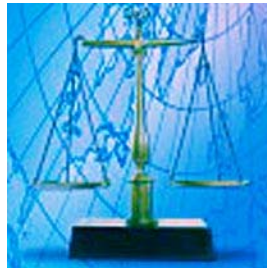




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Consumer Insurance (Disclosure and Representations) Bill



Introduction

As part of their ongoing review of insurance contract law, the Law Commission and the Scottish Law Commission (the "**Commissions**") have today published the Consumer Insurance (Disclosure and Representations) Bill (the "**Bill**"). The Bill focuses on the period prior to the formation of the insurance contract: Most crucially, it replaces the consumer's duty of utmost good faith with a duty to respond honestly and with reasonable care to questions asked by the insurer. Once the Bill becomes law, it will bring insurance law broadly into line with current Financial Ombudsman Service (**FOS**) practice.

The Bill follows on from the Consultation Paper published by the Commissions in July 2007 on the reform of insurance contract law and the summary of responses relating to consumer insurance published in May 2008.

The case for reform

The Commissions say that there was a wide consensus amongst consumer groups, lawyers and brokers, and also amongst most insurance companies that consumer insurance law is in urgent need of reform: The law, which is partly based on principles that were codified more than hundred years ago in the Marine Insurance Act 1906, has not kept pace with the changing economic conditions. It can lead to unfair results for policyholders who can find their claims rejected unexpectedly.

The duty of utmost good faith puts the potential parties to a contract of insurance under an obligation to disclose all material facts. The aim is to help insurers to obtain sufficient information from potential policyholders to assess risks and price policies properly. However, under current law, the insurer is entitled to avoid the policy and refuse all claims under it if the consumer did not volunteer all information that would influence a prudent underwriter's assessment of the risk. This may include information which is totally irrelevant to the claim in question. In addition, where a policyholder gives a warranty about future actions, any breach will discharge the insurer from all future claims, even if the breach is completely unrelated to the claim.

In support of their arguments, the Commissions cite various cases where the strict legal position of insurance contracts led to results which were manifestly unfair to consumers. One case involved an insurance company that rejected a claim for the loss of a jewellery because the policyholder did not tell it about her husband's previous criminal convictions. Cases like this are common. Notably, in recent years critical illness policies have hit the spotlight.

Over the years consumers have gained a degree of protection against the strict effects of the law by permitting them to rely on industry guidance and self-regulation, rules laid down by the Financial Services Authority (**FSA**), industry voluntary codes of practice and FOS practice, which applies a "*fair and reasonable*" test to complaints brought by consumers and small businesses. However, the Commissions concluded that rather than improving the positions for consumers, the development of these different layers of law, regulation and guidance made it difficult for consumers and insurers to find out what their rights and obligations are. In the words of the Commissions,

"The law gives the insurers rights – for example, to avoid a policy for a consumer's honest and reasonable failure to disclose a material fact. It then says that an insurer who exercises



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those rights will be liable to a fine under the FSA Rules and may be ordered by the FOS to pay the claim. To put it bluntly, this is a nonsense."

The Reforms

The Bill seeks to address existing deficiencies in consumer insurance contract law in five major areas:

- misrepresentation and non-disclosure by the insured before the contract is made;
- remedies for breach;
- warranties and similar terms;
- intermediaries and brokers; and
- group insurance and life insurance of another.

The new law would be mandatory to insurance contracts entered into by a "*consumer*". The definition of a "*consumer*" mirrors the FSA's definition of a "*retail customer*" and is in line with the definitions used in major European Union directives which aim to protect consumer rights: that is, an individual acting for purposes which are outside his trade, business or profession.

Misrepresentation and non-disclosure by the insured before the contract is made

The Bill seeks to replace the principle of utmost good faith with a duty on the consumer to take reasonable care not to make a misrepresentation to the insurer. In determining whether a misrepresentation has been made, the following would be taken into consideration:

- the type of consumer insurance policy in question, and its target market;
- any relevant explanatory material or publicity produced or authorised by the insurer;
- how clear, and how specific, the insurer's questions were; and
- whether or not an agent was acting for the consumer.

The reasonableness test will also take into account any particular characteristics or circumstances affecting the insured, but only in so far as these were known to the insurer. A misrepresentation made dishonestly will always be taken as showing lack of reasonable care.

Remedies for breach

Under proposed changes to the law, the insurer would no longer be able to avoid paying a claim merely because of an inaccurate or misleading statement of the consumer. Rather, the Commissions seek to put the insurer in the position it would have been in had it been aware of the full facts.

The remedies available to the insurer for misrepresentation depend on the degree of fault of the consumer:

- If the misrepresentation was deliberate or reckless, then the insurer:



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- (a) may avoid the contract and refuse all claims, and
 - (b) need not return any of the premiums paid, except to the extent (if any) that it would be unfair to the consumer to retain them.
- If the misrepresentation was careless, then the insurer's remedies are based on what it would have done if the consumer had complied with its duty to take reasonable care not to make a misrepresentation to the insurer:
 - (a) if the insurer would have declined the risk altogether, then it may avoid the contract and refuse all claims, but must return the premiums paid;
 - (b) if the insurer would have excluded a particular type of claim, then it would not be obliged to pay a claim that falls within the exclusion; and
 - (c) if the insurer would have charged more but still accepted the risk, then it would be able to reduce proportionately the amount to be paid on a claim according to a prescribed formula.

To obtain a remedy, the insurer will need to show that the misrepresentation was deliberate, reckless or careless and induced it to enter a contract on the terms it did.

Warranties and similar terms

Under the current law, any breach of a warranty by the policyholder discharges the insurer from all further liability, even in respect of a claim which has no connection with the breach. The solution proposed by the Commissions provides that a statement by the insured about the existence of a current state of affairs should take effect only as a representation, not as a warranty. As a consequence, where a statement is inaccurate, the insurer's remedies will be those for misrepresentation (see above) and the insurer will not necessarily be able to avoid liability under a policy even if the representation was stated in the policy to be a warranty.

Intermediaries and brokers

Insurance is often bought through brokers and other intermediaries, who give guidance on application forms and pass information to insurers. If a consumer gives information to an intermediary and the intermediary fails to convey that information accurately to the insurer, then whether the insurer will be able to avoid liability or not will depend on whether the intermediary acted as agent for the insurer or the insured. Under common law a person is responsible for any lack of care by their agent even if the person is without blame. However, in practice it is not always clear for whom the agent acts. The Commissions have therefore set out rules for determining the status of agents: "tied agents", i.e. agents acting as appointed representatives or with express authority from the insurer should be treated as acting for the insurer. In these circumstances if the intermediary or broker fails to pass information to the insurer, then the insurer would not be able to avoid liability to the policyholder. Where intermediaries are clearly independent, they should be considered to be acting for the policyholder.



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Group insurance and life insurance of another

Group insurance and life insurance of another provide insurance cover to a third person who is not a party to the insurance contract under the Bill. Where this person makes a misrepresentation he will be treated as if he were a policyholder who had arranged insurance directly with the insurer.

Impact on Business

The main effect of the Bill would be to bring the law into line with accepted standards of good practice, as recognised by the FSA and the FOS and provide clarity on the rights and obligations of the insurers as well as of the insured.

Some of the proposed changes, however, will necessitate redrafting by insurers of their TOBA - proposals forms and policy wordings.

How Addleshaw Goddard LLP can help you

If you would like to understand the potential impact the proposals in the Bill will have on your business, Addleshaw Goddard LLP would be happy to advise. Please contact one of the Insurance and Reinsurance Group below for more information.



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