**The Professional Indemnity Insurance Policy and the Insurance Act 2015**

**Introduction**

To begin with some basics, The Insurance Act 2015 (“the Insurance Act”) will come into force on 12 August 2016. Statutes which relate directly to insurance (as opposed to Directives/Statutory Instruments and tax changes) are rare beasts which come in at intervals of several decades often after a long gestation. It is tempting to see them as revolutionary events and it is an easy trick to present them as such in talks such as this.

The Insurance Act will introduce some very significant changes in the law and does so in part by direct amendment of the Marine Insurance Act 1906, superseding the common law that has developed during the 110 years subsequently and includes also amendment of the Third Parties (Rights Against Insurers Act) 2010 – which is itself an update of the original dating back to 1930.

The Insurance Act is also part of a wider reform of Insurance Law which includes the Consumer Insurance (Disclosure and Representations) Act 2012.

The French are somewhat more used to revolutions than we are and they are more inclined to give them a Gallic shrug as even at the point of upheaval continuity may be stronger than change. They have a phrase for it:

“*Plus ça change, plus c’est la même chose*.”

A bit like: “*The king is dead, long live the king*!”

The purpose of this brief talk is to indicate what the Insurance Act means for professional indemnity wordings. Is it all change or will things just stay the same?

**What is New?**

There are six major changes being:

1. A Duty of Fair Presentation(section 3);
2. Qualified Remedies for Breach of Condition (section 11);
3. Restrictions on Insurers reliance on Warranties **(**sections 9 and 10)**;**
4. Fraudulent Claims(section 12 and 13);
5. Contracting Out(sections 15 – 18); and
6. Third Party (Rights Against Insurers) provisions (sections 19).

**What Stays the Same?**

There are some things which the Insurance Act does not touch:

1. The Cover;
2. TheLimits and the Excess;
3. The Exclusions; and
4. The Premium.

Accordingly all the main Insurance Act action is within the Conditions and with what now will be the duty of fair presentation.

**Professional Indemnity Insurance.**

It is a specialised class of liability insurance written on a claims made basis. It is not consumer insurance but there is huge variety in the nature of the businesses which have a requirement for this type of cover.

Some Insureds are large sophisticated businesses, others are one-man bands.

For some Insureds their professional risks are coextensive with their business, for others it is one of several risks of the business and not necessarily the dominant one.

Some Insureds are members of powerful professional organisations, others are not.

The consequence of this is that professional indemnity insureds have historically been exposed to the rigour of the unreformed law of insurance and they have enjoyed unequal means of protecting themselves from falling foul of the penalties which struck the innocent and guilty in almost equal measure. In particular, it is not an exaggeration to say livelihoods were threatened by:

The Basis Clause;

Breach of Warranty;

Misrepresentation and Non-Disclosure;

Breach of the Duty of Utmost Good Faith; and

Breach of Conditions Precedent to Liability.

These matters can lead to there being no policy (avoidance) or no indemnity. Perhaps the most difficult aspect of this from the point of view of Insureds was the difficulty in making assessment of what the requirements might be. Examples would

include: determination of what would be material to an underwriter; and determining what must be notified in respect of claims and circumstances.

The imbalance inherent in these kinds of provision resulted in a reaction which safeguarded Insured’s interests by recourse to:

The Law, for instance, *contra preferentum*;

Innocent Non-Disclosure Clauses;

Minimum Terms; and

Commercial Reality.

In a way, this is a war which the Insured side of the argument substantially won, but not without a few casualties. Twenty-five years ago, the insurance market was engaged in a fratricidal conflict every bit as damaging to the industry as the sub-prime crisis was to finance. In retrospect, this was the last swansong of the Marine Insurance Act. Professional indemnity was only at the margins of this civil war, but the weapons which the insurance industry turned on themselves influenced the whole legal environment of insurance law which would affect ordinary Insured’s too.

As this conflict receded the unreformed law was increasingly hard to apply. The main reason was undoubtedly commercial reality. Claims managers remembered that a purpose of insurance was to pay claims. The Insurance Act has been some time in gestation but everybody is apparently happy to celebrate its coming. This will be particularly the case in professional indemnity where its effect will not be to overturn all that we are accustomed to but rather to provide a set of rules which will confirm the evolutions of recent years.

**Adapting to the New Regime**

Although I argue that the professional indemnity market is to a degree pre-adapted to the new realities of the Insurance Act it is not completely so. Brokers’ clients will have to be schooled in their new duty of fair presentation but since it is, if anything, diminished from what now exists this should not present any excessive difficulty.

The question, I would like to focus on is what impact the Insurance Act will have on professional indemnity wordings? One possible answer is not much. The Insurance Act changes the general law and policies will have to be construed in accordance with that law.

Any existing form of wording which is carried on into the future un-amended and issued for new contracts will simply be interpreted by reference to the new law.

Terms which are inconsistent with the Insurance Act will be of no effect if disadvantageous to the Insured (applying section 16).

The problem with carrying on as before is therefore that there is a good chance existing wordings will have conditions which cannot be put into effect the way they were intended and so they will not reflect the reality of the bargain as it would be applied by the Courts should there be a dispute.

**Getting Around it – Contracting Out** (sections 16 and 17)

Some things cannot be evaded, to be specific:

The basis clause provisions; and

The abolition of any legal provision to avoid a contract for the non-compliance with the duty of utmost good faith. This is so abolished that they have deleted the relevant provisions in section 17 of the Marine Insurance Act.

Even for non-consumer contracts contracting out of Parts 2, 3 and 4 of the Act (Duty of Fair Presentation, Warranties and Other Terms, and Fraudulent Claims) is only possible (section 16) if the transparency requirements (section 17) are satisfied.

The transparency requirements are difficult to comply with in that the Insurer has to establish what is sufficient steps to draw the disadvantageous terms to the Insured’s attention prior to the contract being entered (17(2)), but they must be clear and ambiguous (17(3)) and then the characteristics of the insured persons must be taken into account (17(4)).

Achieving the transparency requirement is not impossible, but what is the likely appetite for contracting out going to be in a market where policy wordings will normally be standard and the commercial pressure is presently all the other way towards generous terms of cover? If contracting out happens at all it will be in respect of foreign policies where a different choice of law may apply in any event, or with bespoke policies in which everything is negotiable.

**Amending the Policies**

Once it is recognised that continuing with old wordings may be less than ideal and that contracting out will not be normal in professional indemnity what are the changes which the actual wordings might require?

**Omitting or Replacing the Basis Clause**

Section 9(2) of the Insurance Act does away with basis clauses that convert statements in proposals into warranties.

Accordingly, policies drafted for application from August 2016 shall not have basis clauses and any such will be ineffective. This cannot be evaded by contracting out either (Section 16(1)).

Associated with the basis clause was often a recital which incorporated the proposal into the contract and referred to the premium as the consideration for the contract and the indemnity provided. There are aspects of this which Underwriters might want to continue though they cannot do so relying on the representations in the proposal as warranties.

Often the proposal has been used in reference to the definition of the Professional Business or Services which are covered. Alternatively, the proposal might disclose a number of subsidiary businesses which would feed into the definition of the Insured for the purposes of the policy. When there is an omission so that some of the Insured’s Services are not disclosed or a subsidiary provider of the Insured’s business is not disclosed then it might be asked; is that a misrepresentation or non-disclosure, in which case the duty of fair presentation is in question; or is it simply that the losses occurring in those undisclosed parts of the business are not covered, just as they might be excluded had the Insurer been aware of them? Whatever the answer it is clear that we are no longer considering a basis clause where the misrepresentation or non-disclosure could be grounds for avoidance.

**Enforcing the Duty of Fair Presentation**

Sections 2 – 7 of the Insurance Act provide the new code which replaces the old duty of disclosure.

It is not going to be necessary to put all of these six sections in the wording of a policy though reference to the duty of fair presentation may be beneficial. If you refer to it then you may want to define what you are talking about.

One point on which reference to the duty might be made would be in respect of the remedies for breach of the duty of fair presentation. These are set out in section 8 of the Insurance Act.

There is an argument for directly including the section 8 remedies in the wording. They are a reminder that although the law has evolved so that its teeth are not so sharp, they still have some bite.

Reckless and deliberate breaches of the duty of fair presentation give the Insurer the power to avoid the contract with no return of premium. That sounds familiar, but this does not catch (as the old law did) innocent and merely negligence breaches.

For the non-reckless and non-deliberate breach the remedies depend on the Insurer proving:

1. They would not have entered the contract at all in which case avoid and return the premium;

2. They would have entered the contract on different terms in which case apply those terms;

3. They would have entered the contract with a higher premium in which case the Insurer may proportionately reduce any claim payment.

**Is the Innocent Non-Disclosure Clause still necessary?**

As we have noted, the Insurance Act does not deprive the Insurer of all their teeth. It is still possible for the Policy to be avoided for an innocent breach of the duty of fair presentation if the Insurer can show they would not have entered into the policy with the correct information. From the point of view of the Insured there is still reason for the Innocent Non-Disclosure if you can get it. Such a clause is not disadvantageous to the Insured so it will not fall foul of the contracting out restrictions.

It should be stressed that there is no single form to INDCs. They are usually composite clauses which provide relief from the application of the general law in more than one situation. Each sub-clause should be checked separately to ensure that it is not setting up conflicting requirements when compared to the remedies provided for by the Insurance Act.

For example a common INDC provision is for Insurers to agree not to avoid in cases of non-disclosure or misrepresentation where the Insurer can be satisfied that the non-disclosure or misrepresentation was free of fraudulent conduct or intent to deceive. The relationship of such a provision with the Section 8 remedies for breach of the duty of fair presentation is potentially a little complex as the Section 8 remedies are related to a different test of reckless and deliberate breaches. However, this is not actually an incompatibility and it would increase the categories of infraction for which avoidance is not allowed. For example, it appears the

Accountants Minimum Terms will present exactly this situation where a breach of the duty of fair presentation will be excused if Insurers (!) cannot establish that the breach resulted from fraudulent conduct or intent to deceive.

Other INDC provisions relate to relief from breach of conditions or even bring cover for claims which might be excluded. The Insurance Act is still concerned with the former but not the later.

**Breach of Conditions and Prejudice**

The Insurance Act does not eliminate the rights Insurers may have to reduce indemnity for breach of condition or to refuse to provide indemnity at all where the condition is precedent to liability or the right to be indemnified.

However, it does limit these rights and demands a link between the breach and the loss. This is made clear in section 11 (Terms not relevant to the actual loss). This might be considered to be a new definition of prejudice – a term which sometimes appeared in professional indemnity conditions often without definition.

The section 11 provisions relate to terms which (not including terms defining the risk as a whole) would,

 “…tend to reduce the risk of one or more of the following –

1. Loss of a particular kind,
2. Loss at a particular location,
3. Loss at a particular time.”

Should such terms be breached and a loss occurs then the Insurer can exclude, limit or discharge their liability (section 11(2)) but only if the Insured “shows that the non-compliance with the term could not have increased the risk of the loss that actually occurred in the circumstances in which it occurred” (section 11(3)).

It would seem that a Policy which simply asserts Insurers’ rights to limit or discharge their liability for breach of condition (and many current Policies do this) will not be fully reflecting the law as it will shortly be. It would be an improvement to make reference to the qualification of prejudice which the Insurance Act introduces because this will be a necessary consideration each time any such condition is invoked.

A question which is presently not easy to answer is how much scope the Insurance Act’s notion of prejudice will have on professional indemnity covers. The conditions an Insured might be most likely to breach are those relating to notification,

cooperation, and non-admission. If a “loss” can be equated to a liability such as you might get as a result of a default judgement or an unauthorised settlement then it would seem the conditions do tend to reduce the risk. However, if the intention is the loss relates to something else such as the original negligent acts then this type of prejudice will be hard to relate to typical professional indemnity conditions.

**Minimum Terms**

Specific considerations must apply to the wordings of Policies which are required to be compliant with Minimum Terms. That depends on the degree to which they are advantageous.

It is hard to think the Insurance Act has anything to offer to the Solicitors Minimum Terms in terms of making it more favourable to the Insured. But the consultation of the SRA has envisaged changes to the provisions for reimbursement from Insureds who committed or condoned (knowingly or recklessly) breaches of the duty to make a fair presentation of the risk, misrepresentation, breach of conditions, or fraudulent or dishonest acts. This does not reduce consumer protection but might be regarded as a small chink of light for Insurers.

The professional bodies are looking at their wordings and considering changes – as they regularly do. The next version of the accountants wording looks (from drafts seen) that it will have relatively modest amendments which can be tracked to the Insurance Act. It never had a basis clause so there is none to delete. The other recitals relating to the proposal and the premium will still be there. There are a few changes to the clauses relating to breach of condition and those relating to fraudulent claims of the type I am outlining here. They will keep their Innocent Non-Disclosure modified by reference to the duty of fair presentation. They will not specifically refer to warranties.

**Warranties**

A lot of the wider interest in the changes in the Insurance Act stems from the provisions relating to warranties. I am not convinced this will have a huge impact on professional indemnity because warranties are not a prominent feature of the formation or performance of the contract after the basis clause is ruled out.

In case there are warranties which do not fall foul of section 9(2), the policy could in short form confirm the provisions for breach of warranty as set out in section 10.

The Insurer can only rely on a warranty to refuse liability for a loss occurring, or attributable something happening, prior to the breach of warranty being remedied (section 10(2)).

The Insurer cannot rely on a breach of warranty if the warranty is no longer applicable to the circumstances of the policy, because of a change in circumstances, or if unlawful or if the Insurer waives the breach (section 10(3)).

The Insurer is liable for losses occurring, or attributable to something happening, before the breach or after the Insured is no longer in breach or if the risk is essentially the same as that originally contemplated (section 10(4) and 10(5)).

 **Fraudulent Claims**

There is usually a condition in professional indemnity Policies relating to dishonest and/or fraudulent claims. The principle difference is that the termination of a Policy for fraudulent acts cannot now be retrospective prior to the time of the fraudulent act (Section 12 (2)). Therefore any drafting of this type of condition should henceforth be compliant with this and only allow cancellation with effect going forward from the date relevant to the fraud.

**Conclusion**

The “must do” changes to professional indemnity Policies resulting from the Insurance Act are fairly limited. At one end of the spectrum it is possible to do nothing at all and the legal consequences would be minimal. However, it may easily lead to confusion if parts of the wording are out of synch with the new law.

It is not necessary to restate the law in insurance policies but some of the existing wordings do assert rights which existed but which will soon be circumscribed. The most important of these are the basis clauses which will be abolished. Using some of the language from the Insurance Act or the concepts in paraphrase may be a helpful approach to updating and ensure that the new realities are at everyone’s fingertips. All the changes are focussed on the Policy Conditions (and Definitions).

The death of the Innocent Non-Disclosure Clause is not imminent.

All of the above seems to favour Insureds though that may be for the good of the market. The changes will not prove to be such a radical shift. If you can live with Innocent Non-Disclosure or Solicitors Minimum Terms you should be able to live with this.

**Late News on Late Payments**

By the Enterprise Act 2016 coming into force next year (4 May 2017), it will be an implied term of insurance contracts that claims must be paid within a reasonable time. This will give the basis of claims for damages and interest in the case of breach by the Insurer. The obvious difficulty will be what is a reasonable time. In professional indemnity this should not be a serious issue because Insurers are usually closely involved in the defence and settlement of claims and the timescales for payment are typically set out by deadlines in orders and agreements.

Perhaps the most interesting aspect of this is that these provisions will take place as additional sections of the Insurance Act and therefore they stand as a precedent for any further implied terms that legislators care to write into the policies.

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**Caytons Law – 12 July 2016.**