidance of the contract for breach of the duty of good faith in section 17 of the 1906 Marine Insurance Act (which applies to all types of insurance, marine or not), and any equivalent common law rule.

Contracting Out

The new Act will be a default regime for all business insurance contracts. However, the Act does allow parties to contract out of the default regime (apart from as regards the prohibition on basis of contract clauses), and to contract into an alternative regime, provided any "disadvantageous term" (i.e. any term which puts the insured in a worse position than it would have been in under the new default regime) meets certain "transparency requirements".

These requirements are that:

(i) The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention in advance; and
(ii) The disadvantageous term must be clear and unambiguous as to its effect.

What can you do now to align your business insurance needs to the new act?

Even though the new duty to make a "fair presentation of the risk" will only relate to policies that you place, renew, or vary as from 12 August 2016, we recommend that you start preparing now, by thinking about the following in advance:

- **Start the renewal process earlier**
  Be ready to start the placement/renewal process earlier than usual, to leave enough time for data-gathering.

  This way, we can look to try and pre-agree with your insurers what information you will search for and disclose, and how you will search and disclose, so as to give insurers sufficient time to ask questions about what you have disclosed.

- **Identify who is your "senior management"**
  As you will have a duty to disclose relevant information known by your "senior management" (as defined by the Act), start considering now who within your organisation falls within the definition (set out above).

- **Identify who is responsible for placing your insurance**
  You will also have a duty to disclose relevant information known by the individuals responsible for placing your insurance, such as your risk managers, your employees who assist in the collection of data or who negotiate your insurance, and your broker. Again, think about and identify who falls within these categories.

- **Raise awareness of the Act internally**
  Think about how you will start to raise internal awareness within your organisation about the Act and the new duties of disclosure required under it.

SFS

- **Raise your board's awareness**
  Think about how you will raise awareness with your board about the Act and the important changes it will make to how you collect information for the disclosure process.

- **Review your data-gathering process**
  Think about whether you currently ask enough questions of senior management and your insurance team or whether you need to adapt your standard data-gathering process to be more in-depth.

- **Identify who has information you "ought to know"**
  The new duty to carry out a "reasonable search" for information you "ought to know" (and to disclose it to insurers) requires you to make enquiries not only within your organisation but also of "any other person" who may have relevant information. Think about which individuals or entities fall within this requirement, such as your broker and any entities (such as subsidiaries) or individuals to be covered by the insurance. The reasonableness of the search you carry out will depend on factors such as the size and complexity of your organisation.

  Based on the structure of your business, you should think about:

  i) Who you will need to consult for the insurances you buy (for example, property damage, business interruption, public liability, and professional indemnity, etc.).

  ii) How much time you should allow for it.

  iii) How you will carry out this search, for example, whether by visits, discussions with key staff, or questionnaires.

  iv) For policies you buy as a business which provide cover to individuals (for example, directors and officers liability, pension trustee liability, and medical malpractice, etc.), how you can check that those individuals have no material information that needs to be disclosed, without each individual having to fill in a lot of forms.

  v) Think about how you will record that you have carried out a "reasonable search" so that you can verify to insurers (for example, if later challenged in court) that you have done so.

- **Prepare for personnel and broker changes by capturing information**
  Remember that a change of broker, or a change of personnel within your organisation, could present challenges when ensuring that you disclose the information that you are deemed to "know" and that you "ought to know". Start to consider what, if any, steps can be taken now to record all the relevant information prior to any changes taking place.

- **Agree what information your broker will keep**
  Your broker's knowledge will now be treated as part of your actual knowledge that is to be disclosed. Make sure you have a clear agreement with your broker regarding who will be responsible for searching for and storing the categories of the information which may need to be disclosed (for example, records of historic site surveys).

- **Think about how you will present your information**
  Think about and discuss with your broker and insurers how you will present your disclosure information and underwriting presentations in a manner that is "reasonably clear and accessible", and how such information will be structured. Remember, once the Act comes into force:

  i. It will no longer be acceptable for presentations to be overly brief or cryptic.

  ii. It will no longer be acceptable to "data dump", that is, to deluge insurers with an incomprehensible mass of unstructured electronic information without any signposting as to what is material.

  Underwriting presentations will need to be **structured, indexed, and signposted**, to highlight key information to underwriters.

SFS Group Limited Spring Court, Station Road, Dorking, RH4 1EB
Telephone:01306 746300 Fax:01306 746301
Email:info@sfs-group.co.uk Website: www.sfs-group.co.uk