

RebuildCostASSESSMENT.com

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**UNDERINSURANCE  
AND THE  
INSURANCE ACT  
(2015)**



## INTRODUCTION

Since the Insurance Act came into force in August 2016, many of us have been wondering what difference the new legislation will make in cases of underinsurance.

At **RebuildCostASSESSMENT.com** we have been involved in quite a few discussions on the subject, particularly with insurance brokers and underwriters. Some we've spoken to think the Act won't make much difference at all. Others see it as being far more significant.

So who is right and who is wrong?

When it comes to legal matters, we always think it makes sense to talk to legal experts. So we turned to some very clever lawyers at Herbert Smith Freehills LLP in London and asked them what they thought...

Within this White Paper we present the opinion of Herbert Smith Freehills to help brokers and underwriters gain insight into the potential implications of the Insurance Act for cases of underinsurance...



## PROPORTIONATE REMEDIES

The first thing Herbert Smith Freehills told us is that under the new Act, the insured must make a “fair presentation of the risk” to the insurer.

Previously the duty related to “disclosure and representations” and many key aspects of this have in fact been retained. However, the big change is that whereas previously the insurer’s only remedy for breach of the duty of disclosure was avoidance of the policy, the new Act now provides for a range of “proportionate remedies” if the insured breaches the duty of fair presentation.

If the breach is “deliberate or reckless” avoidance will still be available and the insurer can keep the premium. For all other breaches, the onus is now on the insurer to show what it would have done had it received a fair presentation of the risk.

So here are those “proportionate remedies” under the new Act:

- The insurer will still be entitled to avoid the policy (but must return the premium) if it can show that it would not have entered into the contract;
- If the insurer shows that it would have entered into the contract, but on different terms, then it may treat the policy as having included those terms from the outset; and
- If the insurer would have entered into the contract, but only at a higher premium, the insurer may reduce the amount to be paid on the claim proportionately. Thus, if it would have charged double the premium, it is only liable to pay 50% of the amount of the claim.

Now that’s quite a few more options and in the legal world this actually opens up an even wider range of possibilities to insurers in cases of underinsurance than you may perhaps expect...

## AVAILABLE REMEDIES

Here's what Herbert Smith Freehills LLP had to say about the potential underinsurance remedies an insurer now has following the introduction of the Insurance Act...

If the insured makes an under-declaration that amounts to a material non-disclosure or misrepresentation, the insurer's remedy under the Act depends upon "what it would have done had it received a fair presentation of the risk."

There is an issue as to whether, if the policy contains an average clause and the insurer can also show that it would have charged more premium had it received a fair presentation, the insurer has two potential remedies, namely to apply the average clause and/or to reduce the amount to be paid on the claim proportionately to the higher premium it would have charged.

Herbert Smith Freehills LLP pointed out there is no commentary dealing with this aspect in relation to the legislation and this would need to be tested before the courts or in practice.

They went on to say it could be argued that the parties intended the average clause and any proportionate remedy based on an increase in premium to work together, such that the insurer can elect which remedy to apply. However, could the insurer take this further and 'double-dip'? The proportionate remedy based on an increase in premium is applied against what "the insurer would otherwise have been under an obligation to pay under the terms of the contract" and it may be suggested that the amount the insurer would have been required to pay under the contract is the amount for which the insurer is liable after application of the average clause. However, Herbert Smith Freehills said it would be highly unlikely that a court would permit an insurer to apply both remedies cumulatively in this way.

## THE BETTER VIEW

The answer as to what remedies the insurer may have available in these circumstances is probably far more straightforward. The better view, according to Herbert Smith Freehills, is that the remedies operate in different circumstances.

Ordinarily an under-declaration of insured values (whether under the previous law or the new Act) is unlikely to give rise to a breach of the duty of fair presentation and the insurer's remedy will be in application of the average clause. Only in circumstances where the under-declaration is made deliberately or recklessly, or is otherwise extreme, is it likely to be considered material such as to constitute a breach of the duty of fair representation. In this case the insurer is more likely, in fact, to be able to show that it would not have entered into the contract had it known the actual value at risk entitling it to avoid the policy rather than have to rely upon the new regime of proportionate remedies under the Act.

## CONCLUSION

There you have it. According to our helpful legal experts the Insurance Act presents a number of tricky questions to which there may be some quite straightforward answers. However, these are untested waters and the approach the courts might take remains to be seen.

So if you think the Act won't make a lot of difference when it comes to underinsurance, or if you think it's actually very significant... it appears you're kind of both right for now! We'll keep you updated.

Many thanks to Anthony Dempster (Partner) and Greig Anderson (Senior Associate) of Herbert Smith Freehills LLP for their kind permission to reproduce aspects of their guidance concerning the Insurance Act 2015. Please visit [www.herbertsmithfreehills.com](http://www.herbertsmithfreehills.com) for further information.

## WE HOPE THAT WAS HELPFUL

If you found our latest White Paper useful, or if you would like to provide us with any feedback, please get in touch by emailing to [info@rebuildcostassessment.com](mailto:info@rebuildcostassessment.com).

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