HFW

INSURANCE BULLETIN
JANUARY 2022

In this Insurance Bulletin:

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REGULATORY UPDATE

UK: Consumer Duty – FCA publishes further proposals and guidance

The FCA has published a second consultation paper[1] regarding its proposals for introducing a new "Consumer Duty", which would set higher expectations for the standard of care that firms provide to consumers.

In broad terms, the Consumer Duty would require firms to:

- ask themselves what outcomes customers should be able to expect from their products and services;
- monitor and regularly review the outcomes that their customers are experiencing;
- ensure that their products and services are delivering the outcomes that their customers expect; and
- identify where their products and services are leading to poor outcomes or harm to customers.

Scope of the Consumer Duty

The proposed Consumer Duty is wide in scope and would apply, in the context of firms carrying on regulated activities, to:

- products and services sold to a firm's "retail clients" – the FCA does not propose to apply a single standard definition of "retail client" to the Consumer Duty. Instead, it proposes to align the scope of the Consumer Duty with the existing scope of the FCA's sectoral sourcebooks e.g. for insurance, the scope of the Consumer Duty will follow the position in the Insurance Conduct of Business Sourcebook (ICOBS);
- firms that manufacture or supply products and services to such clients, even if they do not have a direct relationship with the customer;
- prospective customers – the practical impact of this will depend on the needs, characteristics and objectives of a target market of customers when designing products or services. The FCA has cited financial promotions as a specific example which is often targeted at potential customers;
- authorised firms' own retail business activities, i.e. firms would be responsible only for their own activities and would not need to oversee the actions of other firms in the distribution chain; and
- unregulated activities that are ancillary to regulated activities i.e. activities carried on in connection with a regulated activity or held out as being for the purposes of a regulated activity.

The FCA does not propose to apply the new Consumer Duty retrospectively to past business. However, the Consumer Duty would apply on a forward-looking basis to existing products or services that are either still being sold to customers, or closed products or services that are not being sold or renewed. The FCA has clarified that it would not expect firms to apply rules that are not relevant for closed products or services.

Structure of the Consumer Duty

The three key elements of the Consumer Duty are:

1. A new "**Consumer Principle**", which provides an overarching standard of conduct that the FCA expects from firms: "to deliver good outcomes for retail clients". This imposes a higher standard of conduct than Principles 6 (Customers' best interests) and 7 (Communications with clients).[2]
2. A series of **cross-cutting rules**, which develop and clarify the Consumer Principle's overarching expectations of firm conduct, and set out how it should apply in practice. The rules require firms to demonstrate the following three key behaviours:

"The FCA proposes to embed a concept of reasonableness in the Consumer Duty, which would be an objective test."

(a) act in good faith toward customers;

(b) avoid foreseeable harm to customers;

(c) enable and support customers to pursue their financial objectives.

3. A set of **outcomes** that support the Consumer Principle by setting expectations for firms' cultures and behaviours in relation to:

   (a) **products and services**, which must be specifically designed to meet the needs of customers, and sold to those whose needs they meet;

   (b) the **price** of products and services, which must represent fair value;

   (c) **consumer understanding** – communications must (i) meet the information needs of customers, (ii) be likely to be understood by the average customer and (iii) equip customers to make effective, timely and properly informed decisions about financial products and services; and

   (d) **consumer support** – customer service meets the needs of customers, enabling them to use the product as reasonably anticipated and ensuring that they do not face unreasonable barriers in doing so.

Concept of reasonableness

The FCA proposes to embed a concept of reasonableness in the Consumer Duty, which would be an objective test. The FCA expects firms to interpret the draft rules and non-Handbook guidance in line with the standard that could reasonably be expected of a prudent firm (i) carrying on the same activity in relation to the same product or service and (ii) with the necessary understanding of the needs and characteristics of its customers.

Application to the Senior Managers and Certification Regime (SM&CR)

The FCA proposes to amend its SM&CR individual conduct rules to reflect the higher standard of the Consumer Duty. There will be a new rule requiring all conduct rules staff within firms to "act to deliver good outcomes for retail customers" where their firms' activities fall within scope of the Consumer Duty.

Where this new rule applies, the existing individual conduct Rule 4, which requires conduct rules staff to "pay due regard to the interests of customers and treat them fairly", would not apply.

The FCA also proposes to include obligations as part of this new individual conduct rule that reflect the three key behaviours of the Consumer Duty's cross-cutting rules (see above).

Private right of action and the Consumer Duty

A private person (generally, individuals, not businesses) who has suffered a loss through a firm's breach of one of the FCA's rules has a right to take legal action for damages from the firm. The FCA does not currently propose to provide a private right of action for breaches of any part of the Consumer Duty. However, the FCA will keep the possibility of a private right of action in relation to the Consumer Duty under review in light of evidence of firms' compliance with the Consumer Duty.

Implementation timetable

Comments can be made on the consultation until 15 February 2022.[3] The FCA expects to publish a policy statement summarising responses and making any new rules by 31 July 2022.

Firms are then expected to have until 30 April 2023 to implement the Consumer Duty.

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Footnotes

1 FCA Consultation Paper CP21/36 can be accessed **here**. The FCA is consulting on its revised rules and draft non-Handbook guidance relating to the Consumer Duty, as set out in CP21/36. CP21/36 also includes feedback to the FCA's first consultation paper on the Consumer Duty (CP21/13), which was published in May 2021.

2 The FCA proposes to disapply both Principles 6 and 7 where the Consumer Duty applies. Principles 6 and 7 would continue to apply to conduct outside the scope of the Consumer Duty e.g. certain SMEs and wholesale business.

3 The online response form for submitting comments can be accessed **here**.

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PRA sets out its 2022 insurance supervision priorities

The Prudential Regulation Authority (PRA) has set out its 2022 priorities for insurance supervision in a Dear CEO letter dated 12 January 2022.

These are:

- **Financial resilience:** It is noted that the full impact of COVID-19 has yet to be felt on credit portfolios and recovery is likely to be uneven across sectors. The pandemic has also demonstrated the potential for systemic risks to result in losses across the insurance sector, and the PRA notes that it has seen limited evidence to show insurers have properly considered their aggregate exposures, including from silent cyber risk.
- **Operational risk and resilience:** The PRA notes, in particular, that by 31 March firms must have identified and mapped out important business services, set impact tolerances and initiated a programme of scenario testing. It also includes a reminder of the new expectations on outsourcing and third-party risk management in **SS2/21**[1].
- **Financial risks arising from climate change:** The PRA sets out that, although some firms have made good progress in embedding supervisory expectations in **SS3/19**,[2] this is not consistent. The PRA notes the risks in focusing overly on the business opportunities of climate change and reminds firms that climate change presents an increasing risk that is foreseeable and demands action now. The PRA will incorporate supervision of the financial risks presented by climate change into its core supervisory approach.
- **Regulatory change:** This includes the review of Solvency II. It is also noteworthy that the House of Lords Industry and Regulators Select Committee recently **announced** an inquiry into the regulation of the London commercial insurance and reinsurance market. There is a call for evidence, which may be submitted until 11 February 2022.
- **Third country branches seeking authorisation in the UK:** The PRA expects to process around 150 third country branch applications from insurers in the Temporary Permissions Regime in 2022-2023.
- **Diversity and inclusion:** The PRA expects firms to consider the themes set out in **DP2/21**[3] which sets out the PRA's ambition to support resilience by encouraging diversity. The PRA sees a clear link to its objectives as diversity brings a mix of views, perspectives and experience and an inclusive culture reduces groupthink, encourages debate and innovation and supports the safety and soundness of firms.

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Footnotes

1 Outsourcing and third party risk management, March 2021

2 Enhancing banks' and insurers' approaches to managing the financial risks from climate change, April 2019

3 Diversity and inclusion in the financial sector, working together to drive change, July 2021

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"Rule 8.1.1(3) was intended to guide how insurers deal with claims and not to provide third parties with enforceable rights under insurance policies."

CASE LAW

Third party rights against insurers considered in relation to an employment liability policy in *Komives and another v Hick Bedding Ltd* (in administration)

Where an insurer is entitled to avoid a policy by reason of a non-disclosure/misrepresentation, the ICOBS[1] rules cannot be construed so broadly so as to fetter that right of avoidance by reference to a broad range of circumstances, including those of third parties. That said, the Court was clear that the ICOBS rules are a process requirement and regulate how an insurer should set about rejecting a claim. They remain an important consideration.

Background

This case arises from tragic circumstances involving two victims of human trafficking and modern slavery.

The Claimants, Mr Komives and Mr Varhelyi, were sent to work as cheap labour at the First Defendant, Hick Lane Building (HLB), owned by Mohammed Rafiq. As a consequence of their appalling treatment the Claimants both suffered psychiatric injuries. Mr Varhelyi was also injured in an incident involving a fork lift truck that led to a below-knee amputation.

HLB became insolvent so the Claimants turned to HLB's employer's liability policy that was in place at the time of the relevant events. The policy was issued by the Second Defendant, AmTrust Europe Limited (AmTrust).

Issues

Following the Claimants coming forward with details of the modern slavery practices, insurers avoided HLB's policy as a result of a material non-disclosure and misrepresentation relating to its modern slavery practices and trafficking of labour.

In March 2020, Master Davison determined that insurers were entitled to avoid the policy and the Claimants were not entitled to bring a claim pursuant to the Third Parties (Rights against Insurers) Act 1930[2].

The position under the Third Parties Act (both the 1930 Act and the 2010 Act that has replaced it) is that the rights of an insolvent insured under the policy are transferred to a third-party claimant. This transfer puts the claimant in the same position as the insured, and the insurer may rely on the same defences in relation to the policy as it could have done against the insured.

There was no challenge to the Master's finding that insurers were entitled to avoid the policy as against HLB. However, the Claimants appealed on the basis that the Master had incorrectly interpreted Rule 8.1.1(3) of ICOBS which provides that the insurer, must "not unreasonably reject a claim (including by terminating or avoiding a policy)". The Claimants argued that the insurer was required to look in these circumstances, not at the position of the policyholder, but at the workers who were bringing the claim.

Decision

Mrs Justice May DBE rejected the appeal. It was held that Rule 8.1.1(3) was intended to guide how insurers deal with claims and not intended to provide third parties with enforceable rights under insurance policies. The Judge also held that when considering whether a claim had been unreasonably rejected, the focus of this assessment should be on the relationship between an insurer and their insured. Rule 8.1.1 (3) did not require a broader consideration of the rights of third parties.

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Footnotes

1 Insurance Conduct of Business Sourcebook.

2 This Act has now been replaced by the Third Parties (Rights Against Insurers) Act 2010, however the policy and the liability arising under it pre-dated the coming into force of the 2010 Act.

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COVID-19 Business Interruption: Outstanding issues currently under consideration

A year has passed since the Supreme Court handed down its widely reported judgment in the FCA test case on COVID-19 business interruption claims, yet a number of complex questions remain in issue, many of which will come before the English courts in 2022. As always, each case will turn on its own facts, but there are some critical points of principle which are explored briefly below.

Number of triggers

- The Supreme Court found that each case of COVID-19 was a separate occurrence of a notifiable disease. There is now an issue as to whether each occurrence is capable of triggering cover under BI policies containing disease clauses.
- Some policyholders, who typically want to maximise the number of available limits and indemnity periods, are arguing that cover is triggered by each and every case of COVID-19 which occurs within the required radius of insured premises.
- Insurers argue that the cover is triggered, not by the individual cases of COVID-19, but by the single interruption to business caused by the restrictions imposed, which were concurrently but inextricably caused by all cases of COVID-19.
- A similar issue arises in relation to prevention of access and hybrid clauses where there is a question as to whether each update of the applicable restrictions and/or the issue of new restrictions constitutes a fresh trigger.
- There are a number of claims, proceeding in the High Court, which may resolve these issues. This includes the Stonegate matter (due for trial of stage 1 issues in June 2022) as well as others.

Number and Duration of Indemnity Periods

- Cover under a BI policy is typically subject to a temporal (in addition to a financial) limitation on cover. Cover for BI losses ceases when the insured peril ceases to have an effect on the policyholder's business, subject to a maximum period (the maximum indemnity period), which depends on the policyholder's circumstances, but might be 3 months, 12 months or as long as 36 months. Such periods frequently extend beyond the policy period and it is in policyholders' interests to argue for as long an indemnity period as possible, subject to certain nuances in individual cases arising from the date on which cover incepted and terminated.
- Some policyholders have argued that if each case of COVID-19 is a fresh trigger under the applicable insuring clause, then covered events occur as late as the final day of the policy period and the maximum indemnity period runs from that point. Thus, all COVID-19 losses occurring within the period are covered because they were proximately caused by each individual COVID-19 case.
- As explained above, insurers are arguing for a much smaller number of policy triggers, and say that the applicable indemnity period runs from the relevant trigger to the point at which the relevant restrictions cease to have an impact on their business.
- Thus, where disease cover was triggered by (for example) restrictions introduced by the government on 23 March 2020, which were a result of all cases of COVID-19 occurring before that date, the indemnity period would run from 23 March to the point at which the 23 March guidance was reviewed, amended or withdrawn because, from that point forward, losses could not be said to be the result of pre-23 March cases.
- We await hearings in the pending claims which involve these issues, including Stonegate and Various Eateries (which is currently, we understand, at the case management conference stage).

"There is a considerable body of English case law on aggregation issues, but none, unsurprisingly, considers aggregation in the context of a global pandemic."

Aggregation

- There is also a related issue as to how policies should aggregate losses. This will depend on the particular aggregating language in the policy being considered.
- For example, where aggregation wording refers to losses that arise from or are attributable to or in connection with an occurrence, a question arises as to the meaning and operation of occurrence.
  - By analogy to the majority decision in the FCA Test case, some policyholders argue that an *"occurrence"* equates to a single case of COVID-19 (so that the losses generally do not aggregate).
  - Certain insurers, on the other hand, argue that the relevant occurrence is, for example, the outbreak of COVID-19 in China, or the outbreak or spread of the COVID-19 pandemic in the UK, or the governmental response to COVID-19 (so that all or many of the losses would aggregate)
- There is a considerable body of English case law on aggregation issues but none, unsurprisingly, considers aggregation in the context of a global pandemic.
- Again, these issues may be determined in the Stonegate, Various Eateries and other matters.

"Localised" wordings, including "at the premises" wordings

- The Divisional Court held in the FCA test case that non-damage prevention of access wordings, which provide cover in response to an emergency or danger or disturbance in the vicinity of the premises, provide narrow and localised cover, and therefore do not respond to perils occurring across a wider area, such as a pandemic.
- This aspect of the decision was not appealed to the Supreme Court by the FCA.
- Some policyholders contend that the first instance decision is inconsistent with the Supreme Court's findings on concurrent causation (i.e. that every case of COVID-19, including cases occurring in the locale of insured premises, at the relevant time, was an effective proximate cause of the government restrictions) and are seeking to overturn it.
- Policyholders have highlighted the published arbitral award of Lord Mance (formerly Deputy President of the Supreme Court) in *Policyholders v China Taiping Insurance (UK) Co Ltd* , in which Lord Mance referred to the *"disease at premises"* wordings, noting that he considered the Divisional Court would have had a different approach to the wordings if it had had the benefit of the Supreme Court's analysis on causation. It was not necessary for him to decide the point however, and it should be noted that an arbitration decision is not binding on third parties.
- Localised wordings are due to be considered by the High Court, including in Corbin & King (heard at the end of January 2022 and judgment has been reserved) and Smart Medical Clinics Ltd (at the case management conference stage).

Exclusion clauses for specified illnesses including SARS and/or atypical pneumonia

- One insurer, in Smart Medical Clinics has sought to rely on an exclusion, which excludes cover for specified illnesses including SARS and/or atypical pneumonia or any mutant variation thereof.
- Whether the exclusion applies will depend on whether COVID-19 is held to constitute atypical pneumonia, or a mutant variant thereof, as insurers contend.

Furlough/Government support

- A recurring question in many of the cases up for judicial attention, which was not considered in the FCA test case is whether various government support measures, such as furlough payments and reduced VAT rates not passed on to customers can be deducted from claims by insurers.

- In March 2021, the FCA provided updated guidance in relation to the issue of government support generally, but this was effectively limited to saying that each claim should be assessed on a case-by-case basis, considering the nature of the support received, how the policyholder used the support and the terms of the relevant policy.
- However, the FCA also listed a number of insurers that have agreed not to deduct some of the specific government grants and many have inferred them to say that this is the appropriate response.
- No specific guidance is given in relation to furlough.
- The FCA statement predates any judgment on the matter and may not necessarily correspond with how the court interprets the effect of government support on claims.
- This issue is also likely to be decided by the Courts in some of the matters already highlighted above.

Conclusion

It was always inevitable that, despite the wide-ranging nature of the FCA test case, there would be further issues for the court to consider. Whilst the ongoing cases may not receive the same mainstream media attention as the FCA test case, policyholders and insurers alike will await the outcomes with interest.

If you would like any further details in relation to this article or have any queries in relation to business interruption, please do not hesitate to contact one of our team.

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Spire v RSA – Round 4: Court of Appeal considers aggregation wording "one source or original cause"

On 14 January 2022, the Court of Appeal gave judgment on the wording of a clause in a professional indemnity insurance policy which aggregates claims arising from "one source or original cause" (Spire Healthcare Limited v Royal & Sun Alliance Insurance Limited [2022] EWCA Civ 17).

Variations of this wording are found across many different types of insurance and reinsurance policies, and the Court provided a useful summary of the applicable principles, holding that language of this sort aggregates claims on a broad basis.

In so doing, the Court of Appeal unanimously overturned the decision of the Commercial Court, which had applied a more restrictive approach. More information is available **here**.

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