Insurance Contract Law Reform in the UK

AIDA - Swiss Chapter
Zurich, 10 June 2013
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AIDA Swiss Chapter

We thank our sponsors of today’s event:
AIDA Swiss Chapter

— AIDA – FERMA conference took place on 3 June 2013 in Paris. Documentation is published on the FERMA-Website.

— **Next Event:**

  ▪ Evening event on **11 November 2013**, 17.00 - 18.30 at SCOR Auditorium; further details will be published on the AIDA Swiss Chapter-Website.

— Please inform any interested colleagues in your organization about our activities.

— Sponsorship – Please let us know should you be willing to provide a contribution.
Introduction of speakers

**David Hertzell**  
UK Law Commissioner – Commercial & Common Law, London

**Helmut Heiss**  
Professor, University of Zurich
Total revision of Swiss Insurance Contract Act

Milestones:

- **Feb 03** – Appointment of expert commission
- **Dec 04 (effective Jan 06)** – Partial revision of Swiss Insurance Contract Act («ICA»)
- **Jul 06** – Preliminary draft and report of the expert commission
- **Jan 09** – Opening of consultation procedure (closing: July 09)
- **Oct 09** – Report of the Federal Department of Finance (FDF) on the results of the consultation
- **Oct 10** – Report on regulatory impact assessment (RIA) by FDF and revision of regulations on insurance mediation
- **Feb - Sept 11** – Dispatch and bill on the total revised ICA
- **2012 – 2013**
  - Rejection of bill by the National Council (13/12/12) & the Council of States (20/03/13)

**Current status** – With the rejection of the parliament, the Federal Council was instructed to carry out a partial revision of the ICA.
INSURANCE CONTRACT LAW REFORM

Consumer Insurance (Disclosure and Representations) Act 2012 and Business Insurance Reform Proposals

Zurich - June 2013
The need for reform

- Question – is C19th law still appropriate for all types and classes of insurance?
- Particularly acute for consumer products (discrepancies between law, FSA (now FCA), FOS, Industry Codes and Guidance).
- **First area of reform**: disclosure in consumer insurance.
- **Result**: Consumer Insurance (Disclosure and Representations) Act 2012. **Now implemented**.
The need for reform (2)

• Similar concerns regarding business insurance – rules of 19th marine market do not always suit other areas of insurance: eg commercial property.
• 96% of surveyed Airmic (UK Risk Managers) members agreed law needs reform.
• Issues: application to modern corporate organisations, data dumping, IT, electronic contracts, complexity, size and scale?
• Deficiencies in the law: insurable interest, damages for late payment, s 53?
• UK insurance law increasingly divergent from other jurisdictions.
Traditional English Insurance law

- Contracts of utmost good faith.
- Proposer must disclose every “material circumstance” a prudent underwriter wants to know.
- If questions - “material representations” must be true.
- Failure to disclose or a misrepresentation – insurer can avoid policy. Only statutory remedy MIA 1906.
- Breach of “warranty” – policy discharged whether material or not or whether caused loss.
- No damages for late payment of general insurance claims – only interest. (England and Wales only).
- Restricted categories of insured – particularly life.
Topics covered by Law Commissions

- Placement - disclosure and representations.
- Warranties.
- Damages for late payment.
- Insurers' remedies for fraudulent claims.
- Policies and premiums in marine insurance.
- Insurable interest.
Lessons from consultations

- Disclosure: consumer insurance and business insurance are different – economically, IT effect, market practice, FOS.
- Market preference for mandatory consumer scheme but default business scheme.
- Market preference for single business regime.
- Principles behind ss 18-20 MIA sound but some uncertainty + avoidance too blunt as single remedy.
- Constraints > Default regime, targeted at mainstream, neutral outcomes.
Project Update

• Divide Project into 3 –

1. Consumer pre-contract,
2. Post-contract matters and other topics, and
3. Business pre-contract and warranties (business and consumer)

• Consumer/business divide unusual for insurance law but normal elsewhere.
• Reflects market, FSA, FOS practice.
• Economic and social policy reasons for split.
Consumer Insurance (Disclosure and Representations) Act 2012

- Active market participation has produced workable solution to 50 year old problem.
- Like 1906 Act codifies existing rules.
- Royal Assent March 2012.
- Implementation 6 April 2013.
Definition of consumer and consumer insurance contract

• Section 1

  – An individual – so a natural person
  – who enters into the contract wholly or mainly for purposes unrelated to trade, business or profession.
  – contract between the individual and a person who carries on the business of insurance.
  – No contracting out.
No Duty to Disclose without Questions

- Section 2(4) substitutes any duty relating to disclosure (Marine Insurance Act 1906, section 18) with a new statutory duty.
- Section 2(2) - the consumer must take reasonable care not to make a misrepresentation. Otherwise “Qualifying Misrepresentation”.
- Section 3 sets out test for reasonable care. Objective but determined in the light of all relevant circumstances. [NB relevance of insurers’ questions]
- Section 3(4) – particular circumstances or characteristics of which insurer aware (or ought to have been) taken into account.
- If consumer takes reasonable care – no breach. Claim paid.
Qualifying Misrepresentations

• **Qualifying misrepresentation** (section 4) is one made in breach of duty to take reasonable care.

• **Deliberate/reckless**: insured knew (or did not care) statement untrue or misleading and knew the matter (or did not care) relevant to insurer. [“must have known”]

• **Careless** if not deliberate or reckless. [“ought to have known”]

• Dishonest misrepresentation always lacks reasonable care.

• The misrepresentation must induce the insurer to enter into the contract at all or on the particular terms it did.

• Only remedies available are those provided by Act (schedule 1)
Insurer’s Remedies

• Remedies – schedule 1
  – **Deliberate/reckless** - insurer may avoid and refuse all claims.
  – Need not return premium (unless unfair e.g. investment not risk transfer).
  – **Careless** – proportionate remedy based on what the insurer would have done had the consumer complied with the duty.
  – If insurer would not have entered contract – avoid.
  – If entered on different terms (not premium) contract treated as if on those terms e.g. excess, exclusions or warranties.
  – If charged higher premium – reduce claim proportionally.
  – Statutory formula to calculate reduction.
Other bits and bobs

- Section 6 bans “basis of the contract” clauses from consumer contracts. These convert all answers in a proposal form into contractual warranties.
- Section 7 Group Insurance: where a member of a group scheme makes a misrepresentation this will not avoid the whole policy but will only have effect on cover for that individual.
- Section 8 Life insurance on the life of another – person being insured is now under a duty not to make a misrepresentation.
- Section 9 preserves normal agency law – presumption agent of consumer for these purposes unless authorised representative or cover holder. Schedule 2 provides guidance in other circumstances.
- Future proofing important – principles not list.
Business disclosure: proposals (1)

- Obligation to make a fair presentation of the risk (disclosure of material facts, prudent underwriter remain relevant) – a question of substance and form.
- Elements of a fair presentation (non-exhaustive):
  - unusual or special circumstances which increase the risk
  - particular concerns leading to purchase of insurance
  - standard market information.
- Hope test will encourage cooperation within industry to agree disclosure protocols – agree in advance what information should typically be given for types of business.
- Enables policyholder to have confidence that has complied and ensures that underwriter has information needed.
- Disclosure of unusual or special circumstances etc would still be required → duty to volunteer information remains.
Business disclosure: proposals (2)

- Must disclose information actually known or which *ought* to be known (no fact/belief distinction).
- Actual knowledge covers Board/senior management and person(s) responsible for arranging insurance (includes blind-eye knowledge).
- Policyholder has additional obligation to carry out reasonable enquiries, proportionate to type of insurance and size, nature and complexity of its business.
- Insurer expected to be competent and knowledgeable (trade knowledge/ask questions if prompted).
- “Knowledge” also clarified for insurers and brokers.
- Inducement test remains.
Nothing new?

- **Insurance is a contract upon speculation.** .......the underwriter trusts to his (the proposer’s) reputation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risque, as if it did not exist.

- **If he (the underwriter) thought that omission was an objection at the time, he ought not to have signed the policy with a secret reserve in his own mind to make it void;** if he dispensed with the information, and did not think this silence an objection then he cannot make it up now after the event.
  Lord Mansfield 1766 (Carter v Boehm)

- Fair presentation on the one hand and no “claims underwriting” on the other.
Business disclosure: remedies

• Introduce proportionate remedies where non-disclosure/misrep. not deliberate or reckless.

• *What would insurer have done had it known the truth?* (follows inducement)
  – not contracted on any terms → avoidance
  – required additional term → term retrospectively inserted (and/or)
  – charged higher premium → reduce claims proportionately

• “Deliberate or reckless” defined in legislation – insurer entitled to avoid policy in all events.

• Avoidance removed from s 17 MIA 1906, but utmost good faith retained as an interpretative principle.
Consultation results

Need for reform of business disclosure?

- Agree: 80%
- Disagree: 16%
- Other: 4%

Proportionate remedies as a default regime?

- Agree: 73%
- Disagree: 9%
- Other: 18%

- Reform supported by ABI, CII, BIBA, LIIBA, Airmic.
- Many insurers agreed: Direct Line Group, RSA, AXA, Chartis, NFU Mutual.
Warranties: proposals for reform (1)

1. Breach to suspend insurer’s liability for duration of breach. Breaches may be remedied (or waived) and cover restored.
   – Some breaches are irremediable.
   – Policy continues; liability for premium continues.
   – Insurer’s ability to “waive” breach more coherent.

2. If a term is designed to reduce the risk of a particular type of loss, or loss at a particular place or time, then breach will suspend insurer’s liability only for that type/place/time of loss.
   – Aimed at obviously irrelevant warranties.
   – Concentration on type of loss, not exactly how it is caused.
   – For courts to determine.
Warranties: proposals for reform (2)

3. Abolish “basis of the contract” clauses which convert representations into warranties.
   – Badly understood.
   – “Warranted” information to be contained in policy.

4. Identifying a “warranty”.
   – Significance of a “warranty” is not well understood.
   – Categorisation of terms as warranties will become less important.
   – Case law indicates flexibility.
   – Provisions with comparable effects will still be possible, if clear, unambiguous and brought to attention.
   – “Warranty” no longer a short hand.
Consultation results

Need for reform of warranties?

- Agree: 88%
- Other: 7%
- Disagree: 5%

Breach of warranty to suspend liability only?

- Agree: 79%
- Other: 14%
- Disagree: 7%

- Reform supported by ABI, BIBA, BILA, Airmic, A&O.
- Many insurers agreed: RSA, AXA, Chartis, NFU Mutual.
Damages for late payment of insurance claims

- Law regards insurance payments not as debts but as damages for breach of contract.
- No liability for damages on damages.
- No implied obligation to pay within reasonable time.
- Does not apply in Scotland, to life insurance, to reinstatement policies or derivative actions.
- Money claims per se not exception to general contract rules (Sempra Metals).
Late payment: proposals for reform

• Aimed at poor claims handling.

• A statutory duty to pay valid claims within a reasonable time.
  – Will always include a reasonable time to investigate and assess a claim.
  – Reasonable but wrong refusal will not lead to liability.

• Breach of duty may lead to damages on normal contract principles.
  – Actual loss, foreseeability, mitigation.

• Insurers may contract out of liability in business insurance (but not if delay was deliberate or reckless).

• Limitation period for damages for late payment claims to run in accordance with normal limitation rules ie from breach of obligation.
Consultation results

Should damages be available for late payment?

- Agree: 81%
- Disagree: 11%
- Other: 8%
Insurers’ remedies for fraud

• s17 MIA - only remedy for breach of good faith is avoidance. Courts tend not to apply in fraudulent claims.

• Remedies for fraud unclear, especially as regards post-fraud claims.

• The Law Commissions propose:
  – The entire fraudulent claim should be forfeit.
  – Policyholders should forfeit any claim after the date of fraud.
  – The fraud should not affect any previous valid claims.

• Everyone benefits from clarification of remedies.
Consultation results

On receipt of a fraudulent claim, insurers should be entitled to:

- Forfeit the claim: Agree 90%, Other 0%, Disagree 10%
- Forfeit subsequent claims: Agree 90%, Other 0%, Disagree 10%
- Prior claims remain valid: Agree 100%

Scottish Law Commission
promoting law reform

Law Commission
Reforming the law
Marine issues

• **s 22 MIA 1906**: Marine insurance contract must be “embodied in a marine policy”.
  – Now obsolete (Stamp Duty requirement).
  – Law Commissions recommend abolition.

• **s 53 MIA 1906**: Broker responsible for premium.
  – Query effect FSA CASS rules and market TOBAs.
  – Law Commissions recommend policyholder primarily liable. Broker has joint and several responsibility but can contract out.
Consultation results

Remove need for formal marine policy document?

- Agree 100%

Broker joint & severally liable for premium by default?

- Agree 35%
- Disagree 41%
- Other 24%
Insurable interest

• **Indemnity insurance proposals:**
  - Policyholder must have interest at time of loss and prospect of interest at time of contract.
  - Largely intended to “tidy up” the law, probably little practical impact on the insurance market.

• **Life Insurance proposals:**
  - Expanding who can insure the life of a given person.
  - Economic dependency test.
  - Required at time of contract.
  - What limits, if any, on insured amounts.
  - Potentially controversial social and moral considerations at play.
Consultation results

- Strong support for reform, but little consensus as to the option to pursue.
- No clear consensus on proposed definition for indemnity insurance.
- Similar results for life insurance.

Response to our proposed definition for indemnity insurance:

- Agree: 56%
- Disagree: 12%
- Other: 32%
Contracting out proposals

• **Consumer insurance**: mandatory regime.
  – Insurers will not be able to use contract terms to put the consumer in a worse position than under the proposed legislation.

• **Business insurance**: default regime.
  – Insurers will be able to use contract terms to improve their own position but only if the term is clear, unambiguous and brought sufficiently to the attention of the other party (or their broker).
Where next?

- The Commissions aim to prepare a final report and draft bill by year end/early 2014.
- Possible use of Law Commission’s special procedure during 2014 to avoid election clash 2015.
- Probable that will not be possible to include all topics given time available.
Comparative notes on the insurance law reform in the UK

Helmut Heiss
Chair for Private Law, Comparative Law and Private International Law
University of Zurich
10th June 2013
ICLs in Europe

• **Classic** ICL
  - 1st half of the 20th century
  - Swiss ICA 1908, old German ICA 1908, French CdA 1930, English MIA 1906
  - codification of insurance technics/prevention of moral hazard
  - „smoothing“ in favour of policyholders but no „consumerism“

• **Modern** ICL
  - 2nd half of 20th century
  - German VVG 2008; Swedish ICA 2005; Swiss Draft ICA 2012
  - „schizophrenic“ character (HERMAN COUSY, 2011)
    insurance technics ↔ „consumerism“

• ICL as „**Unchartered** territory“
  - Countries in transition (ex-socialist countries)
German ICA 2008

• **Proportionality**
  - Causation of the insured event and warranties („Obliegenheiten“)
  - basic approach
    - Step 1: insurer is relieved from its obligation to pay insurance money only to the extent that the act committed by the policyholder is detrimental to the insurer (causation requirement)
    - Step 2: even then the policyholder will receive a share of the insurance money depending on the degree of fault (100% in case of negligence; 0% in case of intentional acts; 0% - 100% in case of gross negligence; fault requirement)
      = „equitable“ proportionality (↔ English CIA 2012: „technical“ proportionality)
  - alternative approach
    - **pre-contractual disclosure duty**: aggravation of risk [optional]
    - adjustment of premium or terms in cases of either no fault or negligence
Swedish ICA 2005

• Separation of **Consumer Insurance** (Ch. 2 – 7) and **Business Insurance** (Ch. 8)
  - = current English CIA 2012
  - ↔ future codification of English ICL
  - EU: **consumer contract law Directives** applicable to insurance contracts

• comprehensive regulation of **group insurances**
  - Group insurance – insurance contracts based on collective agreements
  - **voluntary** ↔ **mandatory** group insurance
  - ~ English CIA 2012 (even though the regulation is limited to pre-contractual disclosure)
  - ↔ no special regulation of group insurance in the new German VVG 2008!
PEICL 2009

- **no** distinction between **Consumer Insurance** and **Business Insurance**

- **Proportionality**
  - disclosure duty (art. 2:102 (5) PEICL), aggravation of risk (art. 4:203 (3) PEICL): English approach + causation requirement („technical proportionality“)
  - causation of loss (art. 9:101 (2) PEICL); precautionary measures (art. 4:103 (2) PEICL): reduction according to the degree of fault („equitable proportionality“)

- comprehensive regulation of **group insurances**
  - ~ Swedish ICA 2005