

LLOYDS

INSURANCE LAW & REGULATION: NATIONAL & INTERNATIONAL DEBATES AND FUTURE DIRECTION

14 May 2008

DEVELOPMENTS IN THE UNITED KINGDOM

Chair: Prof. Loukas Mistelis,
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DEVEREUX
CHAMBERS

Insurance Law

DEVELOPMENTS IN THE U.K.

COLIN EDELMAN QC
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May 2008

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Goodbye to ...

- One law for all
- Utmost good faith
- The prudent underwriter - and expert witnesses
- Basis of contract clauses
- Strict consequences for warranty breach
- S.19 MIA 1906

Hello to ...

- Different regimes for consumers and businesses
- The reasonable insured
- "Relevance" instead of "materiality"
- Default rules and contracting out
- Reasonable expectations of the insured

The need for reform

- Codification
- Modernisation
- Fairness
- International reputation
- Harmonisation with Europe

Consumer/Business

- Should there be different rules?
- Definition of 'consumer'?
- Mandatory for consumers - unless more favourable
- Small businesses?

Consumer rules

- Pre-contract information - no real change
- Remedies - proportionate for negligence
- Should the remedy for negligent disclosure be discretionary?
- Future warranties - only if clear to consumer and causative

Business rules

- Should there be a general right to contract out of default rules?
- Should contracting out in standard terms be permitted?
- The control of standard terms through "the reasonable expectation of the insured"

Business rules - remedies

- No remedy for innocent misrepresentation/non-disclosure?
- Remedy for negligent misrepresentation/non-disclosure - avoidance or proportionate?
- Remedy for breach of specific warranty - material, causative breach only?
- Warranty re future - pay claim unless causative & right to terminate only?

Intermediaries

- Agent for insurer unless clearly independent of insurer and acting for the insured?
- Impact on business insurance?
- S.19(a) - repeal for consumers?
- S.19(a) - insurer's remedy damages against intermediary only?

Reinsurance & Marine Insurance

- Special cases?
- Different default rules?
- Retain traditional rules for non-disclosure & misrepresentation?
- Retain traditional rules for warranties?
- Retain traditional rules for intermediaries?

Conclusion

Whilst there are details that need to be debated, codification and reform is overdue and urgently required.

DAVID HERTZELL

Commissioner
Law commission



**Law
Commission**
Reforming the law

Scottish Law Commission
promoting law reform

**INSURANCE CONTRACT LAW
REFORM**

**Consultation Paper 1
Issue Paper 4**

Consultation paper 1

- Misrepresentation and non-disclosure
- Breach of warranty
- Misrepresentation and non-disclosure caused by intermediary
 - English and Scots law
 - Consumer and commercial insurance (including MAT)
 - General and long-term business
 - Insurance and reinsurance



Criteria

- Law Commission remit to make law “accessible, intelligible and in accordance with modern needs”
- Law should:
 - Meet reasonable expectations
 - Accord with good practice
 - Be clear, easy to find and coherent
 - Support fair and effective market



Overall aims

- Increase customer confidence - Consumers and Business
- Reinforce UK Position as centre of insurance excellence



Structure - LCs' Proposals

- Single set of proposals but:-
- Mandatory regime for consumers
- Default regime for business. Can opt out by agreement - complete freedom of contract



Pre-contract information from the insured - Current position UK (Marine Insurance Act 1906)

- Utmost good faith
 - Duty to disclose material facts
 - No misrepresentation of material facts
 - The “Prudent Underwriter”
 - Remedy of avoidance
- Warranties of present or past fact
 - Strict liability, need not be material
 - no need to show inducement
 - If breach, insurer discharged from liability



Consumers: Provisional proposals 1

- No “duty to disclose”
- Duty to be honest and use reasonable care in answering questions
 - Accurately and completely
 - misleading partial answer
 - no answer at all
 - General questions acceptable but answer judged by what reasonable consumer would think asking for
 - No “Prudent Underwriter”



Consumers: Provisional proposals 2

- Insurer will have a remedy if
 - Consumer made misrepresentation
 - Misrepresentation induced insurer to enter contract (“material”)
 - A reasonable person in the circumstances would not make that misrepresentation



Consumers: Provisional proposals 3

- Three categories of misrepresentation
 - Deliberate or reckless
 - Reasonable
 - Negligent



Consumers: Provisional proposals 4

- Deliberate or Reckless
- On balance of probabilities consumer made misrepresentation
 - Knowing it to be untrue or
 - Reckless as to whether true
 - and
 - Knowing it to be relevant to insurer or
 - Reckless as to whether relevant
- Insurer can avoid



Consumers: Provisional proposals 5

Honest and Reasonable

- Insurer required to pay claims
- Test takes into account the type of policy, and normal consumer characteristics
- Individual consumer characteristics irrelevant unless known to insurer



Consumers: Provisional proposals 6

Negligent

- Proportional Remedy - what would insurer have done if it knew the truth?
 - Decline risk - avoid
 - Exclude - reject claim - (rewrite policy)
 - Increase premium - proportional claim payment
 - Warranty / excess - (rewrite policy)



Consumers: Provisional proposals 7

- Warranties as to existing or past fact ineffective
 - Treat as representation
 - Australian ICA 1984 s 24
- Abolish “basis of contract” clauses
- No special rules on information insurer might have obtained for itself - (e.g. medical reports)
 - Question of whether policyholder acted reasonably



Businesses and pre-contract information - complex issues

- On average
 - more sophisticated
 - more likely to be advised
- Wide range of business types
- Much greater range of risks
 - most are SME
 - many not expert
 - increasing trend to buy on-line without advice



Business Insurance - Provisional proposals 1

- Default regime but freedom contract option
- Duty disclosure remains
- To have remedy insurer must show
 - reasonable business proposer would appreciate information relevant to insurer or
 - proposer knew relevant



Business insurance - Provisional proposals 2

- Misrepresentation - default Scheme similar to consumers
- Insurer must show
 - Business made misrepresentation
 - Misrepresentation induced insurer to enter into the contract
 - A reasonable business would not have made that misrepresentation



Business insurance - Provisional proposals 3

In the event of a relevant non-disclosure or misrepresentation:

- Deliberate or reckless insurer may avoid
- Honest and reasonable claim should be paid
- Negligent question avoidance or proportional remedies?



Business insurance - Provisional proposals 4

Controls on Standard Terms

- Can contract out of default regime but
 - If contract on standard terms and
 - Terms give greater rights to insurer than default regime to refuse claims for inaccurate pre contract information
 - Insurer cannot rely on term if it defeats the insured's reasonable expectation ("contract clarity")



Business: Warranties of fact

- Permit specific fact warranties
 - If in schedule to policy (or equivalent)
 - Basis of contract clause of no effect
- Refuse claim only if material and causal contribution to loss
 - Unless agreed otherwise
 - Standard term should not make cover substantially different from reasonable expectations



Consumers - warranties as to future

- Set out in writing and consumer aware
- Reject claim only if causally connected to loss
- Mandatory rule
- Exceptions/ definitions of risk - same/similar effect?
 - UTCCR 1999: not exempt as "core term" unless
 - in plain, intelligible language
 - represent how deal presented to consumer



Business - warranties as to future

- Set out in writing
- Reject claim only if causally connected to loss
- Default rule - contract out but
 - not if standard term which makes cover substantially different to what reasonably expected
- Exceptions/ definitions of risk - same/ similar effect?
 - No causal connection requirement
 - Standard term subject to reasonable expectation test ("contract clarity")



Effect on contract

- No automatic discharge
- Claim may be refused if connected to loss
- Insurer will have option to terminate
 - Only if breach serious
 - May reserve right to cancel after notice
- Right may be lost - affirmation/ estoppel



Intermediaries: The problems

- Who is the intermediary acting for = who claims against whom?
- Information disclosed by insured and not passed on
 - Intermediary agent of insured unless authorised rep. (FSMA 2000) or binder
- Proposal completed by intermediary, signed by insured without spotting mistake or omission:
 - “Transferred agency”
 - Signature on form conclusive of knowledge



Intermediaries - Proposals

- Intermediary is agent of insurer unless clearly independent
 - “Tied”/ “multi-tied”/ “panel”: agent of insurer - probably
 - Question - IMD “fair analysis” test for independence?
- Proposal completed by intermediary, signed by insured without spotting mistake or omission:
 - No “transferred agency”
 - Signature on form not conclusive that knew statement was being made
 - Consider whether proposer acted carelessly, reasonably, or recklessly



Consultation Responses

- 25 Lawyers/Legal Associations
- 39 Insurers/Insurance Associations
- 13 Brokers/Brokers Associations
- 7 Consumer/Consumer Associations
- 8 Business buyers/Associations
- 5 Academics
- 8 Others (eg. regulators/service providers)



Summary of views

- Consumer groups very supportive
- Business buyers generally supportive but some reservations and questions
- General Insurers broadly supportive but some reservations and questions
- Life/Protection Insurers supportive
- Specialist Insurers (eg. Marine/reinsurers) less supportive



Structure

- Majority supports:-
 - Need for reform (very strong support)
 - All insurance included (MAT/Reinsurance)
 - Mandatory consumer regime
 - Default regime + freedom of contract for business insurance
 - No separate regime for small businesses



Non disclosure/ misrepresentation

- Majority supports:-
 - abolish duty of disclosure for consumers
 - retain duty of disclosure for business
 - hierarchy of remedies (pay/proportional payment/avoid) matched against policyholder actions (reasonable/negligent/dishonest) **but** less support in business insurance
 - “Material” - “reasonable insured” to replace “prudent underwriter” - **but** less support in business insurance



Warranties

- Majority supports
 - abolish “basis of contract” clauses
 - present or past fact warranties = representation for consumers
 - retain present and past fact warranties for business and future warranties for business and consumers
 - “Causal Contribution” between breach and loss before insurer has remedy



Opposition

- Standard Terms of Business + “reasonable expectations” test
- Intermediary proposals - complex and developing area in practice
- “sanctity of signature”
- 5 year non contestability period for life insurance



Issue Paper 4 - Insurable Interest

Our Proposals:-

- Indemnity Insurance (property, liability etc).
- Current Law is acceptable. Apply “indemnity principle” i.e. must have loss and therefore “interest” to bring claim.
- Abolish marine criminal penalties



Insurable Interest

- Non indemnity insurance (mainly life and related products)
- Choice:-
 - a) Expand and update narrow categories permitted by Life Insurance Act 1774 or
 - b) Abolish requirement entirely?



Insurable Interest - the issues

- Moral hazard - insurance as motive for fraud/murder
- “Insurable Interest” sometimes used to distinguish insurance from other risk transfer products
- Gambling Act 2005 - gambling contracts now enforceable (since 2007)
- Group Insurance - should be encouraged but legal principles difficult to apply



Next Steps

- Summary of consumer responses - May 2008
- Final report (bill) - consumer - 2009
- Summary of business responses - 2008/2009
- Second Consultation Paper - 2009
 - insurable interest (current Issue Paper)
 - claims (post contractual good faith/damages for late payment)
- Project conclusion - 2010



DEVELOPMENTS IN THE EUROPEAN UNION

Chair: Alastair Evans

Head of Government Policy & Affairs,
Lloyd's

GÉRARD DE LA MARTINIÈRE

President
Comité Européen Des Assurances

KAREL VAN HULLE

Head of Unit, Insurance & Pensions
DG Internal Market & Services
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Insurance Regulatory Developments in the EU

Lloyds Insurance Law and Regulation
Conference
London, 14 May 2008

Karel VAN HULLE
Head of Insurance and Pensions

Internal Market & Services DG

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Solvency II

- Need to agree before end of this year
- Long term project but need to prepare now
- Some important issues
 - Relationship between MCR and SCR
 - Group supervision
 - Treatment of third country (re) insurers
 - Equity risk/ Surplus funds

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Other issues

- Insurance guarantee schemes
- Retail market in financial services
- Solvency regime for pension funds
- Review of the Insurance Mediation Directive
- Motor insurance
- Health insurance

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EU as part of the world

- How can we facilitate operations of our industry in other parts of the world?
- How should we treat industry from third countries operating within the EU?
- Regulatory dialogues with US, China, Japan, India
- Mutual recognition based upon equivalence as the way forward

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INTERNATIONAL DEVELOPMENTS

Chair: Prof. Rosa Lastra
Professor of International Financial and Monetary Law, Queen Mary

MICHEL FLAMÉE

Chairman
International Association of Insurance Supervisors

International developments in Insurance Supervision Michel Flamée - Chair IAIS

1. Global approach of the IAIS
2. Scope and methods for action
3. Need for tighten up of the standard-setting activities
4. Current IAIS key activities
 - Review of Insurance Core Principles
 - Developments on solvency and risk management
 - Work on group-wide supervision
 - International supervisory cooperation and mutual recognition
 - Addressing the emerging markets
 - Activities relating to financial stability
 - Contributing to accounting developments



5. Conclusion
BANKING, FINANCE AND INSURANCE COMMISSION

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SEAN MCGOVERN

Director & General Counsel
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**LLOYD'S INSURANCE LAW AND REGULATION
CONFERENCE**

14 May 2008

International Developments

Sean McGovern, Director and General Counsel, Lloyd's

Structure of Talk

- Broader international context beyond insurance.
- Solvency II.
- US system of insurance regulation.
- Other national and international developments.
- Harmonisation of legal rules internationally.
- Why we need to be active in international regulatory and trading debates.
- Our objectives in such debates.

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Broader International Context Beyond Insurance

- Many factors currently in play.
- A dynamic environment.

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Solvency II

- Solvency II's significance.
- Its impact on IAIS work.

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US System of Insurance Regulation

- The SEC's international perspective.
- Criticisms of the current NAIC State-based system.
- US Treasury Blueprint on modernisation of Financial Services.

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Other National and International Developments and Harmonisation of Legal Rules

- Choices faced by countries when regulating insurance and reinsurance.
- Brazil.
- EU work on harmonisation of legal rules.

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Lloyd's Engagement with and Objectives in International and Regulatory Trading Debates.

- Why Lloyd's needs to be active in such debates.
- Our objectives in such debates.

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Conclusions

- Support for sensible, proportionate, convergent international regulation.
- Continuing engagement with IAIS and other national and international regulatory bodies.

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Q&A DISCUSSION

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