CITY OF LONDON LAW SOCIETY

INSURANCE LAW COMMITTEE

Minutes of the meeting that took place at the office of DAC Beachcroft, 7th Floor, 3 Minster Court, Mincing Lane, London EC3R 7DD on Tuesday 25 February 2014 from 17:00 to 18:55.

Present:

Richard Spiller – Holman Fenwick Willan LLP ("**RS**") (Chair)
Helen Chapman – Hogan Lovells International LLP ("**HC**")
Nigel Frudd – Minories Law ("**NF**")
Simon Garrett – CMS Cameron McKenna LLP ("**SG**")
Philip Hill – Clifford Chance LLP ("**PH**")
Chris Jefferis – Ince & Co International LLP ("**CJ**")
Stephen Lewis – Clyde & Co LLP ("**SL**")
Francis Mackie – Edwards Wildman Palmer LLP ("**FM**")
Ken McKenzie – DAC Beachcroft LLP ("**KM**")
Michael Mendelowitz – Norton Rose Fulbright LLP ("**MM**")
Terry O'Neill ("**TO**")
Joanna Page – Allen & Overy LLP ("**JP**")
Tim Scott – Linklaters LLP ("**TS**")
Jonathan Teacher ("**JT**")
David Webster – Reynolds Porter Chamberlain LLP ("**DWebster**")
David Wilkinson – Kennedys Law LLP ("**DWilkinson**")

In attendance:

David Hertzell – Law Commissioner for Commercial and Common Law, Law Commission ("**DH**")
Sarah McCadden – Research Assistant, Law Commission ("**SM**")
James Smethurst – Freshfields Bruckhaus Deringer LLP ("**JSmethurst**")
Romin Dabir – Freshfields Bruckhaus Deringer LLP ("**RDabir**")
Will Reddie – Holman Fenwick Willan LLP (Secretary)

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1. **Apologies for absence**

Apologies were received from Michelle Bramley (Freshfields Bruckhaus Deringer LLP), Simon Brooks (Eversheds LLP) ("**SB**"), Robert Carr (Greenwoods Solicitors), Beth Dobson (Slaughter and May), Christopher Foster (Herbert Smith Freehills LLP), Martin Mankabady (Clyde & Co LLP) and Paul Wordley (Holman Fenwick Willan LLP).

2. **Welcome to new members**

2.1 RS welcomed the Committee's new members, Helen Chapman, Nigel Frudd, Simon Garrett, Chris Jefferis, Joanna Page, Tim Scott and David Webster.

2.2 RS also welcomed SB, who had been unable to attend the meeting, as a new member.

3. **Approval of minutes of meeting of 3 December 2013**

RS reported that the minutes of the meeting of 3 December 2013 had not been finalised and would be circulated for approval at the next meeting.

4. **Matters arising from previous meetings**

(a) Update on European Insurance Contract Law reform (Joanna Page)

4.1 JP gave the background to the European Commission's proposals. She explained that the European Contract Law initiative had become the Common European Sales Law initiative (which had not yet become law) and that the Insurance Contract Law was intended as a bolt-on to the Sales Law.

4.2 JP explained that the aim of these initiatives was to provide an easy way of achieving consistency of trade law throughout the EU. The common European law would create a system, sitting alongside the law of each member state, that counterparties could choose to use in place of the law of a member state.

4.3 JP stated that she was a member of the European Commission's Expert Group on European Insurance Contract Law, and would continue to be a member for another year. The Expert Group had been asked to analyse whether differences in the contract law of member states posed an obstacle to cross-border trade in insurance products. JP stated that the Expert Group had met on ten occasions during 2013 and had released its final report last month. *[The report was not available on the European Commission's website at the time of the meeting but is now available at: http://ec.europa.eu/justice/contract/files/expert_groups/insurance/final_report_en.pdf]*

4.4 JP stated that the Expert Group's report had found that, with regard to large risks, there were rarely any obstacles to cross border trade arising from differences in the contract law of member states, as although there were differences in the law of each member state, parties could choose which member state's law to use. The report considered that this was not as true in relation to mass risks, as the applicable law was generally required to be the law of the member state in which the policyholder was habitually resident. The report generally focussed on issues arising in relation to motor, life and PI insurance. JP expected the European Commission to issue a consultation paper in the third quarter of 2014.

4.5 JP reported that new members of the EU generally regarded a common European law as a way to tap into new markets, as companies in these member states would be able to use the common European law to launch products in member states that had more complicated systems. The Committee noted that English law was generally much simpler than the law of certain other member states.

4.6 JP also noted that the Law Society had concerns over the common European law because, as proposed, English law would be eroded. The Committee also discussed the investment that academics had made in achieving a common European law; it was considered that, although sensible ideas regarding a common system did exist, the proposals were not always workable.

(b) Update on Solvency II Quick Fix Directive

4.7 RS stated that the main purpose of the Quick Fix Directive was to extend the dates from which Solvency II would apply and by which Solvency II had to be transposed into the law of each member state.

4.8 The Committee had no further comments on the Quick Fix Directive.

5. **Issues for discussion**

(a) Draft Insurance Contracts Bill

5.1 RS welcomed DH and SM, and invited DH to discuss the feedback that he had received on the draft Bill.

5.2 DH explained that the Bill was very much a first draft, although he noted that there may not be much scope for making drafting changes, as the Bill had been prepared by a Parliamentary draftsman and there were certain rules and conventions relating to the drafting of Acts of Parliament.

5.3 DH stated that the Law Commission had proceeded only with those areas of reform where there was a strong majority view in favour of reform, so the draft Bill generally had strong support. The feedback he had received suggested that there were some (but not numerous) common concerns arising out of the draft Bill.

5.4 DH stated that the draft Bill did not contain clauses on warranties, contracting out and fraudulent claims. He hoped that these clauses would be available in the next few weeks.

5.5 DH provided an update on the timetable. The Bill needed to be introduced into Parliament by October at the latest, as it could not be carried across to the next Parliamentary session. In any event, DH would only have the use of the Parliamentary draftsman for a short while longer. The Law Commission still intended to use the uncontroversial procedure, so a special committee would review the Bill, which would generally be made up of experts rather than politicians.

5.6 DWilkinson asked how it would be decided whether the Bill was controversial or uncontroversial. DH explained that it would be by reference to whether the Bill was politically controversial or uncontroversial.

5.7 MM said that he was generally supportive of the clauses in the draft Bill and that they seemed to achieve the Law Commission's aims. He stated that he had two main comments to make on the draft Bill:

1. Definition of "insured"

(a) MM considered that the definition of "insured" in the current draft did not distinguish between (i) the party contracting with the insurer and (ii) the beneficiary of the policy, so greater clarity on the distinction was needed. He considered that there was a possible disconnect between the proposer of a policy and the policyholder. DH agreed with MM and stated that the defined term "proposer" would most likely be removed from the next version of the Bill.

2. Attribution of agent's knowledge to his principal

(b) MM referred to clause 5(4) of the Bill and the attribution of a proposer's agent's knowledge to the proposer. MM considered a situation where information was not passed on to an insurer by a proposer (or, rather, by his agent on his behalf) in a way which amounted to fair presentation, but the agent who had the relevant information was in fraud of the proposer. MM considered that the agent's knowledge should not be attributed to the proposer in this situation, as the agent was acting fraudulently. MM believed that clause 5(4) should produce this result, as a reasonable search by a proposer of information held by its agent would not uncover the information because the agent was acting fraudulently.

(c) RS noted that in an organisation that operated Chinese walls, the senior management may know information that the employee placing insurance did not. For example, the senior management may know information about a client as a result of a trading relationship, but the employee responsible for the organisation's insurance arrangements may not know this information. RS was unsure whether such information would, under clause 5(4), constitute information that would have been revealed by a reasonable search, but he did consider that there could be some members of senior management on other side of wall who would be deemed to know the information. RS suggested that knowledge should be attributed to the proposer only if the employee responsible for the organisation's insurance arrangements had such information and was not prevented from disclosing it by a Chinese wall.

5.8 DWilkinson agreed that the draft Bill reflected the Law Commission's proposals. He stated that he had two main points to make:

1. Knowledge of the insurer

(a) DWilkinson considered that clauses 4 and 6 aimed to avoid a proposer dumping data on an insurer, as clause 4 required the proposer to give the insurer sufficient information in a reasonably clear and accessible manner, although JP considered that there would still be scope for disputes over proper disclosure. For example, where technical specifications were being disclosed, the amount of information that could be disclosed could be very large. DH agreed, and explained that whether acceptable disclosure had been given would turn on the facts.

(b) DWilkinson noted that a proposer would not need to disclose things that were was known to an insurer. He questioned whether a proposer would be able to say that information that was on the internet did not need to be disclosed. DH agreed that the contents of the internet should not constitute information that was readily available or common knowledge, although he considered that this could become an accepted position in future. DH explained that he had been wary about being too specific in the Bill in order to prevent references or the stated position going out of date too quickly. For this reason, the term "common knowledge" had been taken from existing legislation.

(c) DH explained that clause 6(3)(b) aimed to protect an underwriter from being deemed to know a wide range of things by requiring information that it was deemed to know to be "readily available".

(d) MM considered that another issue regarding knowledge could arise where an insurer's underwriting department was unaware of information that an insured had told the claims

department. He wondered whether the insurer or the insured should bear the risk in this situation, and considered that it would not be acceptable to hold that the underwriting department should have the knowledge of the claims department. DWilkinson agreed that this was also a practical problem, as even if the claims department had relevant information, it may have been received only shortly before the underwriting department accepted a risk.

2. Proportionate remedies

(e) DWilkinson also commented on the proportionate remedies contained in the Schedule. He wondered how underwriters would calculate the true premium that would have been charged had the undisclosed information been known. DH considered that the calculation of this premium would generally be driven by models, but that in some esoteric areas there may be scope for argument over the calculation.

(f) DWilkinson also considered that paragraph 11 of the Schedule seemed to suggest that it would be possible for the insurer to pay 0% of a claim if £0 of premium had been charged in respect of a particular risk (i.e. a risk that the insurer did not know that it was accepting because the insured had not disclosed it) but £x would have been charged had the undisclosed information been known. DH explained that this formula was under review. MM noted that the same formula was contained in the Consumer Insurance (Disclosure and Representations) Act 2012.

5.9 RS said that the Lloyd's Market Association (the "**LMA**") had sent him some questions for the Committee to consider. RS put the following questions to the Committee:

*(1) Is the repeal of section 19 of the Marine Insurance Act 1906 (the "**MIA**") potentially hazardous?*

(a) The Committee was in favour of narrowing the information to information held by an agent on behalf of an insured. The effect of clause 5(3)(b) of the draft Bill is to require the proposer to disclose information that is known by its agent (or the individuals at its agent), so section 19 will effectively be retained but in a narrower form. The Committee believed that a further change was needed to the Bill to provide that information held by an agent should only be attributed to an insured, and therefore disclosed to the insurer, if the agent acquired that information in the context of working on behalf of the insured in question.

(2) Will the duty of fair presentation (in particular the second limb of clause 4(1)(a) of the draft Bill) lead to a material shift in the way the market operates?

(b) It was noted that case law and market practice is that the insured and its agent to insurer are involved in a Q&A dialogue with the insurer to a much greater extent than is suggested by the MIA, even in a subscription market context. MM considered that the proposed duty of fair presentation encapsulates the current case law well by codifying the requirement for an underwriter to take an active role in the disclosure process. MM also noted that an average placement in the subscription market now consists of a much smaller number of insurers than used to be the case, so followers are in practice likely to review a potential risk and ask questions about it.

(3) How will the sections relating to knowledge (in particular clause 5) work in practice – e.g. flow of knowledge through a multinational group where the holding company is the insured? Or where a policy does not name all contractors, one-ship companies etc?

The Committee's view was that:

(c) Clause 6(1)(b), which stated that the proposer would not need to disclose information that the insurer knew, could give rise to problems relating to the flow of information through an organisation. For example, an insured may give information to the claims department that was relevant to a risk being considered by an underwriter, but there was no guarantee that this information would be passed on.

The Committee agreed that there should be a greater onus on insurers to ensure effective communication between claims and underwriting departments – and improved IT systems should deliver this – but the courts would need to take into account the fact that insureds may notify circumstances to the claims department at the same time as, or only very shortly before, the underwriter agreed to write the risk, leaving very little time for information to be passed on. It should be possible for large insured organisations (or groups with several subsidiaries) to put in place measures to ensure that relevant information was passed on.

(d) There was an issue regarding large organisations, such as financial services groups, that operated Chinese walls e.g. between an commercial bank making loans and its investment bank trading debt, as the senior management of the commercial bank may know material information about a risk that was relevant but the employee placing the insurance may not. A potential solution to this issue could be to limit "knowledge" to what the individuals responsible for placing the insurance knew and were not prevented from knowing by Chinese walls required by regulation.

(e) Clause 5 may prevent insurers pursuing non-disclosure claims against the holding company under a composite policy, as the duty to disclose would have been on the senior management of the relevant subsidiary.

(4) Will significant amounts of litigation, issues on evidence etc, result from "proportionate remedies" for breach of the duty of fair presentation?

(f) DW considered that it was possible that proportionate remedies would give rise to litigation initially, but this would not be unusual following a change in the law or practice. However, TS noted that when a similar principle was introduced in Australia, that did not give rise to a large increase in litigation. TS and KM agreed that in the longer term there would be less litigation as there would be less need to pursue an all or nothing remedy, which was all that the law currently offered. It would be less likely that hopeless cases will be pursued.

(g) MM considered that the risk of an increase in litigation may stem from underwriters taking a black and white view to the non-disclosure. When asked how the premium would have been adjusted had the unknown information been disclosed, an underwriter may say that he would not have written the risk at all or would have substantially increased the premium.

(h) On the other hand, KM noted that underwriting was now much more model-driven than it used to be, so evidence that the premium would have increased would need to be obtained from the relevant models, but there would be bespoke risks where the pricing structures

were less defined. Disputes over the "true" premium in respect of these more bespoke risks would be more likely.

(i) It was considered that proportionate remedies should give the respective parties good scope to discuss a settlement, rather than pursuing a dispute all the way to judgment.

(5) Do the damages for late payment provisions present a hazard to the market, e.g. in terms of speculative litigation, limitation and reserving matters? And do these provisions actually capture just what we understood the Law Commission wished to capture, bad mishandling of claims, or much more?

(j) It was considered that the provisions may give rise to speculative litigation, although it was noted that there was no evidence of this practice in Scotland, where similar principles existed. It was thought that only more extreme cases would be pursued.

5.10 MM noted that he had spoken to Kees van der Klugt of the LMA. MM believed that, although the LMA had not originally been in favour of the broker and the insured being jointly and severally liable for premium, it may now be willing to accept this position.

5.11 RS stated that he had also been speaking to the LMA, the IUA and LIIBA separately, with the aim of securing a compromise on a reform of section 53 of the MIA. He reported that last week it had appeared that a consensus might be possible, which would have seen (i) section 53 continue to apply only to direct marine business, (ii) the broker and the insured being jointly and severally liable for premium and (iii) brokers and insurers able to contract out of section 53 on a bilateral basis (i.e. without the insured's agreement). RS noted that attempting a definition of "marine" may not be possible given the time pressure.

5.12 RS explained that the three organisations were concerned about the time pressure and had said that, although they could devote more time to agreeing a compromise, they were not convinced that there would be sufficient time for the relevant clauses to be prepared by the Parliamentary draftsman if a compromise was reached. DH considered that there would be time if a compromise was reached within the next month and was relatively straightforward (i.e. as outlined by RS [see paragraph 5.11]).

5.13 RS hoped that the organisations would agree to the proposed compromise regarding joint and several liability, and the ability of parties to contract out bilaterally. He considered that the more contentious area would be what was included in the reforms, i.e. what constituted "marine" business. RS said that he would go back to the LMA, IUA and LIIBA to see if he could secure a compromise, and would let DH know how he got on.

5.14 RS suggested forming a sub-committee to review and provide feedback on the new clauses of the Bill as they were published. FM, MM, JP, DWebster and DWilkinson volunteered to be part of the sub-committee.

(b) The approach of the PRA and FCA to change of control of regulated firms

5.15 RS thanked JSmethurst and RDabir for attending the meeting. He invited them to discuss the approach of the PRA and the FCA to changes of control of regulated firms.

5.16 JSmethurst explained that both of the regulators had adopted new processes. The PRA now required the change of control application to be submitted in draft and a pre-meeting to be held. The PRA

tended to request further information, meaning that the pre-submission phase could last up to 8 weeks. JSmethurst stated that this process effectively side-stepped the statutory period in which the PRA was required to determine an application.

5.17 JSmethurst considered that the pre-completion phase also seemed to free the PRA from the restraints on the nature of the information it could request from an applicant. He reported that clients had been asked to provide due diligence (and accounting) reports to the PRA and that this request was becoming increasingly standard. To date, he had not been required to provide a due diligence report to the PRA, as it had been possible to reach a compromise, such as by arranging a meeting with the PRA or by sending it a description of the scope of the due diligence exercise.

5.18 JSmethurst considered that the PRA's request for the report created issues. First, due diligence reports were not prepared as regulatory audits. Second, a law firm may present issues differently in the report if it knew that the report would be shared with the PRA. Third, the sharing of a report could give rise to issues regarding privilege. MM noted that his colleagues had raised issues about confidentiality, privilege and what the PRA would use the report for.

5.19 JT noted that there was also a potential issue regarding freedom of information. He explained that there was a risk that information regarding a PRA-regulated company could be released by the "backdoor", as requests could be made to the PRA under the Freedom of Information Act 2000.

5.20 JSmethurst questioned why the PRA would want to see a due diligence report. He considered that the PRA would not need to see the report in order to conclude that full due diligence had been performed. It was noted that it also seemed strange that the PRA would want to see a report which had been prepared for a non-PRA regulated owner of a PRA-regulated company. JT agreed that the PRA's reasons for requesting due diligence reports were unclear. He believed that in some cases the PRA had asked for reports even where the acquisition had not gone ahead.

5.21 RS considered that providing full due diligence reports to the PRA would not be wise, as reports might contain commentary on senior management which was unflattering. He considered that, if firms were required to provide reports, reports could be made purely factual and the advice element could be provided in a letter of advice, which would not be as easy for the PRA to obtain.

5.22 JSmethurst wondered whether there was any scope for, or merit in, trying to agree with the PRA what a legitimate request in relation to due diligence may be. RS considered that there was, and explained that there were other Committees of the CLLS that may be interested in participating in such a discussion, such as the Regulatory Law Committee and the Financial Law Committee. JSmethurst and JT stated that they would be willing participate in any discussion with the PRA.

[Update: JSmethurst met with Steven Lacey from the PRA in the week commencing 2 June 2014 and they had a general discussion on this subject. JSmethurst considers that the PRA recognises some of the issues raised by Freshfields and understands the point regarding privilege. JSmethurst reported that the PRA had confirmed to Freshfields that it would generally be prepared to accept a description of the scope of due diligence rather than requiring the report itself.]

5.23 JSmethurst said that his partner was a member of the Regulatory Law Committee and had previously raised the matter at a Committee meeting, but that other members of the Committee had not experienced the issue. However, JSmethurst considered that it would be worth him raising it again with the Committee.

5.24 It was considered whether the Financial Markets Law Committee should be involved in any review of, or discussion regarding, the change of control process, but it was noted that this Committee dealt with legal uncertainty and misunderstandings in the market, so would not necessarily be involved in a change of control review.

6. **Monitoring of sector developments**

The Committee noted several sector developments that had occurred during the last three months.

7. **Any other business**

7.1 RS stated that Jonathan Goodliffe ("**JG**") had retired from Freshfields Bruckhaus Deringer LLP. RS explained that, although JG was not a formal member of the Committee, he had attended many meetings and contributed a great deal. RS recorded a vote of thanks for JG's considerable contribution to the Committee over the previous years.

7.2 There being no other business, RS thanked KM for hosting the meeting, thanked DH and SM for attending and declared the meeting closed.