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TIME FOR CHANGE

FINAL

THE ENTERPRISE ACT 2016 AND LATE PAYMENTS

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TIME FOR CHANGE

THE ENTERPRISE ACT 2016 AND LATE PAYMENTS

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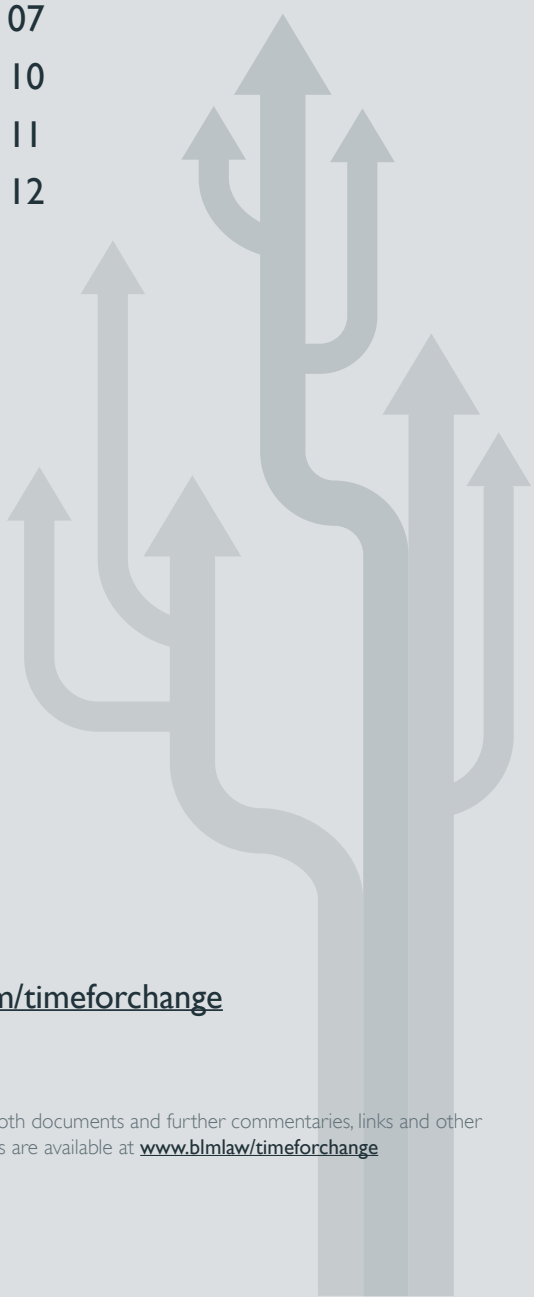

We hope you find this update informative.

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There is further Enterprise Act 2016 information at blmlaw.com/timeforchange

FOOTNOTE
This document is produced in conjunction with the third edition of 'Time for Change'. A soft copy of both documents and further commentaries, links and other information and a CII CPD Supplement with video commentary by the authors of the enclosed articles are available at www.blmlaw/timeforchange

IMPLIED TERM OF PAYMENT WITHIN A REASONABLE TIME

FOREWORD

For many years Insurance Law in England and Wales (but not Scotland) adopted the "hold harmless" principle. This meant that an insurer was in breach of contract whenever a loss occurred. Payment under the policy was therefore treated as damages. One effect of this was that if a policyholder suffered further loss as a result of an insurer failing to pay their claim they could not recover compensation. English law did not permit damages on damages. The policyholder could only recover their original loss and simple interest. This rule was an exception to normal contract principles and did not apply to life insurance or reinstatement. It was not applied by the Ombudsman in consumer and small business cases and it had begun to seem anomalous internationally. The Law Commissions had consulted on changing the law but did not include any change in the draft bill that became the Insurance Act 2015. This Act has now been amended by the Enterprise Act 2016 and a "late payment" term applies to policies incepted or renewed from 4th May 2017.

Despite the amendment the Law Commissions, it should be noted, did not find any historical evidence of systemic late payment by insurers. Their proposals were intended to remove a legal anomaly and bring English insurance law more into line with general contract principles, Scottish law, the law as it applied to life insurance, FOS practice and various other civil and common law jurisdictions.

The Enterprise Act 2016 amends the Insurance Act 2015 providing that it is an implied term of every insurance contract that the insurer pay claims within a reasonable time and that failure to do so can lead to compensation for any resulting loss. The amendment is considered by Terry Renouf at pages 02-03 and guidance by Philip Vallance QC on existing case law on the heads of damages payable is at pages 04-05. Additionally the amendment provides guidance on what is a reasonable time. What is reasonable will depend on all the circumstances. However insurers should have adequate time to investigate and a court should take into account issues such as the type of insurance, the size and complexity of the claim, regulation and factors outside insurers' control. Practical issues are considered by John O'Shea at pages 07-09 and the broader regulatory issue of conduct risk by Ian Sinho at page 10. In order to have a successful claim the policyholder will have to prove that they have suffered a loss as a result of the late payment and, in practice, that the insurer's conduct of the claim fell well short of what might be expected. In short insurers should not be liable for delays caused by genuine disputes. Insurers can also contract out of these provisions.

David Hertzell
BLM Consultant and former Law Commissioner

Key points

- Insurance Act 2015 to be amended
- Act introduces implied term that claim will be paid in a reasonable time
- Consequential losses for breach now recoverable
- Insurance law aligned with general contractual principles

INTRODUCING AN IMPLIED TERM: ENTERPRISE ACT 2016

The Enterprise Act 2016 amends the Insurance Act 2015 inserting a Clause 13A which addresses the anomalous case law relating to "late payment". The key provisions are:-

1) It is an implied term of every insurance contract that sums due must be paid in a reasonable time;
2) Reasonable time includes time to investigate and assess the claim;
3) What is reasonable depends on all the circumstances but includes the type of insurance; the size and complexity of the claim, compliance with regulation, factors outside the insurer's control (such as delay by the policyholder);
4) The insurer will not breach the implied term by disputing the claim provided the dispute was genuine;
5) Any payments for breach of the term are in addition to payment of the original indemnity and interest.

The Act also introduces a special limitation provision. The normal six year periods will apply running from the date of loss for the indemnity and the date when the claim should have been paid for additional damages. However in order to provide some certainty for insurers there is a longstop of one year from the date when sums due under the policy were paid in which to bring additional damages claims. No further claims can be brought after this. (Appendix A includes the details of the new sections of the Insurance Act 2015).

Commencement

The new implied terms relating to late payment will apply to policies renewed or incepted from 4th May 2017 this being one year after the Enterprise Act 2016 received Royal Assent. An underwriter could therefore, during the course of the calendar year commencing on 1 August 2016, write commercial policies where the underlying law was different: the Marine Insurance Act 1906 for those policies incepted from August 1st to 11th; the Insurance Act 2015 for policies from 12th August and, subject to the new implied term regarding "late payment" for any policies incepting from 4th May 2017.

Opting In

A number of insurers during the implementation phase of the Insurance Act 2015 indicated that they intended to apply the provisions or "the spirit of" the Act to current policies. Those insurers may, though it is unlikely, find that the implied term of the Enterprise Act 2016 could be imported prior to formal commencement. Alternatively there may be commercial advantage to be gained, and simplicity of administration, in adopting the new "late payment" clause to policies incepting from 12 August 2016.

It should be noted that as a matter of law the "hold harmless" principle only applied to

contracts of insurance for indemnity. Thus the remedy of damages for consequential losses in the event of breach of contract was always available to a policy holder of both life policies and policies for reinstatement.

Additionally it should be noted that whilst the new law on late payment does extend to Scotland the present law has always allowed claims for payment of damages for breach of contract. The application of the new implied term arises because the Judiciary in Scotland advised the Law Commissioner that a difference in the law on the point could lead to unnecessary divergence on essentially the same issue and suggested that the law should harmonise as it now will do following enactment of the Enterprise Act 2016.

Consumers, Micro-businesses and the Financial Ombudsman Service

The new law applies to all insurance policies but the Financial Ombudsman Service (FOS) has jurisdiction over consumer disputes and those involving a micro-business (ie a business with fewer than 10 staff and less than €2m turnover). Awards made by the Ombudsman have for many years ignored the law and awards for distress and inconvenience are commonplace. It is the BLM view that the new law on "late payment" would result in fewer successful claims but that the awards for contractual damages are potentially higher. Whether the FOS will, in respect of microbusinesses, maintain frequency levels and increase the cost of each claim is a matter for conjecture but some allowance should be made for the risk that success rates will not fall and awards per case will rise.

Implied Term and contracting out

1) **Mandatory for consumers and in case of deliberate / reckless breach of commercial policies.**

The Government has concluded that an insurer may contract out of the implied term where the policyholder is a commercial entity (or a "non-consumer" to use the terminology of the Act). However such contracting out may only take place where a breach by the insurer of the clause to pay in a reasonable time was not deliberate or reckless. "Deliberate or reckless" is defined to be the situation where an insurer knew that it was in breach and did not care that it was in breach. This definition mirrors the test that is applied to remedies available to an insurer where a policyholder breaches its duty of fair presentation. Thus the term for payment within a reasonable time will be implied into all consumer contracts and in circumstances where the breach of the term by the commercial insurer is deliberate or reckless.

2) **Contracting out for Commercial policies and transparency-**

In those circumstances where an insurer chooses to contract out of the implied term to pay a claim within a reasonable time it will also be required to comply with the transparency provisions of the Insurance Act 2015. These provisions require the insurer to take sufficient steps to draw the disadvantageous term to the policyholder's attention before the contract is entered in to. The term must be clear and unambiguous. The transparency requirements within the Act also make it clear that the characteristics of the policyholder and the circumstances of the transaction are taken in to account when determining whether the conditions have been met. In short the requirement on the insurer is greater (and more costly) and carries greater legal uncertainty where the policyholder is a sole trader or SME than for a large sophisticated corporate advised by a top broker.

Limitation of liability clauses

Consideration should be given as to whether insurers would wish to protect their position by agreeing a limitation of liability clause within the contract of insurance. Such a term would be a "disadvantageous term" and subject to the requirements on notification, unambiguity and transparency mentioned in the preceding paragraph.

Financial Ombudsman Service

Terms that contract out of the new terms relating to timely payment of claims will be considered by the Ombudsman. The transparency requirements will be considered. In many instances the "characteristics of the policyholder" will be indistinguishable from that of a consumer and it seems likely that the FOS will conclude that the statutory requirements have not been met or more practically treat the sole trader as a consumer where contracting out is of no effect. Careful consideration should be given to whether contracting out of the "late payment" term for microbusinesses will be cost effective given the notification requirements and likely legal uncertainty as to whether the term could be relied upon in Court.

Terry Renouf
BLM Partner

Introducing an implied term

- Reasonable time to pay claim includes time to investigate
- Type of insurance, size of claim and complexity all relevant
- New one year limitation period introduced
- Commencement: policies incepted, renewed or varied from 4 May 2017
- New term mandatory for consumers
- Transparency provisions apply to commercial policyholders where opting out

DAMAGES AND CONSEQUENTIAL LOSSES

The general principles of contract law apply.

To avoid uncertainty it will be noted that the section 13A of the Insurance Act provides that the Policyholder's rights are retained to:

i. enforce payment of sums due

ii. recover interest on damages

Damages payable: general contract case law considered

The obligation to pay claims within a reasonable time takes effect by way of the incorporation of an implied term into the contract of insurance. This means that the relevant principles as to recoverable heads of damage and remoteness will be contractual rather than tortious. Whereas in tort the over-arching control mechanism is one of "reasonable foreseeability", in contract, the focus is more upon what the particular parties to the particular contract ought reasonably to have contemplated (at the time the contract was made) as likely to occur in the event of breach. (In general terms, awards of damages are generally regarded as somewhat more conservative and restricted in contract than in tort.) This is confirmed by para 26.37 of Law Com No. 353[1]: "Any damages payable to compensate for late payment [and n.b. that at common law the function of a remedy by way of damages is indeed compensatory and not punitive] will be limited by the general principles applicable to contractual damages, as articulated in *Hadley v Baxendale* and further refined and restricted in subsequent cases." (See also para 25.5 : "The Courts have stressed that the rule on foreseeable loss should be applied with a view to commercial reality, the context in which the contract was made and what the parties may reasonably have expected.")

Ordinary principles apply

Ordinary principles of causation and mitigation of loss will of course apply. So far as remoteness (the most likely area of dispute) is concerned, *Hadley v Baxendale* (1895) 9 Exch 341 famously held that in order to be recoverable as damages, loss (that is to say, financial loss) must be of a type which either arose naturally ("in the ordinary course of things") or which might reasonably be supposed to have been in the contemplation of the parties when the contract was made (which will in turn be dependent on what was *known* to them – both of them – at the time). The rule was "refined" thus by Lord Reid in *Koufos v Czarninikow Ltd* ("The Heron II") [1969] 1 AC 350 (repeated by Lord Walker in *Jackson v RBS* [2005] UKHL 3 – a loss of profits case) : "The crucial question is whether, on the information available to the defendant when the contract was made, he should, or a reasonable man in his position would, have realised that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation."

Whether and if so to what extent the rule has been "restricted" depends on the view taken of *Transfield Shipping v Mercator Shipping* ("The Achilleas") [2008] UKHL 48, esp. the opinion of Lord Hoffmann, which is the subject of academic controversy. The general consensus, however, appears to be that although in most cases a conventional application of *Hadley v Baxendale* principles will continue to suffice, those principles are "capable of rebuttal in cases in which the context, surrounding circumstances or general understanding in the relevant market shows that a party would not reasonably have been regarded as assuming responsibility for such losses" (per Lord Hoffman in *"The Achilleas"*.) In other words, there may be other factors which determine that loss of a certain type or scale is not recoverable even though it was or should have been contemplated. One such factor (again according to Lord Hoffman) might be where "the quantum of liability is disproportionate to the scale of the transaction and the benefit the bank [or other party in breach, say insurers] stood to receive."

In *John Grimes Partnership v Gubbins* [2013] EWCA Civ 37, Sir David Keene (in the Court of Appeal) observed : "It seems to me to be right to bear in mind, as Lord Hoffman emphasised in *"The Archilleas"*, that one is dealing with the law of contract, where the situation is governed by what has been agreed between the parties. If there is no express term dealing with what types of losses a party is accepting potential liability for if he breaks the contract, then the law in effect implies a term to determine the answer. Normally, there is an implied term accepting responsibility for the types of losses which can reasonably be foreseen at the time of contract to be not unlikely to result if the contract is broken. But if there is evidence in a particular case that the nature of the contract and the commercial background, or indeed other relevant special circumstances, render that implied assumption of responsibility inappropriate for a type of loss, then the contract breaker escapes liability." In *John Grimes*, the Court held an engineer, whose breach of contract had caused a project to be delayed, liable for loss sustained as a result of a falling market.

[1] Law Commission Report on Late Payment (Law Com No 353)

Case law and commercial risk

In the context of insurance of commercial risk (say against the risk of damage to profit-earning property or plant and machinery or against loss caused by business interruption) it is not easy to discern any reason why the standard *Hadley v Baxendale* approach should not apply. Almost by definition, insurers will be possessed of at least outline knowledge of the nature of the insured enterprise and, given the commercial purpose of the policy, it seems inevitable that they will be held reasonably to contemplate that delay in meeting valid claims might well be in principle causative of prolonged disruption and thus loss of profit or business opportunity. Equally, and using Lord Hoffmann's terminology, the "commercial setting" of such insurance would seem to dictate that insurers will be held reasonably to have "assumed responsibility" for that type of loss. An example of such loss is of course to be found in *Sprung v Royal Insurance* [1999] Lloyd's Rep IR 111 (the decision in which set in train the impetus for reform which eventually led to the present change in the law) : a delay of nearly four years in settling a claim for damage to plant and machinery led to closure of the business (and loss of the opportunity to sell it to a competitor). It should moreover be noted that any argument that Mr Sprung's loss was in fact caused by his impecuniosity (inability to repair the plant out of his own resources) rather than by insurers' delay would now be bound to fail in the light of the decision in *Lagden v O'Connor* [2003] UKHL 64 (overruling *The Liesbosch* [1933] AC 449) : the wrongdoer must take his victim as he finds him and bear the consequences.

Foreseeability of loss

In order to sound in damages those consequences must of course be foreseeable in the sense envisaged by *Hadley v Baxendale* (and, arguably, must be a consequence for which insurers will be held to have "assumed responsibility"). If delay in settling a claim leads (as a matter of mechanical cause and effect) to an outcome which, in terms of either quality or quantity, bears no sensible relation to the nature or scale of the insured enterprise (as known to insurers) then such outcome will be both outside the contemplation of the parties and (arguably) something for which insurers cannot reasonably be said to have assumed responsibility : in this connection Lord Hoffmann's example of the exceptional case where "the quantum of liability is disproportionate to the scale of the transaction and the benefit the bank [say insurer] stood to receive" may prove relevant.

Damages for distress

A company (or other corporate entity) has no feelings but where the insured is an individual (whether a consumer or non-consumer) delay on the part of insurers may well be productive of predictable distress, anxiety and vexation. At common law, damages for insured feelings cannot be recovered in a contractual action (*Watts v Morrow* [1991] 1 WLR 1421). As an exception to this rule, however, damages for distress and vexation may be awarded in cases where one of the "major or important" objects of the contract was to provide "enjoyment, security, comfort or sentimental benefit" (*Jarvis v Swan Tours* [1973] QB 233) or as it was put more recently in *Farley v Skinner* [2001] UKHL 49 "pleasure, relaxation and peace of mind." Only the most hard-hearted of insurers would seek to deny that an important object of most insurance policies is to afford security and peace of mind and accordingly in an appropriate case it is to be anticipated that damages for mental distress will be awarded; insurers may take comfort however from Lord Steyn's observation in *Farley v Skinner* that awards of non-pecuniary damages should be "restrained and modest" because "it is important that logical and beneficial developments in this corner of the law should not contribute to the creation of a society bent on litigation."

Philip Vallance QC
BLM, Consultant and in-house Silk

Damages and Consequential losses

- Remedies to enforce payment and interest on damages retained
- Recoverable heads of contractual damages more conservative than tortious
- Foreseeable losses assessed as those in contemplation at time contract was made
- Insurers of commercial risks will have outline knowledge of policyholders business
- Ordinary principles of causation and mitigation apply
- Damages for distress where important object of contract is enjoyment, security or "peace of mind"

DEFENCES AVAILABLE

An implied term that payment of a claim should be made within a reasonable time is new to insurance but it does bring the industry into line with general commercial practice. The case law discussed above enables a number of general principles to be established:

1) The policyholder must establish a loss;

2) The loss was reasonably foreseeable;

3) Foreseeability of losses at the time the contract of insurance was incepted is the relevant date;

4) The policyholder has an obligation to mitigate its loss. By way of example: a large cash rich multinational corporate with access to alternative funding sources seems unlikely to be able to establish a claim against an insurer if it has not accessed those alternative sources of funding.

5) Causation – the damages claimed must have been caused by the breach: of relevance may be the size of the claim in relation to the company and its sources of funds; whether there was a sizeable excess that might have caused difficulties in any event.

6) Limitation – see above and note the special one year provision.

Statutory factors to be considered

Evidentially the burden of proof rests with the policyholder. Additional safeguards and protections are provided as it is recognised by the Government that insurers not only provide contingent capital for the policyholder making the claim but are also custodians of the pool of premiums against which other policyholders will need to claim. Therefore the legislation provides that:

1) Insurers have a reasonable time to investigate and assess a claim.

   "Investigate AND assess" suggests that time will be allowed not only to consider the obligation to indemnify but also to value the claim. Good practice would however suggest that a timely interim payment might be made once indemnity is confirmed.

2) In considering what is reasonable the Court may need to take into account:
   i. type of insurance;
   ii. the size and complexity of the claim;
   iii. compliance with any relevant statutory or regulatory rules or guidance;
   iv. factors outside the insurer's control.

3) Failure to pay where there were reasonable grounds for disputing a claim is not, of itself, a breach of the implied term but the conduct of the insurer in handling the claim may be a relevant factor:
   i. reasonable but wrong is not anticipated to lead to a claim for late payment;
   ii. note: reasonable but wrong might be a recoverable claim under present Scottish Law.

Terry Renouf
BLM Partner

PRACTICAL CONSIDERATIONS

Evidence and legal professional privilege

In common law jurisdictions legal professional privilege protects all communications between a professional legal advisor (a solicitor, barrister or attorney) and his or her clients from being disclosed without the permission of the client.

The purpose behind the legal principle is to protect an individual's ability to access the justice system by encouraging complete disclosure to legal advisors without the fear that a disclosure of those communications may prejudice the client in the future.

In a claim for damages for late payment it is a defence for the insurer to say there were reasonable grounds for disputing a claim. Insurers may have taken legal advice on the merits of the claim in order to arrive at that decision. The advice from the appointed solicitor forms part of the overall matrix which insurers may wish to rely upon in their defence to a claim.

The decision of insurers to take advice on a particular matter, which might itself delay a decision on payment if further work is recommended, is hardly challengeable by an insured provided that insurers in good faith follow the advice given. However, where insurers, on advice, make a decision that is unfavourable to an insured the issue arises as to whether legal professional privilege attaches to the advice and if it does attach whether the insurer client can rely on it without waiving privilege.

This point was raised during the course of the Act's passage through Parliament and an amendment was proposed at report stage in the House of Lords which would have permitted waiver of privileged material in some circumstances. However, the Government preferred not to create special sector related exceptions to the general law of legal professional privilege and the amendment was withdrawn.

Therefore, the rules in relation to legal professional privilege remain unaltered for now as to those cases for which litigation is contemplated. However, we may see a challenge in the future to that position as the common law develops through case authority, as matters come before the courts.

The withdrawn amendment was drafted by Colin Edelman QC and concisely states the present legal position:

" It shall be open to the insurer to produce evidence of the fact that it sought and obtained legal advice to the effect that it had reasonable grounds for disputing the claim without thereby generally waiving privilege in the substance or content of the legal advice it received."

Suppliers and third party administration

1) Contracts and indemnities

Insurers conduct their business with the help of suppliers. The most obvious examples are loss adjuster and experts, but there are many more. Further, insurers handle claims themselves through their claims centres but in some cases outsource the whole of the claims function or part of it to third parties.

Those third parties are an extension of the insurers claims departments and act as agents for the insurer. What then is the situation where the agent, whoever that might be, is responsible for a delay which exposes insurers to a claim for late payment?

It would be an implied term of the contract with the supplier that the supplier will act in such a manner as not to expose their principals to a claim for late payment. Such a term would be implied into contracts for which the late payment provisions apply but may not apply where insurers unilaterally decided to adopt the provisions of the Insurance Act 2015 and the Enterprise Act 2016 late payment amendment 'in principle' before those Acts were in force and take effect, i.e. if an insurer had "gone early".

Where however insurers had decided to review their existing arrangements in light of the changes to the law relating to late payment and agreed an express contractual term with their suppliers which provided that if the supplier were responsible for the delay and a claim resulted, the supplier will indemnify the principal for any losses they may incur.

2) Audits

Most if not all insurers audit the performance of their suppliers against their supplier agreements. Necessarily the audits need to involve issues around the Insurance Act 2015 and the Enterprise Act 2016 amendment as they relate to late payment.

Insurers include within their current service standards for suppliers timescales for certain steps to be taken, for example, contact with the insureds, attendance on site and reporting. The late payment clause provides an opportunity for insurers to ensure an ongoing performance standard for their suppliers, if they have not done so already, to avoid, where possible, the risk of a claim for late payment and in the event of default, an indemnity should things go wrong.

Reserving

The concern over the value of potential claims for late payment was in part the reason why the clause for late payment was omitted from the Insurance Act 2015.

As has been said above, an insurer having a well-managed claims operation has nothing to fear with regard to late payment claims. However, the realities of life mean that even in the best run claims operations something can go wrong and it is for that reason that all insurers now need to consider the subject.

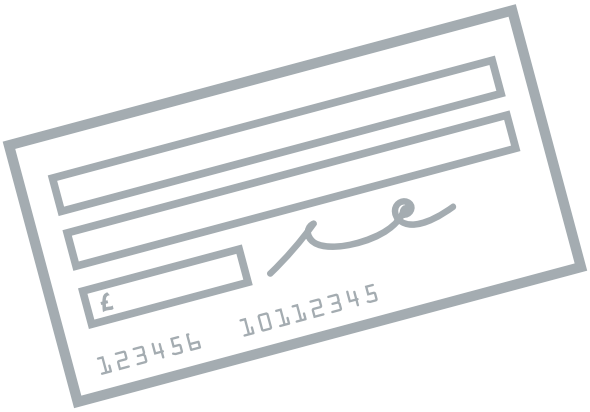
Insurers might decide to increase reserves 'across the board' by a certain percentage to allow for claims for late payment, but that of course is a decision for insurers' actuaries and the assessment of the increase in the claims spend overall in any given underwriting year.

However, there also needs to be reserving decisions made on individual cases. We have spoken above about the extent to which damages are recoverable for breach of contract, so those principles apply.

In any given situation, the decision would be no different to any other claim for breach of contract; the claimant, here the insured, would need to set out the basis of their claim in the normal manner and state the amount claimed and its basis.

There may be claims however whose potential value might be difficult to assess. For example, where an SME goes out of business during the course of a claim and insurers face a claim for that business failure.

A guidance on 'reserving' could form a publication in its own right, but that is not the purpose of this particular text other than to say such decisions should be made on a case by case basis.



Settlement Terms

" We are pleased to enclose a cheque in full and final settlement of your claim."

Do these words preclude an insured from bringing a claim under the policy for late payment, just at the point where the insurer thought the claim was concluded? Do insurers need to keep a file open in all cases, or some cases, in the event of an insured deciding to bring a claim for late payment?

Further, in the hypothetical case of culpable delay by the insurer or their agents, do insurers then need to judge who amongst their insureds might have the appetite to bring a claim against insurers, or even issue proceedings with all the risks associated with litigation; any decision to issue proceedings for late payment would carry a risk because it would be action taken based on very recent and untested legislation.

There is no easy answer to this issue. The only way in which to determine an answer is to ask the question of the insured – *"were you satisfied with the claims settlement overall and the service provided"*. But if you ask the question that might just act as the prompt for an insured to review the handling overall and subject to what they decide, then bring a claim.

A properly managed claims department should have nothing to fear from the legislation and in the spirit of transparency perhaps the answer is to be open about the process and at the point of settlement obtain an agreement from the insured that no claim arises for late payment. If there is an issue raised about delay that is the time to deal with it and before the insured decides to look elsewhere for advice.

Insurers may contract on terms which are disadvantageous to all policyholders, consumers and businesses, in a valid settlement agreement. E.g. a settlement can expressly exclude a claim for late payment. However that has to be a separate agreement not merely a payment under the policy. With regard to consumers it would be subject to all the generally applicable laws against unfair terms – recently updated in the Consumer Rights Act 2015. The FOS might also take a dim view on occasion. However these points lie outside the amended Insurance Act 2015.

Reinsurance

It is worth also mentioning briefly the position in relation to reinsurance contracts. These are separate arrangements between 1) insured and insurer and, 2) insurer and reinsurer.

This only requires brief mention because the reality of the situation is, if there is a claim for late payment and the insured succeeds in their claim against the insurer, and the insurer is ordered to pay substantial damages, that is not a matter for the reinsurer to consider. Put another way, if an insurer is in breach of contract for delay and a late payment claim arises, however substantial, then insurers are liable without recourse to their reinsurance contracts.

John O'Shea
BLM Partner

Practical considerations:

- Additional statutory safeguards and protections available for insurers
- Legal professional privilege available as a general principle of case law
- Consider supply chain, outsourcing and audits in context of new obligations
- Amendment may impact claims settlement terms and processes
- Consider a review of fraud triggers and other processes that impact on claims handling

CONDUCT RISK

The FCA requires claims to be handled and settled promptly. A failure to comply does not entitle a policyholder to claim damages for late payment though, where within its jurisdiction, the FOS may make an award for matters such as distress and inconvenience. It follows that an insurer in breach of the implied term may also be in breach of the FCA's requirements. The FCA expects insurers to have in place controls and processes to identify where a customer's claim has not been handled as it should be, and to ensure the customer is treated fairly, regardless of whether that failing is raised by the customer as a complaint. That does raise the possibility of the FCA expecting insurers to similarly monitor breaches of the implied term, pro-actively advise a customer of that fact and offer compensation if, after the enquiry, a loss has been identified. This is something that insurers should consider with their own regulatory, compliance and legal teams to adopt a position that treats customers fairly, exhibits good conduct, and would meet any queries from the FCA as to how the insurer is approaching the implied term.

Ian Sinho
BLM Technical Consultant

KEY "THOUGHTS" FOR INSURERS

- Insurers have a reasonable time in which to handle and pay a claim including investigation and assessment.
- What is reasonable is guided by the type of insurance, size and complexity of the claim, and factors outside insurers control may be taken into account.
- If the insurers are disputing a claim, but eventually decide to pay it, they may not have taken an unreasonable time if insurers firstly had reasonable grounds for disputing payment and secondly insurers conduct does not suggest that they took an unreasonable time to make payment once they realised that payment should be made.
- Insurers may need to consider how the contractual duty under the Act sits with the Regulators' expectations over how insurers will monitor the claims process and compensate the customer for any failure to deliver the service required.
- Insurers relationships with their supplies need to be reviewed with regard to ensuring SLA compliance and the consequence of supplier delay causing breach and the payment of damages.
- The need to show what was happening and when may require disciplined file note creation so there are not periods in the claims life with no obvious record of the thought processes and intentions are made clear.
- Actions which affect the claims process – a key one is diversion into a fraud stream – will need to be shown to be based on justifiable grounds. Continuing with a fraud trigger known to create high levels of false positives may not be acceptable. Moreover, showing that once it is decided that a claim should, after all, be paid, the timescale and thought process reaching that point, and the action taken after that point was reached, will be relevant to the "conduct" to be taken into account. Evidence from file notes, referrals, correspondence, system logs will all be relevant to an assessment of reasonableness.
- As 'reasonable" time' is undefined other than by relevant circumstances and examples of things to take into account, a forensic analysis of the handling may be undertaken consequent on an allegation of breach. Discipline not only over the creation of records that document the claims process, but also care around what is recorded becomes critical, as does information about the operational context in which
- It will be appropriate to consider any changes that can improve the insurers position in the face of practical or speculative claims as part of overall risk management alongside management of other risks to identify any weak spots which might leave the insurer exposed.

APPENDIX - ENTERPRISE ACT 2016

The Enterprise Act 2016 received Royal Assent on 4th May 2016. The relevant clauses are inserted section 13A of the Insurance Act 2015 relating to "late payment", section 16A in respect of "contracting out" and with section 5A dealing with the long stop limitation clause. The sections are cited below adopting the numbering of the sections as they will appear in the Insurance Act 2015. These clauses will apply to policies incepted from 4th May 2017.

13A Implied term about payment of claims

1) It is an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time.

2) A reasonable time includes a reasonable time to investigate and assess the claim.

3) What is reasonable will depend on all the relevant circumstances, but the following are examples of things which may need to be taken into account:
   (a) the type of insurance,
   (b) the size and complexity of the claim,
   (c) compliance with any relevant statutory or regulatory rules or guidance,
   (d) factors outside the insurer's control.

4) If the insurer shows that there were reasonable grounds for disputing the claim (whether as to the amount of any sum payable, or as to whether anything at all is payable)
   a) the insurer does not breach the term implied by subsection (1) merely by failing to pay the claim (or the affected part of it) while the dispute is continuing, but
   b) the conduct of the insurer in handling the claim may be a relevant factor in deciding whether that term was breached and, if so, when.

5) Remedies (for example, damages) available for breach of the term implied by subsection (1) are in addition to and distinct from:
   a) any right to enforce payment of the sums due, and
   b) any right to interest on those sums (whether under the contract, under another enactment, at the court's discretion or otherwise).

16A Contracting out of the implied term about payment of claims: consumer and non-consumer insurance contracts

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 section 13A than the consumer would be in by virtue of the provisions of that section (so far as relating to consumer insurance contracts) is to that extent of no effect.

2) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects deliberate or reckless breaches of the term implied by section 13A than the insured would be in by virtue of that section is to that extent of no effect.

3) For the purposes of subsection (2) a breach is deliberate or reckless if the insurer—
   a) knew that it was in breach, or
   b) did not care whether or not it was in breach.

4) A term of a non-consumer insurance contract, or of any other contract, which would put the insured in a worse position as respects any of the other matters provided for section 13A than the insured would be in by virtue of the provisions of that section (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.

5) In this section references to a contract include a variation.

6) This section does not apply in relation to a contract for the settlement of a claim arising under an insurance contract."

5A Additional time limit for actions for damages for late payment of insurance claims

1) An action in respect of breach of the term implied into a contract of insurance by section 13A of the Insurance Act 2015 (late payment of claims) may not be brought after the expiration of one year from the date on which the insurer has paid all the sums referred to in subsection (1) of that section.

2) Any payment which extinguishes an insurer's liability to pay a sum referred to in section 13A of the Insurance Act 2015 is to be treated for the purposes of this section as payment of that sum.

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