African insurers beware! Significant changes are coming for buyers of English reinsurance

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The new Insurance Act 2015 (the "**Act**") will come into force in the UK on 12 August 2016, representing the greatest change to English insurance law for over 100 years. The Act will apply to all business contracts of insurance and reinsurance/retrocession (as well as any variations made to existing contracts after the Act has come into force) and will materially alter the way (re) insurance business is conducted in the London market. This article focuses on the impact of the Act on African reinsureds purchasing reinsurance from the London market.

Given the African insurance market's historic and still dominant dependence on foreign reinsurance it is critical that these buyers of English law governed reinsurance are aware of and prepared for the changes the Act will introduce. In light of the "fronting" arrangements in place for many African risks, it will be in the interests of all parties in the risk transfer chain, including policyholders whose policies contain cut-through provisions to London reinsurers, to prepare and plan for the arrival of the Act.

Summary of key changes under the Act:

- (Re)insureds' general obligation to disclose all material facts will be replaced with a new duty of "**fair presentation**". The (re)insured will have to disclose (i) every material circumstance that it knows or ought to know, or (ii) sufficient information to put a prudent (re)insurer "on notice" that it needs to make further enquiries to reveal the material circumstances. This means that a (re)insured may satisfy the duty of disclosure by doing something that falls short of actually disclosing every material circumstance. The (re)insured is expected, however, to carry out a "reasonable search" for information, including a search for information held within its business structure or "by any other person" (such as the (re)insured's broker), a potentially very wide obligation. The intention is to create more proactive underwriting and greater cooperation between (re)insureds and (re)insurers in the disclosure process. The duty to give a "fair presentation" also entails the (re)insured disclosing information in a manner which would be "reasonably clear and accessible" to the (re)insurer. The idea here is to prevent (re)insureds from "data dumping" a large volume of information in order to meet their disclosure obligations.

> Information will need to be clearly presented, indexed and signposted, otherwise it may not be considered a fair presentation of the risk.

- Under current English law, even an innocent failure to disclose material information can result in the policy being voidable. The **remedies** for failing to comply with the new duty of "fair presentation" are more flexible; the (re)insurer can only avoid the policy if the failure was "deliberate or reckless" or, if innocent, if it can show that it would never have entered into the contract had it known the material fact. If the (re)insurer can show that it would have imposed additional terms or charged a higher premium, the policy may be treated as containing those additional terms, or claims may be reduced in proportion to the amount of the higher premium.

- (Re)insurer's liability will only be suspended when there is a breach of **warranty** and, once that breach has been rectified, the (re)insurer will be on risk again. The Act also provides that in the event of breach of certain warranties, the (re)insurer cannot avoid liability unless the breach could have had some bearing on the risk of the loss which actually occurred. So, unlike under the present law, breach of a warranty that premises have a working fire alarm would not discharge the (re) insurer for liability when a flood occurs.

- "**Basis of the contract**" clauses are to be abolished. These currently provide that the (re) insured warrants the accuracy of answers given in a proposal form/renewal submission or state that such answers form the "basis of the contract",

enabling (re)insurers to avoid liability where there has been an innocent misrepresentation.

What will be the impact for reinsurance and retrocessions?

Contracts of reinsurance and retrocession are contracts of insurance for the purposes of the Act, with the party purchasing the insurance (the insurer or reinsurer) being the "insured" and the party providing the insurance (the reinsurer or retrocessionaire) being the "insurer".

> Many of the concepts introduced by the Act will require further input from the English courts and this is certainly likely to be the case when it comes to the Act's application to reinsurance contracts.

How will reinsureds comply with the new "duty of fair presentation"

In the reinsurance context, the Act appears to have created a new and much more onerous duty of disclosure on reinsureds. Under the new regime, a reinsured will have to give its reinsurer a "fair presentation of the risk", which will include disclosing every material circumstance it knows or "ought to know".

The Act provides that an insured *"ought to know what should reasonably have been revealed by a reasonable search of information available to the insured"* including information *"held within the insured's organisation or by any other person."* Such information can be revealed by *"making enquiries"* or by *"any other means"*. From a reinsured's perspective, this could extend to searches outside of the reinsured's organisation, to other teams within the reinsured's structure dealing with other risks, clients and claims, and certainly to information on its own intranet.

Where the underlying insurance policy is governed by English law, there is a risk that a reinsured might find itself in breach of its duty to give a fair presentation to its reinsurers, and therefore without reinsurance, yet still liable to the underlying policyholder. This could arise where the policyholder discloses information that would put a prudent insurer on notice that it needs to make further enquiries to reveal material information, but the reinsured fails to make those enquiries. The reinsured would be unable to avoid the underlying policy, but its reinsurers could argue that the reinsured had breached its duty of fair presentation by failing to make enquiries with the underlying policyholder.

> Where underlying policies are governed by English law, it is critical that reinsureds make all relevant enquiries where proposal forms/renewal presentations flag areas that merit requests for further information.

Where underlying policies are subject to local African laws, reinsureds could also face difficulty in complying with the onerous "duty of fair presentation" owed to their reinsurer, particularly if the standards of local underwriting are less stringent than those envisaged by the new Act. For example, where the underlying policy is underwritten with only minimal disclosure by the policyholder; this might be sufficient to comply with local law, meaning that the policyholder will be covered in the event of a loss, but the reinsured may face difficulty demonstrating to its reinsurer that, under English law, it has conducted a reasonable search of available information and provided a fair presentation of the risk.

Reinsurers too will have to alter the way they currently underwrite business, as the new Act provides that the reinsured may satisfy its duty of fair presentation if it discloses information that would put a prudent reinsurer on notice that it needs to make further enquiries to elicit material information. Reinsurers will have to take a much more active role in the disclosure process than is presently the case.

> It would be sensible for African reinsureds to agree in advance with reinsurers the precise parameters of the reasonable search to avoid disputes arising down the line.

Contracting out

It may be that African reinsureds decide to contract out of some or all of the provisions of the Act, specifically the provisions dealing with knowledge and the duty of disclosure. Indeed, English

reinsurers will carry out their own assessment as to whether they apply the new regime in their contracts.

Conclusion

A careful assessment will need to be undertaken by African reinsureds as to how to benefit and/or prepare for this new regime. Although in the long term the Act should lead to greater contractual certainty, in the short term it will undoubtedly lead to disputes and parties seeking clarification from the English courts.

> **African reinsureds may wish to play it safe for now, and stick to the regime they know, certainly vis-à-vis the new disclosure obligations and provisions as to "knowledge" by "contracting out" of the new regime when purchasing reinsurance after 12 August 2016.**

No truly major catastrophic loss has occurred to date to test current foreign reinsurance lines in Africa, so it may be in African reinsureds' long term interests to join in on the new regime and benefit from a more favorable legal framework for purchasers of English (re)insurance. Alternatively, the changes could encourage African insurers to explore new horizons, including expanding domestic reinsurance capacities…

Get in touch

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