

March 2012

THE CONSUMER INSURANCE (DISCLOSURE AND REPRESENTATIONS ACT 2012

All change?

Legislative changes to insurance law are few and far between. In this context, the Consumer Insurance (Disclosure and Representations) Act 2012 (Act), which was given Royal Assent on Thursday 8th March 2012, is highly significant. As previously reported, the Act is based on recommendations made by the Law Commission and the Scottish Law Commission (Law Commission) in 2009 as part of their detailed review of insurance contract law. The Act will come into force at the earliest in March 2013, at which point it will replace, in parts, the Marine Insurance Act 1906.

Scope of the Act

Despite its significance, the scope of the Act is narrow, in that it focuses on the pre-contractual issues of disclosure and misrepresentation and it applies only to "consumer insurance contracts". These are defined as contracts of insurance between an insurer and an individual "who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession". Parties are unable to contract out the effect of the Act if, in doing so, this would be to the detriment of the consumer.

Disclosure No More?

The Act replaces the duty of disclosure with a duty on consumers "to take reasonable care not to make a misrepresentation to the insurer". Whether a consumer has taken "reasonable care" will have to be determined in the light of all relevant circumstances, including, for instance, the type of insurance and its target market, any explanatory or publicity materials produced by the insurer, how clear and specific the insurer's questions were (including whether it adequately communicated their significance) and whether the consumer needed an agent for the purpose of entering into the contract (or variation). A misrepresentation made dishonestly will always be taken as falling short of the reasonable standard of care expected of a consumer.

This is a major development, given that, to date, the duty of disclosure has been a key factor in differentiating insurance contract law. In practice, however, layers of industry guidance and FSA rules have already restricted the scope for insurers to rely on strict legal rights of avoidance (based on a breach of his duty of utmost good faith) when dealing with consumers. The Act now abolishes the consumer's duty to volunteer material facts.

Proportional Remedies

Until now, the only practical remedy available to an insurer for a breach of the duty of disclosure was avoidance of the contract. Taking inspiration from the practices of the Financial Ombudsman, the Law Commission instead proposed that the law should provide for remedies proportionate to the seriousness of the breach and these are now enshrined in the Act.

As a first step, insurers will have to establish that the misrepresentation is a qualifying misrepresentation. This is a two stage process requiring evidence that (i) the misrepresentation was made in breach of the duty to take reasonable care and (ii) insurers would have acted differently, by not entering into the contract, or only doing so on different terms, had there been no misrepresentation.

The second step for insurers will be to ascertain the nature of the misrepresentation. A misrepresentation which is deliberate or reckless (the consumer knew or did not care whether (i) the information he provided was untrue or misleading and (ii) the information was relevant to the insurer) entitles the insurer to avoid the contract whilst retaining any premium paid unless it would be "unfair" for the consumer not to recover the premium.

Other qualifying misrepresentations are deemed careless, in which case the remedy depends on what the insurer would have done had there been no misrepresentation i.e:

- ▶ if the insurer would not have entered into the contract on any terms, the insurer may void the policy and return the premium; or
- ▶ if the insurer would instead have suggested different terms, the insurance contract will be treated as if those amended terms apply to the claim. The Act includes a mechanism that gives both the insurer and the consumer a choice thereafter to continue with the contract on the amended terms or to terminate; or
- ▶ if the insurer would have charged an increased premium, the insurer may reduce proportionately the amount to be payable to the consumer.

Agents

Under the Act, an intermediary will usually be deemed to be acting as agent of the consumer unless:

- ▶ it is the appointed representative of the insurer under section 39 of the Financial Services and Markets Act 2000; or

- ▶ it has express authority to collect information as agent of the insurer; or
- ▶ it has express authority to enter into the contract of insurance on the insurer's behalf; or
- ▶ circumstances dictate otherwise (e.g. the intermediary places insurances only with one insurer, is permitted to use the insurer's name, is asked by the insurer to solicit customers, etc.).

Even though an intermediary may be classified as the insurer's agent through the application of these rules, this will not necessarily apply at all stages of the contractual relationship. Thus, a broker who is deemed to be the agent of the insurer when collecting information prior to the insurance contract being entered into, may well be considered to be the agent of the consumer at the time when a claim is subsequently presented.

Basis of Contract Clauses

The Act abolishes "basis of contract" clauses, which are declarations (usually made in proposal forms) that turn representations made by policyholders into warranties. The Law Commission did not look favourably on such provisions, because a breach of warranty automatically discharges insurers from any liability in respect of claims. Again, the Act reflects a desire to temper the draconian remedies potentially available to insurers.

Comments

The impact of the Act on individual insurers will depend on how closely each insurer was following industry guidance and FSA regulations regarding the use of the remedy of avoidance and customer care.

Regardless, policy wordings that currently deal with, for instance, the scope of the duty of disclosure, or include a "basis of contract" clause, will have to be closely reviewed and amended in light of the Act. In addition, agreements governing the relationship between insurers and insurance intermediaries, such as brokers or banks, will need to be carefully reviewed to ensure they reflect the new rules concerning the status of agents. Finally, the procedures used by insurers (and their agents) to obtain information from consumers will need to be overhauled, as the onus will clearly now be on insurers not only to ask the right questions (and to explain why they are asking those questions) but also to record the responses that they receive very carefully.

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