

# **The Insurance Act 2015: “Contracting out”**

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# INTRODUCTION

- IA 2015 - default scheme (business & all “non-consumer” assureds)
- First prediction on contracting out - unlikely that insurers will opt for it on a regular basis
- Cases where it may be appropriate to contract out
- Where new term is disadvantageous: need to
  - take sufficient steps & bring term to assured’s attention
  - ensure that the term is clear and unambiguous

# INTRODUCTION

- Initial scepticism towards “contracting out”  
“.... [need to ] monitor and test the efficacy of clause 16, so as to avoid relentless contracting out simply by way of forms because it would undermine much of the benefit of this reform”.

*Lord Davidson, Parliamentary Debate on the Insurance Bill, HL Deb 29/7/2014, colGC627*

# INTRODUCTION

- Hostility towards contracting out provisions  
→ not surprising

Law Commission → sceptical

→ treated them as result of a  
balancing exercise

→ valid reasons for their  
introduction / inclusion

# MARKET'S FIRST RESPONSE

- March 2016
  - Lloyds Market Association (LMA)
  - drafted clauses to fit into the IA 2015
  - clauses contain 5 clauses on contracting out

# LMA MODEL CLAUSES FOR USE IN CONNECTION WITH THE I.A. 2015

## *LMA5257: Insurance Act 2015 – Contracting out of section 8(2) and Schedule 1 - Avoidance as the sole remedy for breach of the duty of fair presentation*

Section 8(2) and Schedule 1 of the Insurance Act 2015 are excluded in their entirety.

If the Insured breaches the duty of fair presentation, and the Insurer shows that but for the Insured's breach it would not have entered into the insurance contract at all, or would have done so only on different terms, then the Insurer may avoid the insurance contract and refuse all claims.

If the breach was deliberate or reckless, the Insurer need not return any of the premiums paid. If the breach was not deliberate or reckless, the Insurer must return the premiums paid.

***LMA5257 16 March 2016***

***[This clause may also be used in reinsurance contracts.]***

<http://www.lmalloyds.com/actclauses> (last accessed 18/11/2016)

# LMA MODEL CLAUSES FOR USE IN CONNECTION WITH THE I.A. 2015

## [LMA5258 Insurance Act 2015 - Contracting out of Section 10 – All warranties](#)

Section 10 of the Insurance Act 2015 shall not apply to any warranty in this insurance contract. If any such warranty is breached, the Insurer's liability shall be discharged from the time of the breach of warranty, regardless of whether the breach is subsequently remedied.

***LMA5258 16 March 2016***

***[This clause may be used in conjunction with LMA5260 to preserve the pre-Insurance Act effect of warranties. This clause may also be used in reinsurance contracts.]***

<http://www.lmalloyds.com/actclauses> (last accessed 18/11/2016)

# LMA MODEL CLAUSES FOR USE IN CONNECTION WITH THE I.A. 2015

## [LMA5259 Insurance Act 2015 - Contracting out of Section 10 – Individual warranty](#)

Section 10 of the Insurance Act 2015 shall not apply to {this warranty/these warranties/refer to specific warranties}. If {this warranty/these warranties/refer to specific warranties} is breached, the Insurer's liability shall be discharged from the time of the breach of warranty, regardless of whether the breach is subsequently remedied.

***LMA5259 16 March 2016***

***[This clause may be used in conjunction with LMA5261 to preserve the pre-Insurance Act effect of the specified warranty(ies). This clause may also be used in reinsurance contracts.]***

<http://www.lmalloyds.com/actclauses> (last accessed 18/11/2016)



# LMA MODEL CLAUSES FOR USE IN CONNECTION WITH THE I.A. 2015

## [LMA5260 Insurance Act 2015 - Contracting out of Section 11– Whole insurance contract](#)

Section 11 of the Insurance Act 2015 shall not apply to any term of this insurance contract. Where this insurance contract contains any term which, if complied with, would tend to reduce the risk of loss of a particular kind or at a particular location or time, and such term is not complied with, the Insurer may rely upon such non-compliance to exclude, limit or discharge its liability, even if noncompliance with the term could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

***LMA5260 16 March 2016***

***[This clause may also be used in reinsurance contracts.]***

<http://www.lmalloyds.com/actclauses> (last accessed 18/11/2016)

# LMA MODEL CLAUSES FOR USE IN CONNECTION WITH THE I.A. 2015

## [LMA5261 Insurance Act 2015 - Contracting out of Section 11 – Individual term](#)

Section 11 of the Insurance Act 2015 shall not apply to {this term/these terms/refer to specific terms}. If {this term/these terms/refer to specific terms} is not complied with, the Insurer may rely upon such non-compliance to exclude, limit or discharge its liability, even if non-compliance with {this term/these terms/refer to specific terms} could not have increased the risk of the loss which actually occurred in the circumstances in which it occurred.

***LMA5261 16 March 2016***

***[This clause may also be used in reinsurance contracts.]***

<http://www.lmalloyds.com/actclauses> (last accessed 18/11/2016)

# CONTRACTING OUT PROVISIONS

## Contracting out provisions

- Expected to attract judicial attention
- No surprise
- Judicial intervention encouraged by Law Commission (2014)
- Intentionally drafted in a broad manner

# PHILOSOPHY BEHIND THE CONTRACTING OUT PROVISIONS

Draconian effect of contracting out :

Result:

→ only two such sections in I.A. 2015

→ ss. 16, 17

→ Aim of the Law Commission

=> avoid creating a complicated test

# PHILOSOPHY BEHIND THE CONTRACTING OUT PROVISIONS

I.A. 2015 supports smooth running of ins.  
market:

- imposes very few restrictions (re altering / excluding existing regime)
- insurers at liberty to opt out of individual parts of the IA 2015 (except s. 9 on “basis of contract” clauses)
- provided they satisfy the transparency requirements (s. 17)

# I.A. 2015 - S. 15 (1) CONTRACTING OUT: CONSUMER INSURANCE CONTRACTS

## s.15 (1)

*A term of a consumer insurance contract, or of any other contract, which would put the consumer in a worse position as respects any of the matters provided for in Part 3 or 4 of this Act than the consumer would be in by virtue of the provisions of those Parts (so far as relating to consumer insurance contracts) is to that extent of no effect*

**- Where the IA 2015 allows for contracting out**

## I.A. 2015 - S.16(2)

### CONTRACTING OUT: NON-CONSUMER INSURANCE CONTRACTS

#### s. 16(2)

*A term of non-consumer insurance contract, or of any a other contract, which would put the insured in a worse position as respects any of the other matters provided for in Part 2, 3 or 4 of this Act than the insured would be in by virtue of the provisions of those Parts (so far as relating to non-consumer insurance contracts) is to that extent of no effect, unless the requirements of section 17 have been satisfied in relation to the term.*

## I.A. 2015 - S.16(2)

# CONTRACTING OUT: NON-CONSUMER INSURANCE CONTRACTS

- ❑ **A term** in a non-consumer insurance contract that **puts the insured in a worse position** than the I.A. 2015 **is of no effect.**
- ❑ **no term which is disadvantageous is valid**
- ❑ **Disadvantageous term to be valid:** I.A. requires
  - insurer take sufficient steps to draw to attention of assured the disadvantageous term **before the contract is entered / variation is agreed**
  - the insurer ensures that the **effect of the disadvantageous term is clear and unambiguous**
- ❑ **Insurers can use a disadvantageous term**
  - if they can prove that the assured or his agent
  - had actual knowledge of the disadvantageous term
  - when the contract was entered or the variation was agreed



I.A. 2015 - S.17(2)  
THE TRANSPARENCY REQUIREMENTS

s. 17(2)

*The insurer must take sufficient steps to draw the disadvantageous term to the insured's attention before the contract is entered into or the variation agreed*

# I.A. 2015 - S.17(2)

## THE TRANSPARENCY REQUIREMENTS

### s. 17(2)

- insurer to take sufficient steps
- to draw disadvantageous term to insured's attention
- before contract is entered into or variation agreed

**Important** → disadvantageous term be identified  
before insurer signs slip  
or accepts insurance proposal online

### **If the assured uses a broker**

- insurer expected to bring the disadvantageous term
- to the attention of the broker
- by providing notes to that effect to be made during the placement or renewal discussions

# I.A. 2015 - S.17(2)

## THE TRANSPARENCY REQUIREMENTS

### s. 17(2)

Law Commission :

asterisk \* next to disadvantageous term  
= bare minimum so as to satisfy s. 17(2)

Broker → onus to review relevant clauses  
question insurer / negotiate amendment

**Approach reflecting English courts attitude towards  
responsibilities of brokers to assureds**

## I.A. 2015 - S.17(2)

### THE TRANSPARENCY REQUIREMENTS

#### s. 17(2) – sophisticated markets

Broker placing risk in sophisticated insurance market knows:

- intricacies of market
- standard policies content and any modifications (online publication, no secrecy)

#### Sophisticated insurance markets

- even referencing to contracting out clause
- with no further discussion
- enough to satisfy requirement to draw disadvantageous term to insureds attention

I.A. 2015 - S.17(2)  
THE TRANSPARENCY REQUIREMENTS

s. 17(2) – sophisticated markets

Critique:

Such simple referencing

→ not enough

→ transparency may be judicially challenged

**Courts to adopt stricter test for such  
sophisticated markets ?**

**I.A. 2015 - S.17(5)**  
**THE TRANSPARENCY REQUIREMENTS**

**s. 17(5)**

*The insured may not rely on any failure on the part of the insurer to meet the requirements of subsection (2) if the insured (or its agent) had actual knowledge of the disadvantageous term when the contract was entered into or the variation agreed.*

**I.A. 2015 - S.17(5)**  
**THE TRANSPARENCY REQUIREMENTS**

Insurer failing to comply with s.17(2)

- Can remedy failure via s.17 (5)
- By proving that assured / agent
- had actual knowledge of disadvantageous term
- when the contract was entered into or variation was agreed

## I.A. 2015 - S.17(5)

### THE TRANSPARENCY REQUIREMENTS

**Beneficial for insurers operating in sophisticated markets (e.g. open market business)**

→ where brokers prepare wording & deemed as having actual knowledge of disadvantageous term

#### **Prerequisite**

→ **Wording in place when contract is entered into**

→ **Actual knowledge occurred at agreement**

(important for the case of **markets where policy wordings are prepared long after the slip terms are agreed** or never and in such cases insurers could not raise such an argument)



I.A. 2015 - S.17(5)  
STANDARD TERMS AND POLICIES

**Actual broker knowledge of disadvantageous term inferred:**

- when broker includes code of standard contracting out clause in slip
- request to use a standard policy & contracting out clauses comes from broker (assumed knowledge)

I.A. 2015 - S.17(5)  
**STANDARD TERMS AND POLICIES**

**If request to use standard policy & contracting out clauses:**

- comes from insurer &
- no discussion over content was made

**Broker deemed to have had actual knowledge if:**

- ⇒ broker had already used standard clause in previous placement
- ⇒ broker had already attended training on the relevant standard clauses / contracting out clauses (as may be common in each particular market)

## I.A. 2015 - S.17(3)

### S.17(3) THE TRANSPARENCY REQUIREMENTS

#### s.17(3) The transparency requirements

*The disadvantageous term must be clear and unambiguous as to its effect.*

#### Disadvantageous term:

- needs be drawn to assured's / broker's
- needs be clear and unambiguous **as to its effect.**

#### As to its effect:

- drafted clearly and unambiguously
- expressly states **disadvantage for assured**  
(effect )

## I.A. 2015 - S.17(3)

### S.17(3) THE TRANSPARENCY REQUIREMENTS

#### Practical example

*“...s. X of the IA 2015 does not apply to this contract”*

- **clear and unambiguous expression**
- **not enough**

#### Example of clear, unambiguous, justified contract. out clause

##### Clause LMA 5258

*Section 10 of the Insurance Act 2015 shall not apply to any warranty in this insurance contract*

**(clear an unambiguous mode of expression of contracting out)**

*If any such warranty is breached, the Insurer's liability shall be discharged from the time of the breach of warranty, regardless of whether the breach is subsequently remedied.*

**(justification)**

## I.A. 2015 - S.17(3)

### S.17(3) THE TRANSPARENCY REQUIREMENTS

#### *Additional practical element to bear in mind*

When contracting out

- parties need reproduce in their contract
- relevant text of law (MIA 1906)
- for which they are opting
- **BECAUSE there is no “old” law to automatically revert to (MIA 1906 *per se* repealed)**
- **Test of time and judicial reasoning**
- measure success of IA 2015

# CONCLUSIONS – CONTRACTING OUT PROVISIONS

- Reflect philosophy of Law Commission
  - Sections 16,17 reach intended compromise without disrupting overarching aim of IA 2015
  - Insurers → flexibility to bypass IA 2015
  - Test to follow → straightforward  
legal in nature & pragmatic to apply
  - Potential issue to be clarified in future judgments
    - s. 17(4)
    - application of transparency to different markets
- Section 17(4)  
→ intentionally drafted broadly  
→ to allow court flexibility