



# The Insurance Act

**Paying additional premium instead of proportionate reduction in claims**  
Sample Clause & Explanatory Note

**June 2016**



HERBERT  
SMITH  
FREEHILLS

## Contents

<b>Executive summary</b> .....	<b>4</b>
<b>Proportionate Remedies available under the Insurance Act</b> .....	<b>5</b>
<b>Alternative Clause</b> .....	<b>7</b>

### **Herbert Smith Freehills LLP**

As one of the world's leading law firms, Herbert Smith Freehills LLP advises many of the biggest and most ambitious organisations across all major regions of the globe. Its insurance and reinsurance lawyers have an outstanding reputation in complex, high profile insurance and reinsurance disputes and for providing strategic legal advice and representation to corporate policyholders. Herbert Smith Freehills LLP is Airmic's Preferred Service Provider on insurance law issues and has assisted Airmic in producing a number of its technical guides over the past few years including this most recent briefing on the Insurance Act 2015. These practical tools assist Airmic members, Airmic partner brokers and insurers to promote legal certainty in their insurance contracts.

## Executive summary

---

“The objective of this briefing is to provide members with a sample clause to enable an alternative remedy to be agreed with insurers such that the insured pays the additional premium that would have been charged rather than face a reduction in its claim.”

---

**One of the headline features of the Insurance Act 2015 (the Act) is the removal of the sole remedy available to insurers of avoiding a policy (ie. treating it as if it never existed) in the event of a material non-disclosure or misrepresentation by the insured.**

The Act introduces a series of ‘proportionate remedies’ which are available to the insurer depending upon whether or not the insured’s breach of the duty of fair presentation was deliberate or reckless and what the insurer can show it would have done had the insured complied with its duty.

One of the new remedies that will be available is where an insurer can show that it would have charged a higher premium had it received a fair presentation of the risk. In this situation, the insurer can proportionately reduce the claims payment made to the insured.

The objective of this briefing is to provide members with a sample clause to enable an alternative remedy to be agreed with insurers such that the insured pays the additional premium that would have been charged rather than face a reduction in its claim.

**This briefing builds on Airmic’s other recent guidance on the Insurance Act:**

- Insurance Act 2015: What members need to know  
<http://www.airmic.com/tech-doc/insurance-act-2015-what-airmic-members-need-know>
- Insurance Act 2015: Taking advantage of the Act’s benefits now  
<http://www.airmic.com/tech-doc/insurance-act-2015>
- Insurance Act 2015: A guide to fair presentation  
<http://www.airmic.com/tech-doc/insurance-act-2015-guide-fair-presentation>

*This briefing has been produced with the assistance of Herbert Smith Freehills LLP as a preferred service provider to Airmic.*

*The content of the briefing relates to the position under English law and does not constitute legal advice. Members are advised to consult their lawyers should they require advice on any matter that is the subject of this briefing. Herbert Smith Freehills LLP is happy to discuss any queries that members may have<sup>1</sup>.*

---

<sup>1</sup> Please contact [Paul.Lewis@hsf.com](mailto:Paul.Lewis@hsf.com)

## Proportionate Remedies available under the Insurance Act

Under the Act, an insurer has a range of 'proportionate remedies' available to it if the insured breaches its duty of fair presentation. In the event that such breach is not deliberate or reckless, the insurer's remedies are as follows:

If the insurer would not have entered into the policy on any terms...	...the insurer can avoid the policy and return the premium
If the insurer would have entered into the policy but on different terms...	...the policy is treated as if it had been entered into on those different terms
If the insurer would have charged a higher premium...	...the insurer may reduce proportionately the amount to be paid on a claim

Looking at the last of these, if there is a breach of the duty of fair presentation by the insured and the insurer can show that it would have charged a higher premium then the Act provides that the insurer is only required to pay X% of what it would otherwise have been under an obligation to pay where:

$$X = \frac{\text{Premium actually charged}}{\text{Higher premium}} \times 100$$

This means that if the insurer can show that it would have doubled the premium then the insurer need only pay 50% of any claim. There is a similar formula set out in the Act which relates to variations of a policy.

Some policyholders and insurers have suggested that in these circumstances it may be preferable for the insured to pay the additional premium that would have been charged, rather than face a reduced claim.

**Worked example of proportionate reduction in operation:**

- A property insurer charges a premium of £100,000 to insure commercial premises with a Limit of Indemnity of £10 million.
- Following total loss of the premises in a fire, the insurer proves that the insured innocently failed to make a fair presentation of the risk, omitting information on circumstances concerning the construction of the building which would have led the insurer to have charged an additional premium of 25% i.e. £125,000 for the same Limit of Indemnity. The insurer would have underwritten the risk at this price.
- The insurer is entitled to reduce the claim payment according to the formula:  
$$(\text{£}100,000/\text{£}125,000) \times 100 = 80\%$$
  
80% of £10 million = £8 million to be paid by insurers.
- This leaves the insured uninsured for £2 million of the loss where the insurer would have underwritten the policy (and potentially faced the full limit of loss) for just £25,000 of additional premium.

## Alternative Clause

Airmic has developed a sample clause for policyholders who wish to amend the default position provided for under the Act. This sample clause provides for the insured to pay the additional premium instead of having its claims proportionately reduced in circumstances where there has been a breach of the duty of fair presentation and the insurer can show it would have charged a higher premium.

This clause may not be appropriate for all members and members should consider which option is more appropriate for them in light of claims frequency and, critically, severity. Members should also note that if they opt to pay the additional premium then this will be payable even in the event that there is no claim on the policy.

As with all aspects of policy wordings, members should discuss this clause with their insurance broker in the first instance and may need to seek legal advice. If the clause is used, care must be taken to ensure that it is compatible with existing terms of the policy.

### Sample clause

1. In the event that the Insured breaches the duty of fair presentation prior to inception of this insurance, or prior to any variation; and
2. the breach is not deliberate or reckless; and
3. the Insurer can show that it would have charged a higher premium,

then the Insured shall be liable for such additional premium as would have been charged had the duty of fair presentation not been breached. It is agreed that in these circumstances the Insurer will have no right whatsoever to reduce proportionately any amount to be paid on a claim.

The phrases “duty of fair presentation” and “deliberate or reckless” in this clause shall have the same meanings as given to them in the Insurance Act 2015. It is not intended that this clause shall amend or vary any other provision of this policy.





6 Lloyds Avenue  
London  
EC3N 3AX  
Ph. +44 207 680 3088  
Fax. +44 20 7702 3752  
email: [enquiries@airmic.com](mailto:enquiries@airmic.com)  
[www.airmic.com](http://www.airmic.com)

