RECENT TRENDS IN INSURANCE AND MARINE INSURANCE IN PARTICULAR

CHINA MARITIME

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Outline

1. Massive Upcoming Changes in Hong Kong
   a) Independent Insurance Authority (IIA)
   b) Risk Based Capital (RBC)
   c) Captives
   d) Policy Holders Protection Fund (PPF)
   e) Consumer Protection
2. Massive Upcoming Changes in England
   a) Amendments to Marine Insurance Act
3. Two Recent Cases that Might Just be Very Important

1.(a) What is the IIA?

- A new regulator for the insurance industry in Hong Kong
- No, I don't mean:

1.(a) So what do we have now?

Government	Self Regulatory Organizations
Annie Choi Commissioner of Insurance	The Hong Kong Federation of Insurers 香港保險業聯會
= Insurance Authority (IA)	CIB 香港保險 THE HONG KONG OF INSURANCE
Office of the Commissioner of Insurance The Government of the Hong Kong Special Administrative Region	PIBA
• Capital/ solvency/ local assets •Adequacy of RI •Valuation and reporting •Actuaries' qualifications & standards	•Registration of intermediaries •Codes of conduct •Complaints •Disciplinary actions

1.(a) What are we going to get in [2015]?

IIA

- Single entity with board chosen by Chief Executive
- Responsible for Licencing
- Levy

- SROs
  - Will only be trade associations?

1.(a) Is IIA a good thing?

- Broad industry support
- Its about time – ICO is dated 1983!
- Need to bring insurance regulation in line with international standards (Insurance Core Principals issued by the International Association of Insurance Supervisors (IAIS) including ICP 2 re regulator independence) to compete internationally (incl. with Singapore)
- But – some problems:
  - Duty of all intermediaries (incl agents) to the insured!
  - IIA will "*promote competitiveness of the industry in the global insurance market*" but seems to want to focus mainly on China only.
  - Role of RO (insurers, insurance agencies and insurance broker companies must have RO = generally CEO)
  - Costs of disciplinary hearings and appeal mechanism
  - Max sanction of intermediaries = greater of HK$10 million or 3 x profit gained/ loss avoided

1.(a) What does IIA mean for

1.(a)IIA and its effect on you...

Broker	New Regulator Fees
Insurer (incl P & I Club)	New Regulator Exemptions? New levy
Customer	[Likely] more protection Levy may be passed on to customers
Consultation?	Over since 2013 Insurance Companies (Amendment) Bill to be introduced this year!

1.(a) Transitional arrangements

- Intermediaries validly registered with SROs deemed fit for 3 years from commencement of new licencing regime
- Uncompleted investigations/disciplinary cases will be taken up by IIA BUT old rules will apply
- Licence fee for intermediaries will be waived for first 5 years of IIA

1.(b) RBC

- About solvency and capital
- Current framework for non-life insurance based on premium and capital and in use since 1980s
- Why:
  - Credit crunch
  - New ICPs
  - Banks are doing it Basel III and Europe is doing it Solvency II
  - Regulators cooperating to avoid regulatory arbitrage
- When:
  - 2014 - Consultation
  - 2014/15 - Detailed rules
  - 2015/16 - Law change
  - **2016/2017 - Phased in implementation starts**

1.(b) RBC

•More stable insurance industry. Risk of failure of insurers should decrease if system is effective.

•M&A in insurance industry?

•Preparatory work and expenses for insurers and external actuaries (e.g. KPMG/PWC).

•Costs may or may not be passed onto customers.

1.(c) Captives

- Captives are insurance companies set up by large companies and restricted to insuring group companies
  - Reduced min capital/solvency
  - Exempt from requirement to maintain HK assets
  - Exempt from statutory valuation of assets and liabilities
- Only 2 captives in HK vs over 60 in Singapore!
- In late June 2012 the PRC government announced support for mainland captives in HK
- 2013/2014 Budget announcement = bill currently being vetted by LEGCO that
  - Halves taxes for HK captives
- Problem: captives in Singapore pay no tax
- But: may be interesting for Chinese companies.
- Watch this space – HILA will organise a lecture

1.(d) Policyholder's Protection Fund (PPF)

- Compensation fund to pay claims in event of insurer insolvency
- Currently only exists for motor and E/C
- Aim = enhance consumer confidence and benefit insurance industry
- One scheme for life, another scheme for non life
- Covers individual policy holders and SMEs
- Compensation mechanism for non-life:
  - 100% of first HK$100,000
  - 80% of balance of claim
  - Up to HK$1 million per claim
- Funding
  - 0.07% levy on insurers
  - Asset recovery mechanism
  - Financing arrangements to bridge liquidty gap

1.(e) Consumer Protection

- Annie Choi has at a HILA lecture referred to such reforms which might include:
  - Vetting customer needs
  - Selling to the right customer for value
  - Clear policy terms and conditions and information and legible format
  - Selling in clear and fair and not misleading way
  - Managing reasonable expectation of customers
  - Dealing with complaints and disputes fairly
  - Disclosing relationship (and remuneration) between insurer and intermediary to avoid conflict of interest (remember Hobbins)

2. Proposed Amendments to Marine Insurance Act

- MIA dated 1906 and yet backbone of insurance law
- RELEVANT: English MIA 1906 = almost exactly same as HK MIO
- Merkin: "In battle with Singapore law reform is essential"

2. Define disclosure obligation

- Section 18(1) assured must disclose “every material circumstance” which “in the ordinary course of business” is known or ought to be known.
- If the assured fails to disclose such information then the insurer “may avoid the contract”.
- Thus an assured who fails to mention an arguably minor issue but is otherwise acting in good faith is at risk of losing the benefit of the policy.
- The absence of a clear definition of what is meant by “is known or ought to be known” has led to confusion and many differing views.
- The Law Commission is to propose the inclusion of a fuller definition in the statute.

2. Clarifying what brokers are deemed to know

- Section 19 of the Act imposes a pre-contractual duty on brokers to disclose material information that is known to them or which they are “deemed to know” (e.g. where material information is known to the broker but not to the assured).
- When a broker breaches these duties, the insurers may avoid the policy.
- The Law Commission believes this is unfair on the assured.
- Accordingly, the Law Commission’s proposals include clarifying what a broker is “deemed” to know” with a recommendation that this is better defined for greater certainty.

2. New remedies for non-disclosure

- Avoidance is currently the only remedy for non-disclosure.
- The Law Commission has proposed a fresh set of remedies that will compensate the insurer putting it in the position it would have been in had it been provided with all the required information by the assured. The proposed remedies include:
  - Where the insurer would have declined the risk altogether, the policy should be avoided, the claim refused and the premiums returned.
  - Where the insurer would have accepted the risk but included another contract term, the contract should be treated as if it included that term.
  - Where the insurer would have charged a greater premium, the claim should be reduced proportionately. E.g. if the insurer would have charged double the premium, it need only pay half the claim.

2. Placement of risk and premium

- Section 53(1) of the Act provides that for the placement of marine risks (only) the broker is directly responsible to underwriters for premium.
- This is the position regardless of whether or not the broker has been paid by the insured.
- Where this applies, only the broker may sue the assured for the premium – not underwriters.
- The Law Commission's proposals provide that the assured should be liable for the premium on marine risks (as is the current position on non marine risks), although the default rule is that the broker will remain jointly and severally liable with the assured to underwriters for premium on marine risks, unless this has been varied by the contract.

Warranties

- Section 33(3) states that a warranty “is a condition which must be exactly complied with, whether it be material to the risk or not”. If a warranty is not complied with then “the insurer is discharged from liability as from the date of the breach of warranty, but without prejudice to any liability incurred by him before that date”.
- The consequences of a breach of warranty are harsh for assureds.
- Other markets moved away from this approach - in New York underwriters can only avoid the policy for a breach of warranty if the breach would materially increase the assured’s risk of loss.
- The Law Commission proposes to reduce the severity of a breach of warranty by suggesting that they should be treated as “suspensive conditions” i.e. that they would suspend an insurer’s liability but not discharge it. If the breach is remedied before the loss takes place, an insurer is required to pay the claim.

2. What do the proposed MIA reforms mean for

2. Reform of MIA and its effect on you...

Broker	Reform of 53(1) positive The reforms of warranties should reduce the broker's own exposures to claims for breach of duty by their assureds for alleged breaches of claims notification and premium warranty provisions.
Insurer (incl P & I Club)	More difficult to avoid polices Industry reputation will benefit
Customer	More protection
Consultation in HK?	Yes Unclear when – likely when MIA amended

3. Versloot Dredging BV v HDI-Gerling Industrie Versicherungs AG - The DC Merwestone

- Case from Australia
- Defendant H&M insurers of cover including ITC Hulls 1/10/83 for loss or damage caused by perils of the seas & loss or damage caused by crew negligence, provided that the loss or damage did not result from want of due diligence on the part of the assured, owners or managers.
- Main engine vessel irreparably damaged by ingress of water into the engine room. On the facts left water in the emergency fire pump, which froze and expanded, causing the casing to crack and distort. Once melted, water leaked through the damaged casing via the bowthruster space (which should have been watertight) and duct keel (which also should have been watertight) into the engine room.
- Owners claimed the cost of replacing the engine (in excess of€3 million).

2. Defences

- Underwriters defended the claim :

1. the loss was not caused by peril of the seas, but instead by crew negligence in relation to the emergency fire pump. There was no cover for the crew negligence because of want of due diligence on the part of the Owners/Managers;
2. the loss was caused by unseaworthiness of the vessel to which Owners were privy under s39(5) of the Marine Insurance Act 1906 (**MIA**); and
3. Owners had made fraudulent statements in support of their claim so that, even if the claim was covered, it had been forfeited.

2.**Peril of the seas**

- Popplewell J found that the loss was proximately caused by a peril of the seas. In order to recover, there had to be a fortuity, and the fortuity had to be of the seas. Here, the fortuity was the ingress of water into the engine room which resulted from the negligence of the crew. Underwriters' argument that the proximate cause was the crew negligence, rather than the water ingress, was rejected.
- Alternatively, if the loss was proximately caused by crew negligence, there was no want of due diligence on the part of Owners or Managers.

Unseaworthiness

- The defence of unseaworthiness with privity under s39(5) MIA also failed, with the judge finding that Owners were not aware of the defective condition of the engine room pumping system.
- The case demonstrates the evidentiary difficulties insurers face in proving unseaworthiness with the privity of the assured, under section 39(5) MIA.

- **Fraudulent devices**
- At an early stage, the vessel's general manager, K, reported to Underwriters that the master had advised that a bilge alarm had been triggered several hours before the casualty, but that this was not investigated by the crew because the vessel was rolling in heavy weather. It was later admitted that this was untrue. The judge found that K's statement was made in order to support Owners' allegation of crew negligence, and to distance Owners from any allegation of want of due diligence., K had been reckless as to whether he had in fact been told by the master that the bilge alarm had sounded.
- The law is that an assured who makes a fraudulent claim forfeits any lesser claim that could properly have been made.

- In CA (obiter) in *The Aegeon* ([2002] 2 Lloyd's Rep 22) extended this rule to cases in which the assured supports a valid claim using fraudulent devices –i.e. where the assured believes he has suffered the loss claimed, but embellishes the facts by means of a material (relating directly to the claim) that if believed, would objectively yield a "not insignificant" improvement in the assured's prospects of winning at trial or achieving a better settlement. "Not insignificant" means not insubstantial, not immaterial or not*de minimis* – a low threshold.
  - Although not binding, Popplewell J applied above materiality test. Finding that K's statement was material, and intended to improve the chances of achieving a prompt settlement from the Underwriters, he reluctantly dismissed Owners' claimPermission to appeal has been granted on the dismissal of the claim for use of fraudulent devices, with the appeal to be heard in Spring 2014. It will be interesting to see whether the Court of Appeal is prepared to consider the judge's alternative materiality test.

Popplewell J's comments

- there is a difference between a fraudulent claim and the use of fraudulent devices in support of a valid claim, where the assured is looking to persuade insurers to pay the claim more quickly, or to make an increased offer of settlement, rather than to recover more than his contractual entitlement. The culpability of an assured who supports a valid claim with fraudulent devices might be "*at the lower end of the scale*."
- the test is capable of producing disproportionately harsh consequences. In particular, there is no requirement for the particular underwriter to be deceived by the fraudulent device. Further, it is not possible for an assured to correct or retract a false statement once made. In this case, the fraudulent device was a reckless untruth, told on one occasion and was not maintained at trial. Further, at the time it was given, K genuinely believed that his explanation was plausible.
- Popplewell J would be "strongly attracted" to a test for materiality which allowed the court to consider whether it was just and proportionate, in all of the circumstances, to deprive the assured of the entirety of his claim.
  - He suggested that "*the policy of the law should be to require at least a sufficiently close connection between the fraudulent device and the valid claim to make it just and proportionate that the valid claim should be forfeit*."

Hua Tyan Development Ltd v Zurich Insurance Co Ltd

- HK Court of Appeal case.
- Leave to appeal to the Court of Final Appeal has been granted.
- Case about warranties.
- Vessel was smaller than warranted DWT.
- Insurer could easily have found out – internet – but didn't.
- CA reversed decision of 1st instance.
- Just because the insurer could find out the DWT didn't mean he had to.
- Decision against insurer reversed so now the broker is on the hook!

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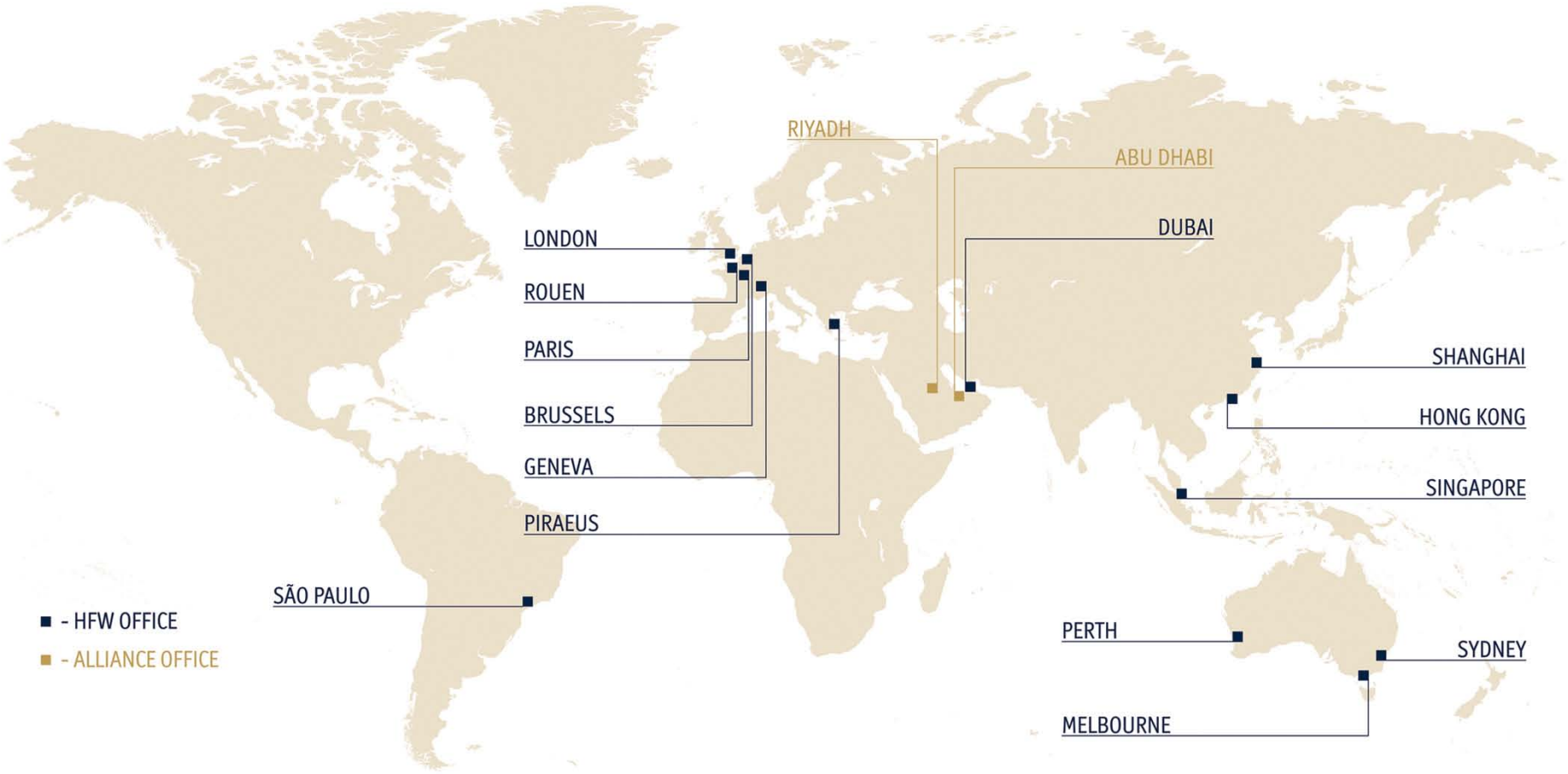

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