Five things you should know about the Insurance Act 2015

Insurance Update

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By: Andrew Symons | Leon Taylor | Talia Taylor

The Insurance Act 2015 (the Act) comes into force on 12 August 2016. It has been described by the government as “the biggest reform to insurance contract law in more than a century” and will apply, by default, to commercial (non-consumer) insurance policies, with the recent Consumer Insurance (Disclosure and Representations) Act 2012, dealing with consumer insurance contracts. The Act amends key sections of the Marine Insurance Act 1906 (the MIA), but does not repeal it. The reforms aim to reflect best practice in the modern UK insurance market and deal with three broad areas - the pre-contractual duty of disclosure, the effect of warranties contained in the policy and insurers’ remedies for fraudulent claims.

This note sets out 5 things you should know.

1. In relation to the duty of disclosure, Section 3 of the Act introduces a new duty of ‘fair presentation’, which overtakes the long-standing duty of utmost good faith placed on an insured. The duty of fair presentation requires policy holders to either:

   - disclose to insurers ‘every material circumstance’ which the insured knows or ought to know, or
   - provide the insurer with ‘sufficient information’ to put a prudent insurer on notice that it needs to make further enquiries into the identified material circumstances.

   Further, in order to avoid the practice of ‘data dumping’, the disclosure must also be made in a manner which is reasonably clear and accessible. More active engagement on the part of the insurer will now be encouraged and under Section 5(3) of the Act, the insurer will be presumed to know things which are common knowledge or which it should be expected to know in the ordinary course of business in the particular field/industry it insures.

2. The Act deals with the issue of material non-disclosure in a less draconian way than the present regime. Currently, an insurer is entitled to avoid the entire contract where the insured has failed to disclose any material information, even if the material information does not lead to the loss, or even if the breach was committed by the broker. The Act aims to provide a proportionate solution where the insured does not comply with the duty of fair presentation, and an insurer will only be able to avoid a policy and keep the premium where the non-disclosure was deliberate or reckless. In all other cases the position will be as follows:

   - Where the insurer would have declined the risk altogether, the policy can be avoided, with a return of premium.
   - Where the insurer would have accepted the risk but included a contractual term, the contract should be treated as if it included that term (irrespective of whether the insured would have accepted that term).
Where the insurer would have charged a greater premium, the claim should be scaled down proportionately (for example, if the insurer would have charged double the premium, it need only pay half of the claim).

The test of what the insurer would have done had it known the true facts is subjective and insurers will need to be able to prove how they would have acted differently if the breach had not occurred.

3. The law on warranties will change significantly under Part 3 of the Act. One change is that basis of the contract clauses (where all pre-contractual representations are converted into warranties) will be prohibited and it will not be possible to contract out of this provision. Another is that a breach of warranty will result in the insurance cover being 'suspended', so that any breach of warranty by the insured suspends the insurer's liability until the breach is remedied. By contrast, under the current law, a breach of warranty entitles the insurer to avoid all claims under the policy from the date of breach, even if it did not induce the insurer to enter into the contract. Section 11 of the Act deals with provisions designed to reduce the risk of a particular type of loss and introduces the concept that a breach of a term of an insurance contract must be related to the loss in question. So, the Act states that where there is non-compliance with such a term, insurers will not be able to rely on that non-compliance as a defence if the insured can demonstrate that such non-compliance could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred. One example of this is a household policy containing a clause warranting that all windows must have fitted locks. This is not complied with and subsequently a loss is caused by flooding of the property. The risk of the loss in this case is unaffected by the failure to install window locks.

4. The current position in relation to fraudulent claims is that an insurer is not liable to pay a fraudulent claim and can avoid the whole contract. Part 4 of the Act takes into account commercial realities and provides greater options to insurers. The Act makes clear (as is currently the case) that there is no liability on the part of the insurer to pay a fraudulent claim, and it may recover any sums paid to the insured in respect of the fraudulent claim. An insurer will now have the option of terminating the contract from the date of the fraudulent act (not the discovery of it), without any return of premium. The insurer can then refuse to pay any claims from that point onwards, but will remain liable for legitimate losses before the fraud. The is no definition of what constitutes a fraudulent claim, so there is no distinction between someone who presents a claim for something that never happened and someone who has genuinely suffered a loss but has been fraudulent in some way in making the claim. The same rights apply when dealing with fraudulent claims made by individuals under group insurance policies, although only in respect of those individuals who committed the fraudulent acts.

5. The changes being introduced by the Act are intended to be a 'default regime', so it applies unless amended. Insurers can contract out of most provisions (except for the 'basis of contract' clauses described at point 3 above). However, where parties agree to terms that are less favourable than those set out in the Act, insurers will need to identify each and every change and must take sufficient steps to draw those provisions to the insured's attention before the contract is entered into. Unfavourable terms must be "clear and unambiguous as to [their] effect". Section 17(4) of the Act also provides that "…the characteristics of insured persons of the kind in question, and the circumstances of the transaction, are to be taken into account", so the greater the sophistication of the insured, the more lenient the approach can be in terms of identifying disadvantageous terms.