Insurance/ Reinsurance

17 March 2016

INSURANCE BULLETIN





Welcome to HFW's Insurance Bulletin, which is a summary of the key insurance and reinsurance regulatory announcements, market developments, court cases and legislative changes of the week.

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1. Regulation and legislation

Europe: The Insurance Distribution Directive: changes to EU law on insurance intermediaries

The Insurance Distribution Directive (IDD), a key piece of EU legislation in regulating insurance intermediaries, came into force on 22 February 2016. 'Directive (EU) 2016/97 on Insurance Distribution (Recast)' focuses on practices for selling insurance products and in particular seeks to establish a level playing field between participants in insurance sales in order to improve customer protection, strengthen competition and facilitate market integration. The IDD updates the 2002 Insurance Mediation Directive 2002/92/EC (the 2002 Directive), which introduced a framework for regulating EU insurance brokers, agents and other intermediaries.

The IDD has a wide scope of application, applying to all sellers of insurance products (including those that sell directly to customers and price aggregator comparison websites), anyone who assists in the administration and performance of insurance contracts (e.g. claims management activities, Lloyd's managing agents, service companies dealing with customers) and ancillary insurance intermediaries. It applies both to insurance and reinsurance distribution.

The overriding aim of the IDD is to ensure that insurance intermediaries act professionally, honestly, fairly and in the best interests of their clients. Some of its specific provisions include:

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- **Professional development:** employees of insurance intermediaries must complete at least 15 hours of professional training or development per year.
- **Disclosure:** before the conclusion of a contract, intermediaries must disclose to their customers the nature and basis of their remuneration (e.g. fee and commission).
- **Remuneration:** intermediaries must not remunerate or assess the performance of employees in a way which conflicts with their duty to act in the best interests of their clients.
- **Provision of information:** intermediaries must provide certain information to their customers (e.g. product information document, which summarises the main features of the proposed contract).

The IDD is not 'directly applicable'. As is the case with all EU directives, this means that it must be implemented into domestic law by each EU Member State. The deadline for domestic implementation is 22 February 2018, at which point the 2002 Directive will be repealed.

Generally speaking, if the UK leaves the EU, it would of course no longer be required to implement EU directives after it ceases to be an EU member state. However, in the event of a vote for Brexit, the UK is unlikely to leave the EU until after 22 February 2018, meaning that it would in theory still be under an obligation to implement the IDD into UK law. The 2002 Directive would continue to apply to the UK through domestic implementing legislation unless it is specifically repealed.

In the UK, the 2002 Directive was implemented into UK law through the Financial Services and Markets Act 2000 (Financial Promotion) (Amendment) Order 2003. This statutory instrument was subsequently replaced by the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005/1529, which does not specifically refer to the 2002 Directive and does not depend on the 2002 Directive being in force at EU level. This


means that if the UK votes for Brexit but does not implement the IDD or repeal the implementing legislation for the 2002 Directive, the 2002 Directive will continue to apply in the UK after 2018 when it has been repealed at EU level. This is likely to be one of the many issues to be decided in the event of a vote for Brexit and an example of the complexities that a vote for Brexit could create.

Assuming that the IDD is implemented into UK law, anyone involved in selling insurance products should take note of the new IDD. In particular, (re) insurers should be aware that the IDD widens the scope of EU regulation by replacing "mediation" with "distribution" to reflect the fact that (re)insurance distribution is carried out by (re) insurers themselves as well as brokers and other intermediaries. In the UK, we expect that the practical effect of this change will be minimal: the UK "gold-plated" the 2002 Directive when implementing it, so the current UK rules and regulations on mediation already catch (re)insurers. However, (re)insurers and intermediaries should review their internal business protocols to ensure that they are compliant with the new requirements.

The IDD is available here[1].

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2. Court cases and arbitration

England and Wales: Insurers' liability for claimants' costs of claims made against insureds: *Legg v Sterte Garage Ltd*[1]

In this case the Court of Appeal held that a judge had been entitled to make a non-party costs under s.51(3) of the Senior Courts Act 1981 against insurers which had (so the court held) determined that a case would be fought by their insured against a third party, exclusively to defend the Insurers' own interests.

The substantive proceedings in this case related to the contamination of certain residential properties caused by diesel oil escaping from an adjacent garage. As originally pleaded, the claim was that the contamination was the result of a spillage from an above-ground tank. If made out, liability for such a claim would have been within the cover under the insured's liability policy with the insurers, which excluded liability for losses caused by pollution or contamination *"other than caused by a sudden identifiable unintended and unexpected incident which occurs in its entirety at a specific time and place during a period of insurance."* On this basis, insurers, despite denying that the contamination was in fact caused by the above-ground spillage, nonetheless appointed solicitors to defend the claim on behalf of the insured.

Having obtained an expert report on the cause of the contamination, the claimants subsequently amended their case to include an alternative plea that the contamination had been caused by the gradual escape of diesel oil from underground tanks on the Insured's property. Liability for such a claim was, in view of the exclusion described above, not within the scope of the Insured's policy with the Insurers. The original claim based on a sudden spillage from an overground tank remained intact.

Shortly after service of the amended claim, the Claimants' solicitors were informed that insurers had *"confirmed that the policy of insurance does not respond to the claims"* and that the solicitors appointed by insurers were no longer instructed to act on behalf of the insured.

The defence of the claims was abandoned by the insured, damages were assessed and judgment was entered for a total sum of £191,654, with the insured being ordered to pay all of the claimants' costs. In the meantime, the insured had gone into creditors' voluntary winding-up.

The insurers were subsequently ordered to pay the claimants' costs both in exercise of the court's discretion to order costs to be paid by a non-party pursuant to s.51(3) of the Senior Courts Act 1981, and under the Third Party (Rights Against Insurers) Act 1930.

In considering an appeal by the Insurers against this order, the Court of Appeal noted that, as per *TGA Chapman Ltd v Christopher*[2], the following features justified the "exceptional course" of making a costs order against insurers:

- The insurers determined that the claim would be fought.
- The insurers funded the defence of the claim.

1 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=EN

1 [2016] EWCA Civ 97
2 [1998] 1 WLR 12

- The insurers had the conduct of the litigation.
- The insurers fought the claim exclusively to defend their own interests.
- The defence failed in its entirety.

The Court of Appeal determined that the crucial question in this case was whether the insurers were acting *"exclusively or predominantly in their own interests"* in defending the claims. The Court of Appeal held that they were so acting because as the insurers knew from the start, the Insured would be unable to meet any award of damages if it was not covered under the policy. The purpose of the insurers in defending the claim was therefore not to protect the insured. The only reason for the conduct of the defence and the Insurers' only interest in it was to avoid a claim falling within the cover provided by the policy. In addition:

- Had the claimants abandoned their claim based upon the spillage from an above-ground tank, the insurers would have had a good argument that they had in substance funded the successful defence of such a claim. However, the claimants had not abandoned that claim.
- There was no foundation in the evidence for the Insurers' suggestion that, if they had not funded the defence, the insured would have done so.
- The insurers' suggestion that the judge should have determined the issue of fact as to whether the contamination was caused by the above-ground tank spillage was wholly unrealistic, there being insufficient evidence upon which this issue could have been determined.

Insurers were therefore unable to demonstrate that the judge's exercise of his discretion was flawed in any way. On the contrary, there was ample material to justify the order made.

The Court of Appeal also held that, on a construction of the policy, liability for the claimants' costs was within the cover, meaning that the claim against the insurers under the Third Party (Rights Against Insurers) Act 1930 (which gives a third party certain rights to claim directly against an insurer in circumstances in which the insured is insolvent) also succeeded.

The case is an important reminder to insurers of their potential exposure to third party costs orders in circumstances in which they determine that claims made by third parties should be defended. As the reasoning described above illustrates, a crucial factor will be whether or not the decision to defend the claim has been taken purely in the insurers' own interests. This potential exposure is accordingly one of the factors that insurers must have in mind in deciding whether or not to defend a claim on behalf of an insured. The case suggests that an important factor may be the question of whether or not the insurers are protecting the insured from any exposure, or are simply acting to prevent a claim under their policy.

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3. HFW publications and events

HFW sponsors Multaqa Qatar reception

HFW Partners Sam Wakerley, Costas Frangeskides and Wissam Hachem, and Consultant Carol-Ann Burton attended Multaqa Qatar from Sunday 13 to Tuesday 15 March 2016. Multaqa Qatar is the MENA region's leading risk and insurance forum and is designed to provide senior executives with a platform from which they can do business. HFW sponsored the reception for this year's event.

HFW hosts Insurance/Reinsurance Conference in association with the British Consulate in São Paulo

On 16 March 2016, HFW Partners Chris Cardona, Geoffrey Conlin and Paul Wordley hosted an Insurance/Reinsurance Conference in São Paulo in association with the British Consulate. Chris chaired a panel on D&O, Geoffrey chaired a panel on Claims in Brazil and Paul chaired a panel on Global Insurance and Reinsurance programmes.

Brexit: a competition law perspective

The March 2016 edition of HFW's Competition Bulletin[1] considers Brexit and the ramifications of a "leave" vote from a competition law perspective. The article explains how the competition regimes in the UK and EU currently overlap and what the potential alternative arrangements are if Brexit does occur.

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1 http://www.hfw.com/Competition-Bulletin-March-2016#page_0

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