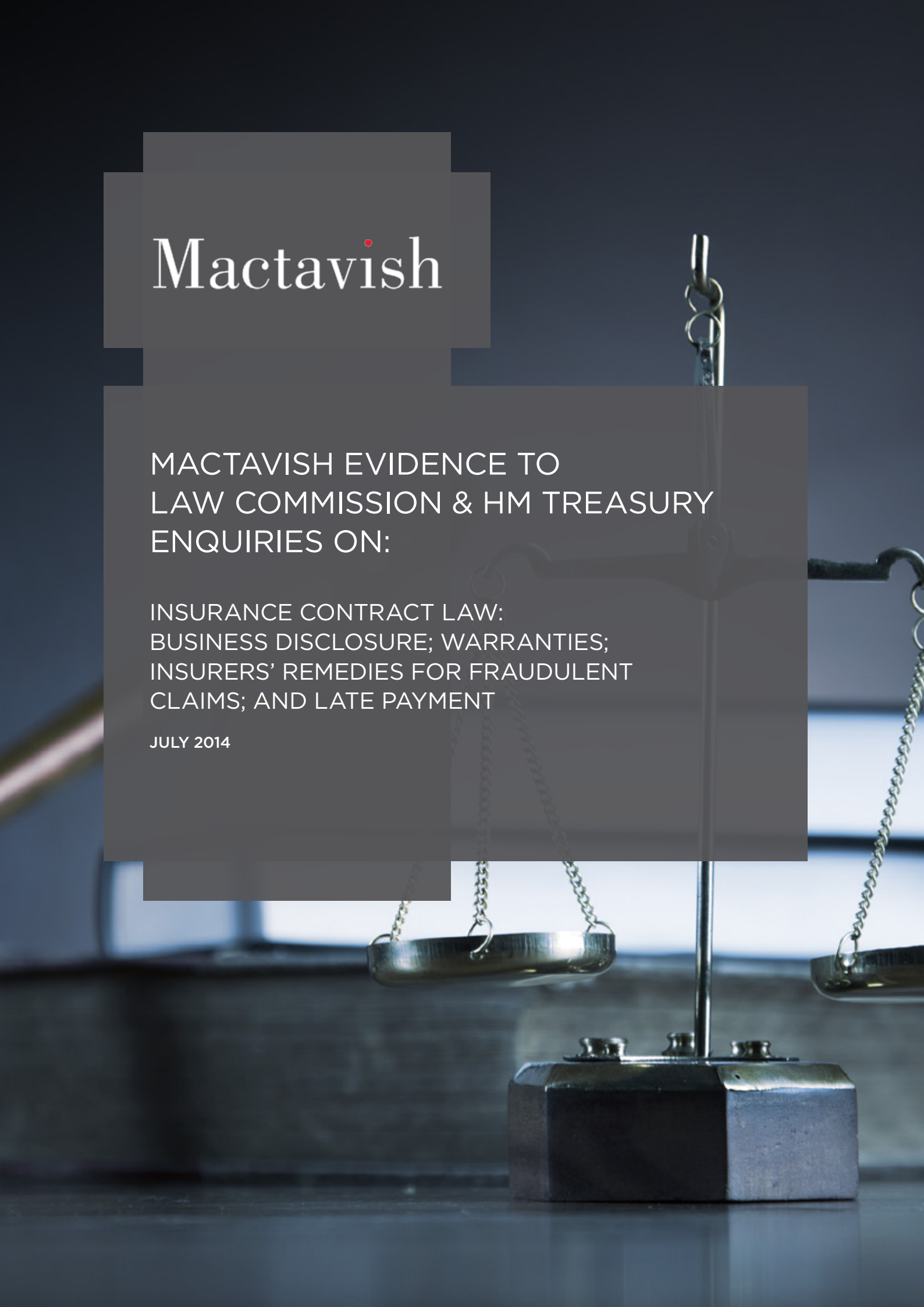


Mactavish

MACTAVISH EVIDENCE TO LAW COMMISSION & HM TREASURY ENQUIRIES ON:

INSURANCE CONTRACT LAW: BUSINESS DISCLOSURE; WARRANTIES; INSURERS' REMEDIES FOR FRAUDULENT CLAIMS; AND LATE PAYMENT

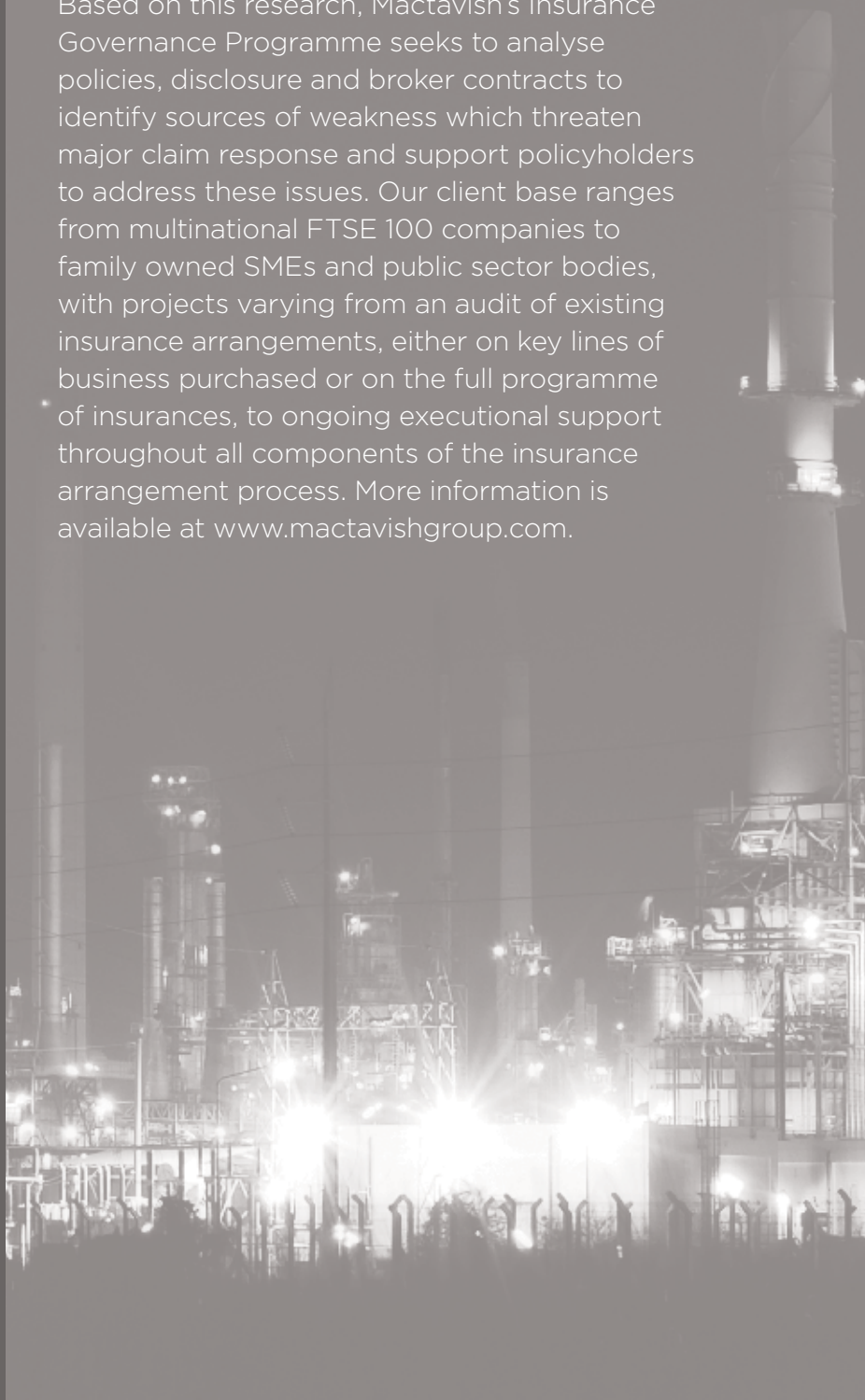
JULY 2014

CONTENTS

1. MACTAVISH BACKGROUND

Mactavish is a research and advisory business specialising in Insurance Governance, policy reliability and commercial risk analysis. We have for many years designed and undertaken unique and large-scale studies across the corporate insurance landscape, culminating in a series of high profile reports into insurance market standards and key threats to policy reliability.

Based on this research, Mactavish's Insurance Governance Programme seeks to analyse policies, disclosure and broker contracts to identify sources of weakness which threaten major claim response and support policyholders to address these issues. Our client base ranges from multinational FTSE 100 companies to family owned SMEs and public sector bodies, with projects varying from an audit of existing insurance arrangements, either on key lines of business purchased or on the full programme of insurances, to ongoing executional support throughout all components of the insurance arrangement process. More information is available at www.mactavishgroup.com.



2. INTRODUCTION

This document sets out a range of summarised evidence from recent Mactavish research, which strongly supports the Law Commissions' proposed insurance contract law reforms, and has been submitted to both the Law Commission and HM Treasury in support of the case underlying the proposed Bill. The evidence is drawn principally from two sources:

1. Ongoing long-term Mactvish research into insurance placement standards, based on in-depth interviewing with senior management across industry sectors from around £50m in turnover and above. Updated statistics below are drawn from the most recent round of consultations with c.410 UK corporates in 2012 & 2013 – i.e. a sample of c.10% of all UK companies in this segment
2. Insurance Governance advisory work to assist insured companies (up to and including the FTSE 100) in detailed analysis of their policies and broker contracts, disclosure materials, placement procedures, obligations and coverage limitations etc. This work explicitly aims to improve the reliability of insurance policies. Although highly confidential, relevant anonymised statistics below are drawn from our most recent analysis of over 500 policies during 2013.

Whist some quantitative analysis is helpful, much of the most powerful evidence is anecdotal – with a small number of anonymous case studies set out below as far as possible whilst maintaining confidentiality of the companies involved. The range of companies involved in our work, and engaging our services to identify and remedy insurance governance limitations, is broad and includes many household names fundamental to the viability of the UK economy (and is, for example, more representative of major UK industry than the buyer organisation AIRMIC which focuses more strongly on larger clients). Much of the material below remains unpublished at this stage, and is set out here in outline to support the current case for legislative change.

The critical conclusions are summarised as:

1. There are clearly serious systemic problems affecting the reliability of insurance contracts, compounded by the evident long-term decline in technical standards across the insurance industry.
2. Although outcomes remain predominantly outside of the public domain (largely through the predominance of obligatory private arbitration as a means to resolve disputes, clearly reducing the availability of usable legal precedent), the issues are far from immaterial or niche, instead affecting the vast majority of businesses buying insurance in the UK.
3. Legislative change is vital but only one part of the picture – the goal of legislation must also remain to foster significant improvements in placement practices from insurers, brokers and insurance buyers if it is to improve the certainty and fairness of outcomes. Without this being achieved we believe the impact of the legislation would be limited.
4. Whilst much of the market commentary has focused on headline issues (such as "basis of contract" clauses) the underlying reliability issues created by systemically poor contracting standards are vastly more varied and complex – such that there is no alternative to up-skilling the actual placement process in addition to improving the legislative framework.

This summary paper merely scratches the surface of a huge volume of underlying evidence held by Mactavish, increasing daily through the course of our work. The firm holds what it believes to be by far the largest research base on this subject today, with additional underlying detail available throughout the matters analysed below.

3. EVIDENCE SUMMARY PART ONE – CLAIMS DISPUTE INCIDENCE & OUTCOMES

3.1 RELIANCE ON INSURANCE

- A central theme of Mactavish research has been on UK companies' strategic reliance on insurance – as contingent capital against an unwelcome loss event, where we conduct regular financial analysis looking at:
  1. The ability of organisations to withstand a loss in the event of insurance failing to respond as intend (i.e. funding through current available cash, new debt or new equity)
  2. The materiality of insurance cost within the current business financial context
  3. The comparability of insurance (contingent) capital access cost against the costs of accessing other (non-contingent) debt and equity capital.
- This analysis is obviously highly company-specific, confidential, and variances in risk profile and insurance programme structure limit the conclusions which can be drawn from broad brush cross-sector or temporal analysis.
- However, the key finding is that when viewed in this light there are very few UK companies today, far fewer than pre-financial crisis, whose dependence on insurance is not material financially – i.e. who could simply absorb a major loss of half or two-thirds of the policy limit on a major class without severe financial and strategic consequences.
- This is driven by both a) enduring difficulty in other capital markets in particular in respect of raising new finance in a distressed post-loss environment and b) the tightening of many companies' own balance sheet position (in particular amongst mid-size and smaller businesses) in a broadly low-growth environment.

3.2 MAJOR CLAIM DISPUTES – SUMMARY EVIDENCE

- Most major UK insurance claims disputes do not reach the public domain (unsurprising given that over 50% of all corporate insurance contracts reviewed, and closer to 100% on key P&C classes, have some form of binding arbitration clause)
- However, anecdotal evidence of real hardening in insurer claims attitudes since 2009/10 (set out in previous Mactavish reports and supported by public commentary from brokers and loss adjusters) is also augmented by more recent statistics from Mactavish research:
  - Based on recorded data from consultations with c.410 UK businesses (£50m+ turnover) in 2012 & 2013 – c.10% of all companies in this segment (excluding subsidiaries)
  - ~40% of these companies reported having suffered one or more large and/or strategically significant insurance claim within the prior 3-4 years. Although a proportion of more recent claims remain unresolved, of this group of large/ significant claims:
    - Only ~25% were progressing, or had been resolved, to the company's broad satisfaction
    - By contrast, around 45% had been formally disputed by the insurer
    - Where disputed, the average resolution time was just short of three years, at 35 months, with an average settlement value of ~60% of the initial claim.
- Based on a statistically significant sample of corporate Britain, these numbers unequivocally support the case for reform – although never an urgent or planned for short-term likelihood, it would be a fortunate business in the long term that continued under the current system to avoid a major claim which results in an outcome believed to be unfair. There is an unacceptable level of delay and uncertainty of outcome, sustained by the current legal framework and exacerbated by poor placement practices.

- It is important to note that this evidence does not isolate the impact on claims disputes of solely the issues addressed by the proposed statutory reform – instead we present evidence of the aggregate impact of (i) the current legal framework, (ii) poor technical standards in risk placement, (iii) poor standards of contracting execution, (iv) inadequate engagement by insurer legal & technical teams on individual cases, (v) non-engagement of legal expertise by insureds at pre-contract stage. Our view is that the legislation should combine addressing some key issues directly whilst seeking to encourage practice improvements and increased regulatory awareness to tackle the whole problem.
- By category, the most common grounds for claims dispute are, in order of prevalence of the primary cause of dispute:
  1. Coverage
  2. Quantification basis
  3. Warranty / condition breach
  4. Non-disclosure
- This order is particularly interesting in light of the above – whilst some of these issues will be addressed through the legislative changes proposed (for example rationalising the impact of breaches of various policyholder obligations) – even more common are problems with coverage and loss quantification which can only be reduced by concerted effort to ensure better placement practices in advance of loss – reviewing wordings & coverage, adaptation and application of standard policies to risk specifics, narrowing uncertainty over intended estimation basis etc. Claims dispute examples are typically highly sensitive from a confidentiality perspective. However, indicative examples of dispute types perceived by insureds as unreasonable in the period under analysis in this paper include:
  - Insurer arguing to extend generic 'duty of care' warranty to specifically include maintenance of a previously unspecified item of equipment, taking 3 years to settle at reduced value
  - Insurer arguing to extend flammable storage condition to include materials the insured would not have considered flammable, leading to eventual total repudiation
  - Insurer negotiating down a crime claim indemnity to <10% of loss value based on ~8 year prior failure to fully adhere to an HR employee screening reference condition which required a level of detail perceived by the client to be impossible to ever comply with.
  - Insurer arguing that a hand-written note on the slip (not previously seen by client) that the client "will do x" was a bona fide warranty despite not having been flagged to the client and being contrary to the client's formal internal policy.
  - Insurer successfully repudiating major claim based on late notification when notification had been made to the broker (but not passed on), with a very low broker limit of liability vs. claim value.

4. EVIDENCE SUMMARY PART TWO – WIDER POLICY DISPUTE POTENTIAL

4.1 INTRODUCTION

- This section sets out by type a number of the most concerning policy issues observed, including statistics on prevalence where appropriate and anonymised examples of issues uncovered on casework in the past six months. As above, this evidence is not of niche examples but is drawn from significant companies' current contracts with all of the leading global insurers and brokers including all of the 'big three' (Marsh, Aon and Willis) as well as the leading second tier players.
- The last sub-section 4.5 then draws together two fuller example case studies – one a regional manufacturing business of around £100m, the other a major FTSE 100 – to highlight the aggregate impact on policy reliability when (as is common) multiple concerns apply together. We have many similar examples and these anonymous cases whilst disturbing should not be viewed as anomalous outliers.
- In general, this section highlights a number of key facts around the market currently supporting the case for legislative change:
    - Far beyond the level of actual disputes where claims do occur and are challenged, our analysis conclusively proves that a much larger majority of policies would be unreliable if tested by a major loss
    - Current awareness by buyers (and the working level underwriters and brokers who interface with them) of the policy issues leading to claims disputes remains low – with claims teams uninvolved at the deal stage and the traditional insurance thought process remaining to use a combination of buying power and broker leverage at claim stage only to secure an acceptable outcome regardless of the contract. Whilst this approach has some appeal to buyer and broker communities, a) it is ever more challenged in a world where major insurers are international and increasingly compliance-led so that large claims are always scrutinised and b) it does not apply to the smaller buyer without the same buying power – exacerbating the need to create a fairer legal framework.
    - The market is not currently self-correcting – even where buyers are aware of the issues and actively seek contract improvements (e.g. endorsements to neuter basis of contract clauses or add innocent non-disclosure protection), the ability to negotiate an acceptable outcome is hamstrung:
        - Huge inconsistency of response from insurers, including between offices/ departments of the same insurers which agree to contract changes for one client whilst refusing it to others without engagement
        - Widespread prevalence of legal misinformation and assurances being made to clients (inadmissible in a subsequent claim dispute) by both insurers and also brokers that insureds need not worry about issues which are, in fact, legally critical to the passage of a claim
        - The persistent undermining effect of the skills gap in adapting generic policies to specific circumstances and finalising contractual changes – such that even where we have seen a more balanced contractual position agreed between the parties the existing deal execution infrastructure within the insurance industry (brokers and insurers) fails to properly effect the contract as agreed (*e.g. Q4 2013 examples include inserting endorsements into the wrong policy section, failing to override contradictory existing clauses, using the wrong versions of agreed clauses to inadvertently weaken rather than strengthen policyholder position, failing to provide policy amendments for over 6 months etc.).*
    - All of these points re-confirm the need to provide legislative guidance to support meaningful change in practices to secure fairer and clearer claims outcomes. Most of all, there is the simple commercial reality that many companies (and all smaller companies) deal with lower level staff at brokers and insurers and simply do not have an audience with whom they can negotiate any such changes - regardless of their own level of expertise or concern.
      To quote from the broker's response on one smaller business which had asked for various contractual amendments to adapt insured obligations within their D&O policy:

"Whilst [the insurers] appreciate your commentary, it is not something that they would look to do as the wording they have quoted with is a standard off the shelf product which they issue at the price quoted and have no intention of amending it to fit specific clients. They were not prepared to provide us with a bespoke product on the matters contained herein at this point in time."

(Sample SME broker response from major UK insurer, 2013)

4.2 OVERVIEW OF POLICY PROBLEMS

- Evidence of major legal and structural problems which threaten major claim payment and arise from poor placement procedures has become overwhelming, affecting every single policyholder reviewed regardless of size, sector, buyer sophistication, broker used etc. This is based as above both on long-term, interview based research across the policyholder community but also from collating in-depth reviews of over 500 policy documents on a wide span of clients undertaken over the course of 2013 – covering all major insurers and brokers across the UK market.
- Key issues reinforcing the need for reform include:
  - Contract uncertainty: very few cases reviewed were in possession of a full set of all relevant policy documentation (i.e. including all classes, schedules, slips, full wordings etc.) and failure to even meet the FCA guideline of core policy document a month after renewal (inherently limited since it does not allow for review pre-inception) remains commonplace – with any negotiated changes to standard contracts worsening the problem and often leading to delays of months to provide documentation following renewal.
  - Basis of contract clauses – clearly very prevalent, strengthening the case to address legally (section 1.13 of impact assessment):
    - Present within 56% of all policy documents reviewed, in addition to 62% of all proposal forms
    - Across several key lines (e.g. Professional Indemnity, Environmental) policy incidence is close to universal (>95%), with aviation, combined line package policies not far behind (>85%). D&O, Crime and PDBI are slightly lower (<50%)
    - 100% of cases reviewed were subject to at least one basis of contract clause on a material class of business, most typically in place across large swathes of the insurance programme
    - Review is made more challenging by the inconsistent placement of such clauses (e.g. in slips rarely shared with the client, within 'innocent non-disclosure' clauses etc.) and extensive variation in language used – such that the words 'basis of contract' need not be used but the legal intention remains similar and likely arguable as equivalent.
  - Obligations in policy wording are often voluminous, unclear, inconsistent and almost always unknown to the insured without significant focus by any party at placement stage.
    - In general, few cases reviewed had (prior to Mactavish undertaking this role) the benefit of any comprehensive or systematic analysis of policy obligations on the insured to ensure they are clearly understood and negotiated / compliance monitored accordingly. Several major brokers explicitly declined to undertake this role to clients based on admitted lack of relevant expertise and/or group legal clearance.
    - Obligations are typically held in multiple sections of lengthy policy documentation spanning hundreds of pages (e.g. across each policy coverage section with multiple sub-sections for each containing conditions, special conditions, additional conditions, warranties, conditions precedent, underwriting assumptions, exclusions, contingencies, additional contingencies etc.) – with standardisation of wording sections leading to common errors in policy issuance such that sections of wording or condition schedules are included where unintended or inconsistent between policy and schedule –

further increasing the likelihood of dispute. The applicability of primary layer conditions to excess layer policies is also often unclear.

- In addition, moves to 'plain English' wordings can serve to *reduce* clarity over condition status, and has itself been adopted inconsistently across the market (and often throughout the same policy document) – e.g. although buyers are typically unaware and final legal interpretation may be arguable, at least 'condition', 'condition precedent' and 'warranty' have some basis of established meaning where vaguer plain English wording (e.g. *"you may lose the right to indemnity if..."* or *"the insured undertakes to..."*) can lack it. Obligations can also be framed as exclusions or even extensions (e.g. *"cover is provided if..."* or *"cover is excluded unless..."*), further complicating the task of identifying and managing obligations held variously within what remains complex and usually incomplete documentation.
- Sheer volume also plays a role with many larger cases buying a complex insurance programme being subject to such a large number of total obligations that even the process of identifying and reviewing them becomes impractical – *e.g. 2012 case study of a large public sector organisation with more than 25,000 words of obligations alone contained within its various policy wordings – the vast majority of which were unknown and several major examples of which (e.g. conditions precedent or warranties) were known to be in breach at the time of discovery, thus invalidating cover).*

◦ As above, coverage uncertainty is the most common factor driving unsatisfactory claims outcomes, yet coverage analysis is rarely a focus at renewal – with our 2011 report finding, that only 2% of buyers both review wordings and conduct analysis of loss scenarios with insurers, remaining broadly consistent today. In addition, coverage is a key area where the decline in technical resource applied at a case level by brokers and insurers increases the propensity for error in adapting standard wordings to specific circumstances. Basic recent examples include:

- *FTSE 100 with all major product groups inadvertently excluded from liability covers via standard exclusion*
- *1bn+ manufacturer with main third party supplier sites 90% excluded from BI cover via accidental sub-limit*
- *1bn+ technology organisation with multi-million pound technology displays uninsured when at (regular, high value) third party events but insured at (non-existent) first party hosted events*
- *Major public sector organisation with several sites inadvertently sub-limited to a fraction of actual value through inclusion in the wrong section of cover*
- *£100m manufacturer with main products excluded from PL as well as key geographies excluded on PDBI.*

• Market self-correction is limited – further reasoning behind the case for statutory reform is that the market is not reliably moving towards the adoption of similar provisions or sufficiently clear legal precedent:

◦ Dispute resolution limitations – binding arbitration clauses present in over half (53%) of all policies reviewed – defined as any clause requiring a dispute to proceed to arbitration (whether in respect of quantum, liability or both) without necessitating the agreement of the insured to this step being taken. Again, this tends to be higher still for a number of key classes: >90% for PDBI, CAR and Motor. Whilst the process of arbitration may be attractive in some circumstances, it reduces options available to the insured by preventing a public hearing where PR concerns might prevent an insurer from running an unreasonable yet legally strong argument (such as basis of contract warranty breach via immaterial factual error).

◦ As above, a lack of clarity or consistency of outcome when seeking to adopt similar measures to the Law Commission proposals within current contracts:

- Pronounced lack of insurer / broker engagement in response to smaller customers when requesting changes such as basis of contract clause removal, innocent non-disclosure protection, provisions to make

warranties suspensory etc. (as noted and response example above)

- Very inconsistent response even to larger customers' requests –the same insurers agreeing in some cases whilst refusing on others; huge inconsistency in terminology adopted; agreed provisions being undermined through poor contract execution.
- For example, one of the areas where companies have sought to compensate for the challenges posed by the Marine Insurance Act is the development of innocent non-disclosure (IND) wordings. Yet today we see a wide variety of hugely contrasting such wordings in use – undermining certainty for the vast majority of policyholders who lack access to legal counsel to understand the differences, and where their points of contact at brokers and insurers equally lack relevant legal expertise and offer inaccurate advice.
  - Recent months in late 2013 have seen examples of brokers erroneously inserting the wrong IND clause to the one agreed, insurers refusing clauses but wishing (presumably in error) to replace with an alternative more unfavourable to their own interests, many variants proposed of unclearly drafted IND clauses which lack clarity or which in some cases undermine the fundamental principles of insurance law by seeking to remove any incentive to disclose etc.
  - There is routine confusion in the assurances made to clients by both brokers and insurers as to the legal implications of various wordings.
  - This is an example of a complex area of law where few of those conducting transactions understand the relevant detail – creating unnecessary uncertainty of outcome and making a clear case for high level legislation to guide the basic principles such clauses should seek to adopt.

4.3 OVERVIEW OF LIMITATIONS TO DISCLOSURE PRACTICES

- In addition to policy issues, company disclosure remains in general extremely inadequate by comparison with either statutory legal obligations or the additional duties around disclosure created by policy contracts themselves. The below summarises some of the key evidence, responding to 1.12 and 1.3 of the Impact Assessment and providing further evidence of passive underwriting across all sizes of business and the limited nature of broker support.
- Our 2011 finding that a full c.65% of UK companies report that they do not obtain and review all information used to place their insurance programme remains in our view consistent – and this remained a majority even amongst only the larger companies interviewed (£1bn+ in turnover). Very few responsible personnel in UK insureds are aware of the full nature of the duty under law or the impact of contractual clauses around basis of contract, 'material alterations', notification etc.
- In light of this, it is interesting to note the Law Commission's intention to maintain the duty of disclosure (with which we would agree) but also to introduce the notion of requiring reasonable procedures to gather information and present the risk appropriately. In addition, we note the strategy of at least one major UK insurer to offer contractual terms improvements only contingent on a fuller review of underlying disclosure procedures – as an example of the type of procedural improvements to market practice the legislation can and should seek to stimulate.
- Contrary to the Law Commission's indication in the Consultation Paper, proposal forms remain in common use even by the largest UK corporates for almost every case reviewed – despite such forms' broad inability to capture the operational complexities of multi-national, multi-divisional business, and their ongoing tendency to include basis of contract provisions and unequivocal assurances of total accuracy:
  - Their use remains predominant for specific lines (e.g. PI, D&O) that operate for all clients almost exclusively using proposal forms, and/or where the proposal form serves as the basis

of underlying data collection for the broker to then collate into broader submission material.

- Examples from significantly sized cases reviewed in the last 6 weeks of 2013 alone
  - *£1bn+ manufacturer – proposal forms across all classes*
  - *£100m-£500m logistics – proposal forms across all classes*
  - *£1bn+ utility – proposal forms for 10 classes including EL, Motor, PA & Travel, PL, Marine, D&O, PI, Crime etc.*
  - *£100m-£500m manufacturer – proposal forms for 5 classes (all except PDBI and EL/PL)*
  - *£500m-£1bn hospitality – proposal forms across all classes*
  - *£1bn+ construction – proposal forms for 7 main classes including CAR, PI, D&O, EL/PL*
  - *£1bn+ publishing – proposal forms for 5 key classes including PI, Crime, D&O, Environmental*
- Other problems created by proposal form use include: inadequacy of Y/N format to capture complexity; common uncertainty amongst multi-divisional businesses of which underlying forms are disclosed or how to manage information conflict between forms (such that answers must be both inaccurate and incomplete – *with the observed broker tendency to present only the more positive version in case of conflicting answers in underlying forms even when dealing with verifiable points of data – e.g. site security measures, sprinkler protection etc.).*

- Regardless of the use of proposal forms or more lengthy risk submissions adapted for the larger corporate segment, in any case the content of disclosure documentation remains focused almost entirely on the data requirements of underwriting models, with little insurance risk specific analysis of key exposures, risk evolution or mitigation impacts in most cases – other than via attachment of pre-existing documentation with typically peripheral insurance risk relevance, and often via 'data dump'.
- The concurrent problem of data dumping continues to exist as a poor response to the demanding disclosure duty – with a significant proportion of respondent cases providing up to several hundred individual documents to support disclosure with little explanation or signposting, often combining many such documents as appendices to a proposal form with them captured by one or more basis of contract clause (almost always without cognisance of the legal impact this has). Even where the more innovative 'data room' structure has been adopted this often operates as a technological facilitation of data dumping – providing large volumes of partially relevant or conflicting documentation without context or narrative specific to the purpose of insurance risk assessment. This does not typically represent a fair presentation of risk in our view.

Case study Q4 2013: FTSE 100

- C.3,000 pages of information provided on risk across more than 150 separate disclosed documents/ emails
- Mostly formatted as emails or unsearchable PDFs with no indexing or commentary and no overarching submission to highlight relevance of specific documents/ sections
- Significant overlap and factual conflict between various underlying data files
- No insurance specific disclosure support work to adapt or explain document relevance to insurance risk – e.g. internal newsletters, staff induction workbooks, lengthy procedural manuals & checklists etc.

- Broker support in this area, outside of technological support to archive documents and pass on, is generally very limited
  - Broker contracts generally exclude any requirement to advise on disclosure adequacy or confirm what is disclosed
  - Record keeping is generally far from complete in respect of:
    a) what documentation has actually been shared with insurers (e.g. with common lack of clarity that the same information has gone to all syndicating markets)
    b) failing to collate or feed back to insureds risk questions raised by bidding insurers (which itself defines materiality)
    c) without any records being kept of verbal broker assurances made to underwriters.
  - Technical advice arising from brokers is also often concerning when assessed against insured disclosure obligations:
    - Regular assurances given on the lack of need to disclose information, without evidence of checking with the underwriter and often advising against disclosing apparently material information.
    - Even more limited disclosure (typically at most an updated schedule of values or recycling of inaccurate out of date documentation) taking place as a matter of course for any renewal without a tender exercise, despite the recurrence of the statutory disclosure duty on the buyer (even when the policy is in an LTA).
    - A consistently low standard of technical advice concerning legal matters where client facing staff are typically not aware of the legal issues involved but nonetheless give advice, e.g.:
      - General lack of relevant legal expertise amongst insurer and broker account management staff – *for example multiple cases where the broker (and even insurer) has assured the buyer that no basis of contract clause is in place for a specific policy/ proposal form when in fact several such clauses applied.*
      - Repeated advice to clients from both brokers and insurers that pursuing discussion to seek coverage clarity at the policy arrangement stage is inadvisable as it "may be contentious" – ignoring the fact that the same discussion when a claim outcome is at stake is even more contentious and also subject to hugely divergent interests, with no alternatives available.

Case study Q4 2013 (FTSE 100)

Having arranged and lined up multiple senior colleagues to undertake a detailed risk and coverage review workshop with broker and underwriter, and having asked both the (major global) insurer and big broker to provide a record of points discussed/ agreed as reflecting the scope of intended cover, the insurance buyer was disappointed to receive no documentation for several months, followed only by an apology from the broker that neither party had ultimately noted the discussion other than high level administrative details, such that no risk detail or coverage commitments had been recorded at all.

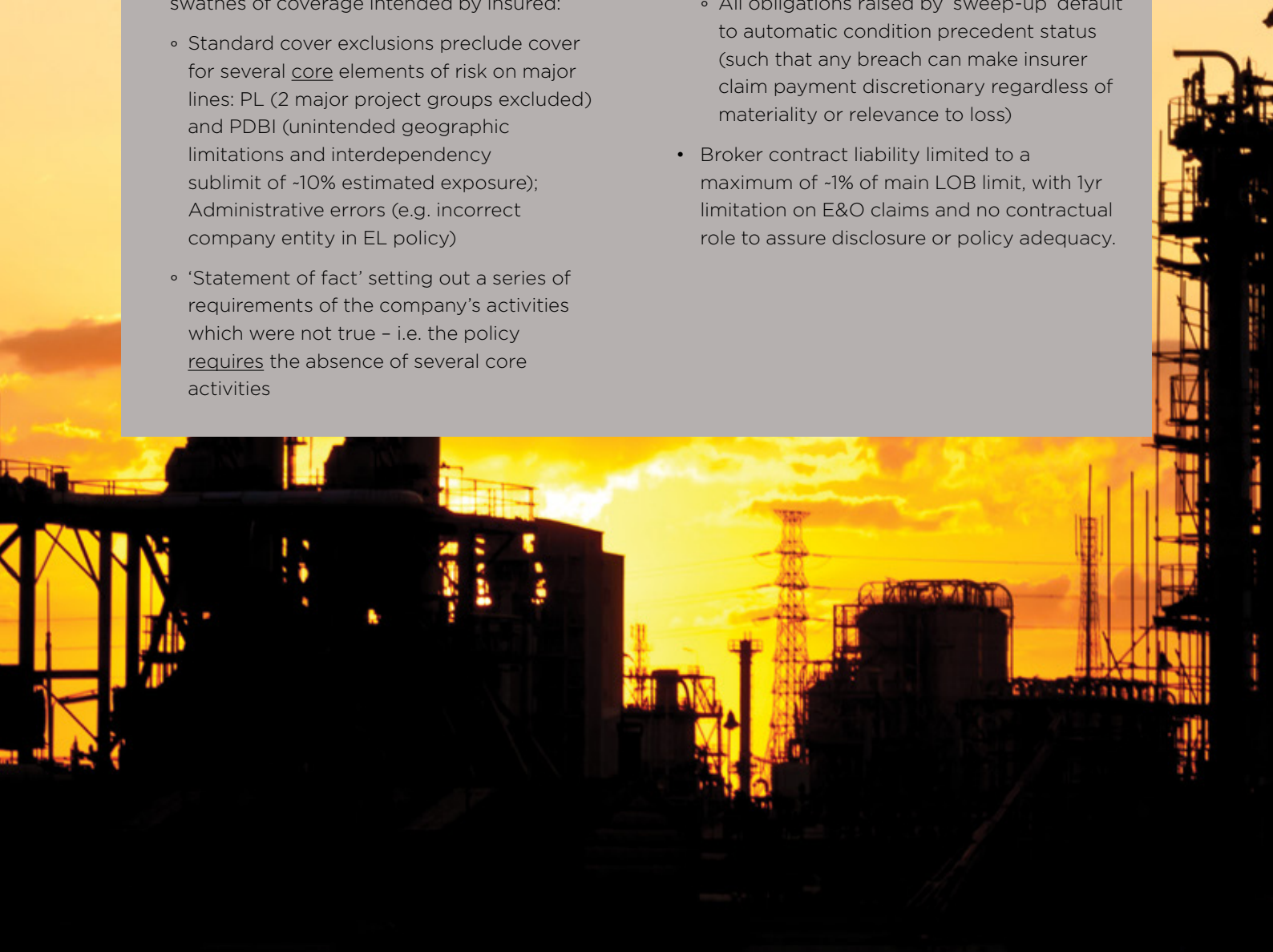
4.4 BROKER ROLE AND CURRENT BROKING CONTRACTS

- It is interesting that the main analysis by the Law Commission in setting out the proposed reforms to insurance contract law focuses entirely on the insurance policy and the relationship between insurer and insured without much reference to the role of the broker even though the vast majority of commercial contracts (even in the SME segment) are broker intermediated.
- Whilst inevitable since the broker contract is governed under general commercial rather than insurance law, the broker retains a critical role in arranging the policies concerned and ensuring the insured is aware of the risks to policy reliability.
- There are two key observations to make in this respect
    - First, despite their commercial clout and global execution capability, given an increased focus by all brokers on transaction cost efficiency and sales/ customer management performance (and an associated reduction in focus on technical standards) this advisory role is not adequately discharged today
    - Second, client-broker contracts (TOBAs) do not support the need to deliver a full placement offering to clients – with most having gone un-negotiated by clients for many years and suffering from three main limitations of which most clients are not aware, in terms of:
        - Near total absence of specifically defined responsibilities to ensure policies are fit for purpose or reliable.
        - Liability level for broker policy execution typically a tiny fraction of the risk of policy failure to the insured.
        - Very limited transparency regarding full proactive fee/ commission disclosure, conflict of interest disclosure, MGA/ insurance scheme disclosure etc.
- Whilst the commercial bargain between client and insurance broker is not the intended focus of this legislative reform, there is a strong case for the legislation and legislative process to help define what the broker role should be to overcome the contracting deficiencies between insurer and insured. Key points should include:
    1. Highlighting to clients the need for greater executional liability limits for the broker given current contracting concerns
    2. Flagging the need for more time and more insurer engagement pre-deal rather than commoditising by default a standard and by consequence inadequate insurance product
    3. Broadening the concept of 'contract certainty' beyond document provision (itself routinely not complied with) to include clarifying and negotiating terms as required to make the contract certain (i.e. reliable) on inception
    4. Flagging to buyers the need to define the broker responsibility in line with reasonable expectations here (beyond current TOBA norms).

4.5 WORDINGS & DISCLOSURE – POLICY RELIABILITY CASE STUDIES

Case Study: ~£100m regional manufacturing business

- Highly disordered disclosure mixing proposal forms and hand-written amendments likely to undermine any material claim at insurer discretion:
  - Multiple points of inconsistency in seemingly material areas such as values data, risk protection measures in place at key sites etc.
  - Not possible to establish what had or had not been disclosed
  - No mention of material recent changes to business & risk, e.g.: design changes; new product types; new outsourced production
- Basic placement errors excluding huge swathes of coverage intended by insured:
  - Standard cover exclusions preclude cover for several core elements of risk on major lines: PL (2 major project groups excluded) and PDBI (unintended geographic limitations and interdependency sublimit of ~10% estimated exposure); Administrative errors (e.g. incorrect company entity in EL policy)
  - 'Statement of fact' setting out a series of requirements of the company's activities which were not true – i.e. the policy requires the absence of several core activities
- Wider review of wording obligations prompted several major areas of concern threatening policy response:
  - 17 basis of contract clauses applying across all lines such that even immaterial inaccuracy in data provided could invalidate the policy
  - Various clauses extending duty of disclosure beyond statutory basis without any IND protection
  - Over 15,000 words of policy obligations never reviewed by, or flagged to, insured with several conditions precedent already breached without knowledge
  - All obligations raised by 'sweep-up' default to automatic condition precedent status (such that any breach can make insurer claim payment discretionary regardless of materiality or relevance to loss)
- Broker contract liability limited to a maximum of ~1% of main LOB limit, with 1yr limitation on E&O claims and no contractual role to assure disclosure or policy adequacy.



WORDINGS & DISCLOSURE – POLICY RELIABILITY CASE STUDIES

Case Study: FTSE 100

- Highly unclear disclosure picture likely to undermine any material claim at insurer discretion:
  - No formal submission disclosure or client sign-off, instead 80+ emails and 100+ attachments variously shared with insurers.
  - Uncertainty as to what information had actually been disclosed to which insuring markets and a large degree of inconsistency/ conflict between disclosed documents.
  - Several clauses increasing the consequence of limitations for all key classes by a) extending the statutory duty of disclosure and b) applying basis of contract status to all information disclosed such that any even immaterial inaccuracy could invalidate the policy.
- Policy wordings not provided until several months post renewal, not formally reviewed by broker or client despite issues of concern therein:
  - A large number of explicit warranties/ conditions precedent including further sweep-up provisions raising all obligations (regardless of their materiality) to condition precedent status across all main classes.
  - Several conditions precedent where client already known to be in breach, effectively making insurer claim payment discretionary regardless of relevance to loss.
  - Binding private arbitration requirement for all classes removing any ability to challenge claim refusal publicly or in the courts.
  - Material drafting errors and multiple conflicting clauses included in error leading to significant uncertainty over insured obligation in areas such as fire protection and waste handling.
- Broker contract liability limited to a maximum of ~10% of key LOB limit and no contractual role to assure disclosure or policy adequacy.

Mactavish is the UK's leading expert on insurance governance

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