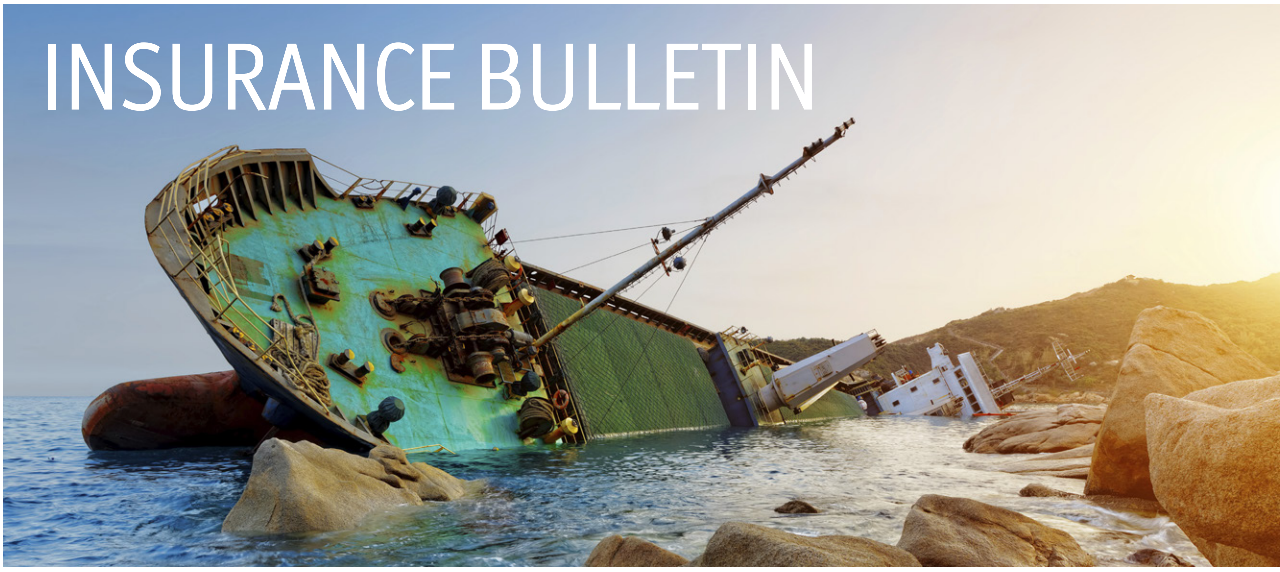
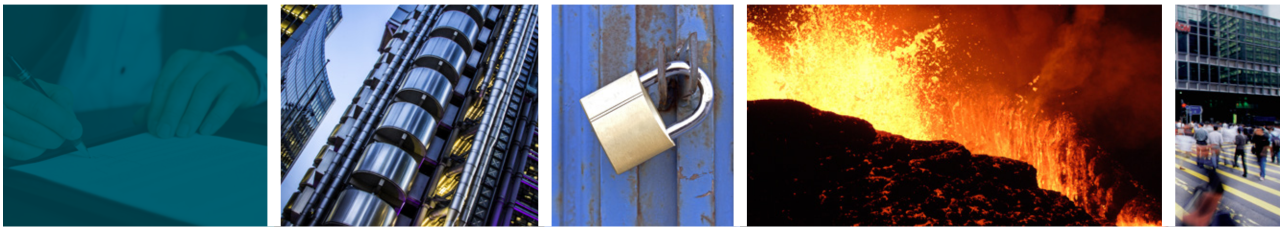
Insurance/ Reinsurance

13 May 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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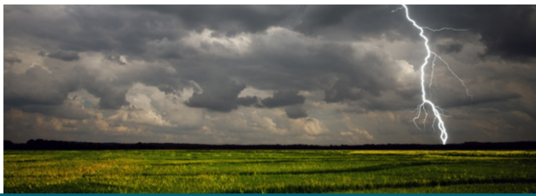
2nd MIDDLE EAST INSURANCE INDUSTRY AWARDS 2015
LAW FIRM OF THE YEAR

holman fenwick willan hfw



1. Regulation and legislation

UK: Enterprise Act – new law on late payment of claims to come into force next Spring

On 4 May 2016 the Enterprise Act 2016 received Royal Assent.

Sections 28 to 30 of the Act, which relate to damages for the late payment of insurance claims, will come into force on 5 May 2017. From that date, insurers will face potential liability in damages if claims are not paid within a "reasonable time", determined by taking into account the type of insurance, the size and complexity of the claim, compliance with relevant statutory or regulatory rules or guidance and whether there were factors outside the insurer's control.

The Enterprise Act applies to reinsurance as well as insurance. For further details, see our 22 October 2015[1] and 20 November 2015[2] bulletins.

For more information, please contact Ben Atkinson, Senior Associate, London, on +44 (0)20 7264 8238, or ben.atkinson@hfw.com, or your usual contact at HFW.

UK: PRA consultation on internal models

The PRA has published a consultation paper on proposed changes to the internal models used by UK insurance firms.

Under Solvency II, the PRA may approve applications to use an internal model to calculate the Solvency Capital and an internal model change policy.

1 http://www.hfw.com/Insurance-Bulletin-22-October-2015

2 http://www.hfw.com/Insurance-Bulletin-20-November-2015

The consultation is relevant to insurance firms with an internal model approval under Solvency II. It may also be of interest to UK insurance firms seeking approval to use an internal model in the future and also to UK subsidiaries of EEA or non-EEA groups.

BEN ATKINSON, SENIOR ASSOCIATE

Under Regulation 48 of the Solvency II Regulations 2015 (2015/575) firms may apply to the PRA for supervisory approval of a major change to an internal model, as specified in the firm's approved internal model change policy, or for changes to the internal model change policy itself.

The inclusion of new elements in the internal model, such as additional business units or risks not included in the scope of the internal model, are subject to supervisory approval as laid down in Article 112 of the Solvency II Directive.

In its paper (which is designated CP19/16), the PRA proposes a draft supervisory statement setting out its expectations on firms and the Society of Lloyd's in relation to changes to internal models and extensions to the scope of internal models that have been approved under Solvency II.

In particular, the draft supervisory statement sets out the PRA's expectations regarding:

1. Firms and the Society of Lloyd's for the period before and during an internal model change application.
2. The quality of firms' model change applications.
3. The information which the PRA expects to be provided with in a model change application.

The PRA is consulting on the draft supervisory statement to allow firms the opportunity to provide feedback and highlight any issues of concern.

The consultation is relevant to insurance firms with an internal model approval under Solvency II. It may also be of interest to UK insurance firms seeking approval to use an internal model in the future and also to UK subsidiaries of EEA or non-EEA groups.

The consultation is open until Friday 5 August 2016. A copy of the consultation paper can be found here: http://www.bankofengland.co.uk/pra/Documents/publications/cp/2016/cp1916.pdf.

For more information, please contact Ben Atkinson, Senior Associate, London, on +44 (0)20 7264 8238, or ben.atkinson@hfw.com, or your usual contact at HFW.

UK: Third Parties (Rights against Insurers) Act 2010 finally comes into force on 1 August 2016

On 28 April 2016, the Third Parties (Rights against Insurers) Act 2010 (Commencement) Order 2016 was made. It provides for the Third Parties (Rights against Insurers) Act 2010 (the New Act) to come into force on 1 August 2016.

The New Act is a long-anticipated modernisation of the regime in the Third Parties (Rights against Insurers) Act 1930 (the 1930 Act). It is designed to simplify the requirements for bringing claims in circumstances where an insured defendant is insolvent, and to reduce expense on both sides. The five year delay in the New Act coming into force was caused by the need to clarify certain definitions relating to insolvency in specific sectors. This has now been rectified by the Third Parties (Rights against Insurers) Regulations 2016.

Under the 1930 Act a party had to establish liability against the insolvent insured before pursuing its insurer. Under the New Act the insurer can be brought into proceedings from the outset due to a statutory transfer of the right to the benefit of a liability policy.

From a practical perspective, perhaps the most important change that insurers should be ready for is that they will be required to provide detailed information about policy coverage to a claimant at the pre-proceedings stage, and within 28 days of a request being made. If they fail to comply, the claimant can apply to Court and the insurer is likely to have a costs order made against it. The idea behind this requirement is that claimants should be able to find out at an early stage whether the insurance policy would indeed have responded to the claim in question, preventing them from pursuing unsustainable claims. However it is likely to create an increased administrative burden for insurers.

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The New Act also limits insurers' defences vis à vis the third party claimant in that (i) pay-first clauses will no longer be valid (except in non personal-injury marine claims) (ii) the claimant will be able to step into the insured's shoes to fulfil policy conditions; and (iii) failure by the insured to provide assistance in defending the claim will no longer be grounds for declining cover if the Insured is a dissolved company.

The 1930 Act will still apply in situations where the insured became insolvent **and** the event giving rise to the liability happened before 1 August 2016.

More information on the Act can be found in our articles of 25 February 2016[1] and 10 March 2016[2]

For more information, please contact Davinia Collins, Associate, London, on +44 (0)20 7264 8276, or davinia.collins@hfw.com, or Ashleigh Williamson, Professional Support Lawyer, London on +44 (0)20 7264 8311, or ashleigh.williamson@hfw.com, or your usual contact at HFW.

1 http://www.hfw.com/Insurance-Bulletin-25-February-2016#page_2

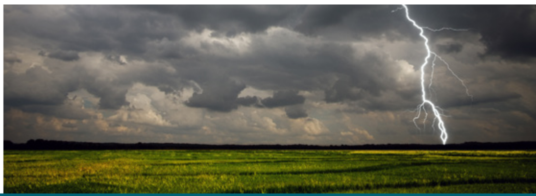
2 http://www.hfw.com/Insurance-Bulletin-10-March-2016

2. Market developments

UK: Choppy seas or calm waters? UK marine insurance in 2016

Marine insurance began in London in the 17th century and the UK's leading position in the sector continues to this day. Indeed, recent research commissioned by the City of London Corporation found that London marine insurers receive 35% of worldwide marine insurance premium income. The UK ranked in the top 10 of global ship owning countries as of last year and accounted for just over 48 million deadweight tons. Key global maritime institutions such as the International Maritime Organization (IMO) and Baltic Exchange are headquartered in London. The maritime sector as a whole contributes an estimated £10 billion to the UK economy, and employs 240,000 people. Alongside marine insurance, the maritime sector is supported in the UK through high quality offerings in related areas such as shipping finance and shipbroking. Yet despite these encouraging statistics, the UK marine insurance sector faces a variety of challenges that must be overcome for it to maintain this leading position:

- The growing number of marine insurance carriers has made the marketplace very competitive. Marine insurance premiums continue to show evidence of downward pressure. Speculation that the August 2015 Tianjin disaster would result in increased premium rates has apparently proven unfounded. Although the explosion caused the death of 173 people and losses of around US$3.3 billion, the excess of market capacity helped to absorb



these losses with minimal effect on premium rates. Indeed, a recent report by Willis predicted that premiums are actually set to fall by up to 10% in 2016.

- 'Brexit' could severely harm the UK marine insurance sector, given that 40% of shipping traffic passing through terminals in the UK is with EU countries. A vote for 'Brexit' could mean many years of disruption as new trade agreements are negotiated and prepared. Moreover, currency volatility could lead to much higher costs, just at a time when the marine insurance industry is fighting against a global downturn exacerbated by an excess of vessels for charter and the Chinese economic slowdown. John Nelson, Chairman of Lloyd's of London, has said that it would be *"fantasy"* to expect the trade negotiations to be simple, and predicted they would take *"many, many years"*. There are also concerns that 'Brexit' would discourage foreign companies from investing in the UK. Niels Smedegaard, President and Chief Executive Officer of Danish shipping company DFDS commented *"We are concerned that Brexit will bring about a prolonged period of uncertainty which could in itself be negative for investments, trade and growth"*. Finally, there are also implications for (re)insurers who have passported into or out of the UK.

- The UK must remain outward-looking and be ready to seize global opportunities when they arise. Between 80% and 85% of the revenues earned by UK companies in the shipping sector originate from outside the UK. Two countries with particularly large potential for the marine insurance sector are Brazil and Iran. Many global insurers are currently expanding to Brazil as local demand for insurance continues to grow. UN sanctions against Iran, which included restrictions on insurance and shipping, were lifted on 16 January 2016, and Iran will therefore have an increasing need to obtain international insurance cover.

The UK is not resting on its laurels and is actively considering how best to maintain its position as the leading global maritime hub.

- The legal environment for insurers in England and Wales is challenging and uncertain with the introduction of the Third Parties (Rights Against Insurers) Act 2010 on 1 August 2016 and the Insurance Act 2015 on 12 August 2016. The Insurance Act 2015 represents the biggest reform to insurance contract law in more than a century. It is generally accepted that overall, the changes will benefit insureds more than insurers. This Act makes important changes such as varying the insured's duty of utmost good faith to a general duty of fair presentation, treating warranties as suspensive conditions and introducing proportionate remedies to insurers. The Third Parties (Rights Against Insurers) Act 2010 will finally come into force on 1 August 2016. This Act will help claimants pursue insurers directly when a defendant insured has become insolvent.

- Losses, although relatively infrequent at the moment, could potentially become larger, more complex and more expensive when they do occur. Deepwater Horizon (2010), Costa Concordia (2012) and Tianjin (2015) are examples. As the volume of international trade continues to increase, vessels carry more cargo, presenting the potential for a large, catastrophic loss. Shipping operators are starting to look more closely at the Arctic for new trade and tourist routes. A total loss in this region could be particularly disastrous, considering the lack of infrastructure or services there.

- Cyber threats are a repeatedly discussed topic in the insurance sector. Marine operators and insurers must brace themselves for ever more sophisticated cyber attacks, including contingency planning for attacks where hackers take control of systems that control navigation, handle cargo and track containers at ports. Vessels are constantly becoming larger and more technologically equipped, increasing the potential for a cyber disaster.

One notable response from the insurance sector to these challenging conditions has been large-scale mergers and acquisitions, which can benefit insurers by offering advantages such as increased global reach, economies of scale and more leverage when purchasing reinsurance. Global marine insurer XL Group acquired Catlin Group which was renamed XL Catlin in 2015. Then, earlier this year, ACE Group acquired Chubb, and is now operating under the name Chubb. Japanese insurers were involved in two notable transactions in 2015: Mitsui Sumitomo's purchase of UK insurer Amlin for £3.47 billion, and Tokio Marine Holdings' takeover of US based HCC for US$7.5 billion. Challenges created by these consolidations include merging two potentially different corporate cultures and


retaining the best marine underwriters and claims specialists, who are in very high demand.

The UK is not resting on its laurels and is actively considering how best to maintain its position as the leading global maritime hub. The UK Government launched its 'Maritime Growth Study' last year which, together with industry representatives, considered the opportunities and challenges that the UK faces in maintaining its preeminent position. The Study focuses on areas where action could be taken to generate growth, and it has led to the publication of a report which identified that for the UK to stay in its current prominent position, it needs to engage more closely with emerging industry issues such as cyber security, international piracy and new trade routes.

The UK Government's full 'Maritime Growth Study' report, *Keeping the UK competitive in a global market*, contains 18 recommendations and is available here[1]. For more information on the Insurance Act 2015, please see HFW's previous briefings here[2] and here[3]. For more information on the Third Parties (Rights Against Insurers) Act 2010, please see HFW's previous briefings here[4] and here[5].

For more information, please contact Simon Banner, Associate, London, on +44 (0)20 72648289, or simon.banner@hfw.com, or your usual contact at HFW.

1 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/460861/maritime-growth-study-keeping-UK-competitive.pdf

2 http://www.hfw.com/The-UK-Insurance-Act-2015-June-2015

3 http://www.hfw.com/Insurance-Bulletin-22-April-2016#page_1

4 http://www.hfw.com/Insurance-Bulletin-25-February-2016#page_2

5 http://www.hfw.com/Insurance-Bulletin-10-March-2016#page_3

hfw 3. Court cases and arbitration

Australia: Insured or not insured? *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)*

In the recent case of *Todd v Alterra at Lloyds Ltd (on behalf of the underwriting members of Syndicate 1400)*[1] the Full Federal Court of Australia considered the construction of an insuring clause in a professional indemnity policy.

The case involved an appeal from a decision of the Federal Court which held that a financial services errors and omissions insurance policy did not respond to cover losses suffered by the clients of a financial advisor. The issue was whether, on proper interpretation and construction, the policy responded to the claim.

Decision

The Full Federal Court was required to consider the definition and construction of the following two phrases:

1. What is an "approved investment product".
2. What is the meaning of "encompassing" in the context of "financial planning".

The Full Federal Court held that the primary judge erred in applying a narrow construction to the phrase "approved investment product" to mean only investments contained in an Approved Product List disclosed by the insured to the insurer. The Full Federal Court considered that the phrase was to be given its natural meaning, as a reasonable person would have understood it, meaning products that were approved by the licensee from time to time.

1 [2016] FCAFC 15

The Full Federal Court then considered whether the phrase "financial planning" contained in the definition of professional services was limited by the provision of services "encompassing advice on approved investment products". The Full Federal Court held that the term "encompassing" meant "including" so that the insuring clause covered all aspects of financial planning, as long as the financial planning included advice on approved investment products.

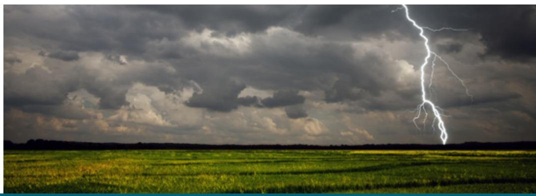
Accordingly, the Full Federal Court found that:

1. The insuring clause was triggered by the insured giving negligent investment advice resulting in a claim for losses suffered by its clients.
2. The insurer was required to indemnify the insured in respect of the claim.
3. A contract of insurance is not a contract of guarantee or indemnity, and the ambiguity as to the scope of cover will not be interpreted narrowly in favour of the insurer.

Discussion

Australian Courts adopt a number of different approaches when interpreting and construing the meaning of words and phrases in different clauses and contracts.

In ordinary commercial contracts, the Courts will adopt a process of interpretation and construction based on the objective view of a reasonable person, having regard to the context in which the contracting parties entered into the agreement. In circumstances where there is ambiguity, the Courts will apply the *contra proferentem* rule which requires the preferred meaning to be one that reads against the party who proposed or drafted the clause or contract.



In contracts of guarantee or indemnity, however, the Courts have accepted that any ambiguity should be construed narrowly in favour of the guarantor or the party providing the indemnity.

The decision in Todd confirms that the Courts' approach to interpreting and construing contracts of insurance will differ from the approaches used for ordinary commercial contracts or contracts of guarantee or indemnity. While contracts of insurance are often mistaken for contracts of indemnity or guarantee (as both provide indemnity from one party to another) provisions of contracts of insurance are often mandated by statute and are subject to principles of utmost good faith.

However, parties are free to agree what is covered under a contract of insurance and, in particular, the insuring clause which determines the initial ambit of cover, to which the normal rules of construction will ordinarily apply in the event of a dispute as to the intention of the parties.

It is important to carefully consider the intention of the parties and the proposed scope of cover when entering into contracts of insurance. While the application of insuring clauses will generally be construed in favour of an insured, the Courts may find that a claim falls outside the scope of cover in the absence of any ambiguity or statutory interpretation requirements.

For more information, please contact Phil Kusiak, Senior Associate, Melbourne, on +61 (0)3 8601 4509, or phil.kusiak@hfw.com, or your usual contact at HFW.

4. HFW publications and events

HFW Partners attend Property Insurance Claims Group Seminar

HFW Partners Andrew Bandurka and Jonathan Bruce attended the Property Insurance Claims Group Seminar at the Royal Geographical Society on Wednesday 11 May.