Chapter 5

Principles of insurance

5–001 Unlike the elephant which is easy to distinguish because you know one when you see one, a contract of insurance may look like a contract of insurance but need not necessarily be one, and the converse is also true. It matters, however, because an insurance contract contains various attributes not found in other contracts, such as a duty of good faith, and because if it is an insurance contract it will have to be regulated and authorised by the appropriate body (and any failure to be authorised may attract adverse consequences). In general terms a contract of insurance is a legally enforceable agreement by which a party authorised to provide insurance (the "insurer") agrees to pay to another person (the "insured") a sum of money or provide its equivalent on the happening of a specified event not within the control of either party, provided that the insured has complied with any obligations imposed by the agreement, and in respect of which contract the insured has agreed to pay a sum of money to the insurer). No statutory definition of insurance exists, despite the strict statutory regulation of insurance business, although art.3 of the Regulated Activities Order contains some examples.

Hampton v Toxteth Co-operative Society[1] confirmed that the absence of any premium at all is conclusive evidence that the contract is not one of insurance. This is supported by such statutory provisions as there are on this point, notably:

- Section 95(a) of the Insurance Companies Act 1982 (as amended by the FSMA 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2000/3649)) which sets out a list of contracts deemed to be insurance where benefits are promised "in return for the payment of one or more premiums"; and
- Section 85(2) of the Marine Insurance Act 1906, which, by expressly disapplying the requirement for payment of premiums in the case of mutual insurance, creates the exception which proves the rule.

It is also apparent from the decided cases that, so long as some benefit (at least quantifiable in monetary terms) accrues to the insured under the contract, it will constitute insurance even though the insurer pays no money directly to the insured. Thus a contract under which insurers agreed to provide a hire car in the event that the assured's own vehicle was damaged in an accident was a contract of insurance.[2]

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[1] [1915] 1 Ch. 721.
[2] *Everson v Flurry* (unreported, February 22, 1999).

Section 19 of the Financial Services and Markets Act 2000 ("FSMA") states that no person may carry on a regulated activity in the United Kingdom unless he is an authorised or exempt person (and is a wider prohibition than that in the superseded Insurance Companies Act 1982). Section 22 of the FSMA specifies that an activity is regulated if, *inter alia*, it falls within Sch.2, para.20 of which refers to contracts of insurance. The FSMA is effected through subsidiary legislation, of which art.10 of the Regulated Activities Order 2001 (SI 2001/544) specifies that "Effecting a contract of insurance as principal" and "Carrying out a contract of insurance as principal" are regulated activities, both requiring authorisation under the FSMA. A single transaction may be sufficient to be "carrying on business", although *In re Companies Nos 007816 and 007822 of 1994*[3] stated that an insurer is not necessarily in breach simply because one of the obligations of an insurance contract was carried on in the United Kingdom, *e.g.* paying a claim. The section is breached only if it was part of a larger scheme, the carrying on of insurance business, which requires some element of continuity and scale. Nevertheless, the separate specification of the two aspects reflects the fact that insurance business contains two principal elements: the negotiation and conclusion of contracts and their execution, *e.g.* by paying claims. If either of these activities is carried on in the United Kingdom, then business is being carried on here which requires authorisation. Conversely, if neither is being carried on there is no such need, even though the insured property or the insured is located here. It should certainly be feasible for an insurer to conclude a contract outside the United Kingdom, and the issue then becomes the extent to which it is carried out in the United Kingdom. It is carried out at the place where the contractual rights are exercised and its obligations performed. Using brokers within the jurisdiction will not dispense with the need to be regulated because "activities customarily undertaken by insurance brokers acting as such" are still the activities of the offshore insurer (with the concomitant effect that the brokers would not require authorisation under this aspect of FSMA).[4] Further, the process of negotiating a contract of insurance falls within the notion of effecting insurance business.[5] Art.10 of the FSMA 2000 (Regulated Activities) Order 2001 clarifies the position by requiring any effecting and carrying out of insurance to be that of principals, so that brokers are excluded.

Section 31 details the categories of authorised person, which predominantly will consist of those who have successfully applied under s.40 for authorisation under Pt IV of the FSMA, or someone authorised in another EEA State exercising an EEA passport right (Insurance Companies' (Third Insurance Directives) Regulations 1994, implementing the Third EC Directive).

[3] [1995] 2 B.C.L.C. 539.
[4] *Re Great Western Assurance Co SA* [1997] 2 B.C.L.C. 685.
[5] *R v Wilson* [1997] 1 W.L.R. 1247.

The effect of non-authorisation

Section 26 of the FSMA states that "An agreement made in the course of carrying on a regulated activity in contravention of the general prohibition is unenforceable against the other party", and the other party is entitled to recover any money paid. Para.16 of Sch.3 removes the application of s.26 in respect of an agreement with an EEA firm not qualified for authorisation under para.12. UK and non-EU insurance companies must still be formally authorised by the FSA. **5–002**

Unauthorised insurers—UK contact offices

The position appears to have been radically changed, at least from the point of view of the party to whose benefit the insurance enures, by ss.26, 27 and 28 of the FSMA (previously s.132 of the Financial Services Act 1986, which will still apply to pre-FSMA contracts), the relevant subsections of which can be summarised as follows: **5–003**

(1) A contract of insurance made by an insurer who is not authorised or exempt is unenforceable by the insurer against the insured, and the insured can recover premium and interest from the insurer (s.26(1) and (2)).

(2) However, the insurer is entitled to be paid or retain premium if the court is satisfied that the insurer reasonably believed that he was not in contravention of the Act, and it is just and equitable to allow him to do so.

(3) The insured can elect not to perform a contract (which is in any event unenforceable against him by the insurer without the court's approval under s.28(3)), and thereby recover premium and interest from the insurer, but the insured is not entitled to be paid claims and must return any claims already paid, *i.e.* as if the contract had been avoided *ab initio*.

  (i) There would therefore not appear to be any prejudice to a policyholder if an insurer should have been authorised but was not, subject to (iii) below. Paradoxically, there may even be a benefit in that if there are no claims by the end of the policy period, and the insurer cannot use s.28(3) because he cannot show that he reasonably believed that he was authorised, then the insured will be able to recover the premium.

  (ii) There would not appear to be any prejudice to brokers in these circumstances (but see (iii) below), at least as far as concerns liability for placing insurance with an unauthorised insurer, apart perhaps to his reputation.

  (iii) It would therefore appear to be arguable that it is not necessary for brokers to ensure that a contact office is FSA authorised or does not require FSA authorisation in order for their client to recover against the insurer.

Unfortunately the position is not totally clear owing to the wording of the provision. Whilst s.132 at first blush states that a contract of insurance shall not be enforceable by the insurer against the insured, it does not make it particularly clear that the contract is enforceable the other way, at least not without recourse to the courts. However, subs.(4) makes it clear that where an insured elects not to perform a contract he shall not be entitled to any claims paid or payable under the contract, although he is entitled to have his premium and interest repaid to him. It must follow that where an insured elects to perform a contract he is entitled to retain claims already paid and to be paid claims that have fallen due. Further, s.28(9) also limits the illegality by providing that a commission of an authorisation offence shall not make a contract illegal to any greater extent than is provided by ss.26 or 27, *i.e.* if it is not invalid under ss.26 or 27, it is enforceable.

5–004 Despite this provision, however, it may be the case that an insurance contract entered into between an unauthorised insurer and an insured who was aware of the fact that no authorisation existed is totally void. This conclusion would follow from the common law principle that a contract to commit an unlawful act is itself unlawful, although there must clearly be an argument that the specific statutory provisions override this common law principle.

The proposition that s.28 does not operate to override the common law principle that a contract to commit an unlawful act will, in part, depend upon the court being satisfied that the insured was aware of such act.

The knowledge of the insured can either be actual or imputed knowledge. In these circumstances the crucial question would be whether the knowledge of the broker that an insurer requiring authorisation was not authorised should be imputed to the insured.

The general rule under the law of agency is that if in the course of any transaction in which an agent is employed on its principal's behalf the agent receives notice or acquires knowledge of any fact material to such transaction, it is the agent's duty to communicate it to the principal. The principal is precluded, as regards the persons who are parties to such a transaction, from relying upon its own ignorance of that fact and is taken to receive notice of it from the agent at the time when he should have received it if the agent had performed his duty of due diligence. However, where the agent, although acting on the principal's behalf in some transaction in which his knowledge would otherwise be imputed to its principal, takes part in any fraud or misfeasance against the principal, the principal is usually not bound by the agent's knowledge of such fraud or misfeasance.

It is probable that the problem of lack of authorisation could arise in two distinct ways:

(1) The broker is aware or has "turned a blind eye" to the need of the concerned insurer to obtain authorisation and the concerned insurer is either actually aware or will be deemed by the court to be aware of the lack of authorisation.

In these circumstances it is unlikely that the knowledge of the broker would be imputed to the insured because this case would fall within the exception to the general rule discussed above. Furthermore, the court would be unsympathetic to the unmeritorious argument of the insurer that the contract is void in the light of the provisions contained in s.28.

(2) The insurer is unaware and has *not* "turned a blind eye" to the need for authorisation but the concerned broker is aware that authorisation is required and ignores the issue.

This theoretical situation is probably unlikely to occur but, presumably, could happen. It is also unlikely that the knowledge of the broker will be imputed to the insured. The reason for this conclusion is that the contemplated situation does not neatly fall within the principle enunciated in *Fitzherbert v Mather*.[6] The court would be likely to distinguish this situation from a case where the fraud or breach of duty committed by the broker causes loss or prejudice to two parties such as where the broker fails to disclose a material fact of which the concerned insured and insurer are unaware.

It is therefore likely that the statutory provision will override the common law principle, but judicial clarification is nonetheless required in the absence of any specific authority.

It would appear to be relatively easy (when obtaining confirmation of the agent's authority) to obtain confirmation in writing from a contact office that it does not require FSA authorisation, together with an undertaking that if authorisation is at any time in the future required because of a contemplated change in the manner of the operation of the contact office, that an application for authorisation will be made and the broker informed before any change in procedures take place.

The Relevant Principles

Insurable interest

5–005 An interest capable of being insured is necessary as a matter of public policy, to prevent gambling or attempts by a beneficiary to hasten the demise of a person whose life was to be insured. Lawrence J. defined it in *Lucena v Craufurd*[7] as:

> "A man is interested in a thing to whom advantage may arise or prejudice happen from the circumstances which may attend it . . . and whom it importeth that its condition as to safety or other quality should continue: interest does not necessarily imply a right to the whole or part of a thing, nor necessarily and exclusively that which may be the subject of privation, but the having some relation to, or concern in the subject of

[6] (1795) 1 T.R.12.
[7] (1806) Bos. & P.N.R. 269, 302.

respectively after making such set off as is appropriate. In arriving at the constitution of debtors and creditors, they do not consider it necessary to have regard to the ultimate principals where these are not parties with whom the accounts are directly settled.[56]

[56] Statement of Council of Chartered Accountants: Accounting by Insurance Intermediaries under the Companies Act 1985. September 1986.

Chapter 11

The broker's professional liability to the insured[1]

An insurance broker is usually instructed at the beginning of his legal relationship with his principal to obtain quotations for intended contracts of insurance, or to procure the best possible insurance, which he must do by using his best endeavours and exercising reasonable skill and care. This is an implied term of his contract both at common law and by s.13 of the Supply of Goods & Services Act 1982. A failure by the broker to do so may result in a claim against him, either for breach of the implied term of his contract, or for a failure to discharge the concurrent duty of care in tort owed by the broker to the insured.[2] The broker's liability in contract and tort is well established *Youell v Bland Welch & Co Ltd*[3]; *Punjab National Bank v de Boinville*[4]; and *Merrett v Babb*.[5] The duty of care in tort, which is coextensive with the implied term in contract (save that the duty may extend to third parties), is discharged by the exercise of reasonable skill and care by the broker, which can generally be considered to be that exercised by reasonably competent brokers operating within the same market and holding themselves out to have the same expertise in the same specialised area of insurance (if any). Thus if a life broker attempts to place marine insurance, he must adhere to the practices in the marine market. He cannot rely upon usage of a practice which may be acceptable in another market if that practice caused a loss and was less "onerous". **11–001**

Usually an aggrieved insured will bring any claim in respect of which he requires redress against the entity which acted for him, rather than the individual broker who carried out the work. Sometimes the changing nature of the individual broker's employment, coupled with the difficulties that can be faced in ascertaining precisely when the act of negligence occurred, means that the insured cannot tell with precision which employing entity of the individual broker should be sued, and it will sue the broker personally to establish some liability, as *Punjab National Bank v de Boinville* demonstrates, albeit as the principals of small broking companies and an arguable personal, voluntary assumption of the duties of a broker. This proposition appears to run counter to that confirmed by *Williams v Natural Life*,[6] that mere employees of a company do not generally have any personal liability, but in *European International Reinsurance Company Ltd v Curzon Insurance*

[1] See also the specific defences suggested in Ch.3.
[2] *Mint Security v Blair* [1982] 1 Lloyd's Rep 188.
[3] [1990] 2 Lloyd's Rep. 431.
[4] [1992] 1 Lloyd's Rep. 7.
[5] [2001] Lloyd's Rep. P.N. 468.
[6] [1998] 1 W.L.R. 830.

Ltd[7] Longmore L.J. considered that the two principles could co-exist because although Williams stated that the "usual assumption will be that a director or employee of a company does not himself voluntarily assume responsibility on his behalf; he assumes it on behalf of his employer"(para.24), he considered that the crucial factor was that a company can only act through its employees and therefore that it was arguable that some personal liability could exist.[8] *Williams* established that there must be an assumption of personal liability and that the claimant had reasonably relied on it; the fact that a company might be small so that the managing director possess all the qualities and knowledge necessary for its running does not necessarily convey the fact that he is willing to be answerable personally. Nevertheless, there could on particular facts (such as in circumstances where the client was not aware of the fact that the broker was employed) be an assumption of personal responsibility by the broker.

Is the standard reduced by the apparent quality of the broker? It is axiomatic that the standard of care is not to be assessed according to the broker's ability but according to the act that he had agreed to carry out. In *Lanphier v Phipos*[9] Tindal C.J. said:

> "Every person who enters into a learned profession undertakes to bring to the exercise of it a reasonable degree of care and skill. He does not undertake, if he is an attorney, that at all events you shall gain your case, nor does a surgeon undertake that he will perform a cure, nor does he undertake to use the highest possible degree of skill. There may be persons who have higher education and greater advantages than he has, but he undertakes to bring a fair, reasonable and competent degree of skill."

11–002 In *NRG v Bacon & Woodrow* [1997] L.R.L.R. 744 the court held that a professional person undertaking professional responsibility for the provision of advice on matters specified by the client, or generally, represents by implication that he has the necessary professional capability:

> "The standard of care to be expected is to be measured by a reference to the quality of work reasonably to be expected from a professional firm or organisation possessed of the skills which by undertaking the work in question that firm or organisation has warranted that it has. If the skill that is warranted is a specialist skill, the client is entitled to the standard of work reasonably to be expected of a specialist professional possessed of that skill. To measure the standard of care in such a case by reference to a non-specialist professional would be wrong in principle because it would involve a dislocation between the work that was contractually assumed and the quality of work to be expected. The standard of care is further to be measured by reference to the purpose for which the client required the advice. The magnitude of the loss that the client might suffer if the advice given turned out to be wrong is a material factor in setting the standard of professional care to be expected . . .".

[7] [2003] All E.R. (D) 364.
[8] Required in this case in order to join as defendants the relevant employing companies, who would then be capable of being found vicariously liable for the acts of their employees. The liability of the employees had to be established in order to found the vicarious liability.
[9] (1838) 8 Car. & P. 475.

Thus personal incompetence resulting from the inexperience of a trainee is not a defence to a claim for failure to produce work of an acceptable professional standard.[10] However, the possibility that alternative standards may exist was opened in *Balamoan v Holden & Co*[11] in the context of the provision of legal services by solicitors. The Court of Appeal urged later courts "not to apply a too rigorous standard" where the professional was "a solicitor in a small country town who is instructed by a legally-aided client to pursue what appears to be a comparatively small claim". In fact the point had been speculated upon in *Duchess of Argyll v Beuselink*[12] and a comment made that it was inappropriate to apply the "uniform standard of care postulated for the world at large". In *Martin Boston & Co v Roberts*[13] the Court of Appeal wondered whether "different standards apply, depending on the level of experience, expertise, and, indeed, expensiveness of individual solicitors". A lower standard of care was applied to a provincial auctioneer in *Luxmoore-May v Messenger May Baverstock*[14] where the Court of Appeal judged the standard "by reference only to what may be expected of the general practitioner, not the specialist".

Further, the court is always alive to the fact that a broker following a practice common in a market may not be discharging his duty if such practice is not to be expected from the reasonably competent broker. It is also the case that the law in the field of the liability of professional advisers is still in a state of development or change, so that any claim at its margins will be entitled to proceed to trial.[15]

Brokers' liabilities usually arise in the following ways.

Failure To Obtain Proper Insurance

Failure to obtain any insurance

11–003 The most obvious item under this head is a failure to obtain any insurance at all.[16] Such a failure gives rise to liability unless the broker can show that he took all reasonable steps to effect the insurance but that it was unobtainable, and that he informed his principal accordingly, or took all

[10] *Dickinson v Jones Alexander* (1989) 139 N.L.J. 1525.
[11] [1999] 149 N.L.J. 898.
[12] [1972] 2 Lloyd's Rep. 172.
[13] [1996] 1 P.N.L.R. 45.
[14] [1990] 07 E.G. 61.
[15] *Independents' Advantage Insurance Co Ltd v The Personal Representatives of Michael John Willis Cook*, July 24, 2003.
[16] *Smith v L Smith v Price* (1862) 2 F. & F. 749.

reasonable steps to do so[17] and by the fastest method of communication.[18] The rationale behind this additional obligation is to allow his principal to attempt to obtain insurance elsewhere.[19]

Failure to obtain requisite or enforceable insurance

11–004 Where details of the risk are clearly specified by the client, a failure to obtain the requisite insurance may give rise to liability. The duty is not absolute, since the broker cannot guarantee that insurance will be available on the terms specified, and is merely to use reasonable skill and care.[20] Failing to obtain insurance requested for several vessels, and limiting the insurance to one is a clear breach of specific instructions and a failure to exercise reasonable skill and care.[21] Where such instructions are unclear the broker will be under a duty to resolve any ambiguity, since if the uncertainty of the instructions is obvious to the broker, he will, in placing the insurance, be making a value judgment which he has not been asked to make and which should result in liability if he errs.[22] Such liability will depend upon the circumstances; the broker may not be liable if, for example, the insurance must be concluded within a specified time and it is not possible to obtain instructions clarifying the position from his principal. In such circumstances it seems better to place the insurance than risk a claim for failing to do so, as long as he selects the option which a reasonably competent broker would bona fide choose in similar circumstances.[23] An incorrect decision does not automatically render him liable for negligence. Presumably it is possible for a broker to agree with an insurer that the insurance will be placed to cover both aspects of any ambiguity and confirm it later. Non-marine insurance, however, cannot be ratified after loss.

The courts used to lean towards the broker in cases of ambiguity. In *Waterkeyn v Eagle Star & British Dominions Insurance Co Ltd/Price Forbes & Co*[24] the insured requested his broker to insure against the collapse of the Russian Bank for Foreign Trade in the light of the Russian Revolution in 1917, since he rightly feared the expropriation of the bank's funds, which included his own. The broker obtained insurance for loss "directly due to damage or destruction of the premises and contents of the said banks through riots, civil commotion, war, civil war [etc]", which was worthless. Upon its construction of the wording the court held that the broker was not liable since he had only "acted prudently in carrying out his activities". This case is interesting not only because the Belgian insured pointed out to the broker that the subject matter of the risk for which cover was required was

[17] *United Mills Agencies Ltd v RE Harvey Bray & Co* [1951] 2 Lloyd's Rep. 631.
[18] *Proudfoot v Montefiore* (1867) L.R. 2 Q.B. 511.
[19] *Jameson v Swainstone* (1809) 2 Camp 546, n.3.
[20] *Youell v Bland Welch & Co Ltd* [1990] 2 Lloyd's Rep. 423.
[21] *Dickson & Co v Devitt* (1917) 86 L.J.K.B. 313.
[22] *Youell v Bland Welch & Co Ltd*, n.20, above.
[23] *Weigall & Co v Runciman & Co* (1916) 115 L.T. 61.
[24] [1920] 4 Ll. Rep. 178; [1920] 5 Ll. Rep. 42.

not tangible, but was that of credits owed to them by the bank being rendered worthless by the vicissitudes of revolution, but also because the court held that the risk could have been covered by the addition of an "extremely simple clause" so that the policy provided for "insolvency caused by rioters, civil commotions, war, civil war [etc]". A more obvious reason to hold the broker liable would be difficult to find. Nevertheless, the court held that this was the only insurance that the broker could have obtained in the circumstances, which is a considerably better reason for excluding the broker's liability, but should not validate the broker's failure to obtain proper insurance. Obtaining one form of insurance because another is not available is an absurdity, if the insurance obtained clearly fails to meet the insured's requirements. It is thought that a court would struggle to uphold the "only insurance available" reason for this decision today, unless the insurance obtained broadly reflected the insurance requested but contained "unavoidable" clauses which the insured would prefer not to have. This rationale is also subject to the probable extension of a broker's duties that a broker must not blithely place the insurance requested by his principal, but must attempt to ensure that the insurance properly meets the principal's real requirements. The broker should inform the insured so that he can reiterate his instructions, or has an opportunity to obtain the insurance elsewhere, and so that he can decide whether he wishes to pay premiums for inferior insurance. A broker today may be unable to refute liability by adhering rigidly to specifications made by the insured, which are clearly wrong and would be seen to be wrong by a reasonable broker, without initially questioning his instructions.

Unauthorised insurers—UK contact offices

11–005 The Insurance Companies Act 1982 and Insurance Companies Regulations 1981 (SI 1981/1654) required any company "effecting and carrying out contracts of insurance" to be registered with and authorised by the Department of Trade and Industry. However, brokers have sometimes used insurers who ultimately have turned out not to be licensed or regulated in the United Kingdom, particularly where the business is simply not of sufficient quality to be capable of placement in anything other than a "fringe" market. A contract of insurance involving an insurer who is not authorised and regulated by the DTI/FSA is illegal and therefore in principle, as a matter of common law, unenforceable by either party. Between 1984 and 1992, five cases were heard by the courts on this point alone,[25] which were interpreted as meaning that a pre-Financial Services Act 1986 contract of insurance could not be enforced against by insurer or reinsurer. In *Bates v Barrow*[26] the court held the FSA 1986 to be

[25] *Bedford v IRB* [1985] Q.B. 966; *Stewart v Oriental Fire* [1985] Q.B. 988; *Phoenix General Insurance Co of Greece v Halvanon Insurance* [1986] Q.B. 216; *Re Cavalier Insurance Co* [1989] 2 Lloyd's Rep. 430; and *DR Insurance Co v Imperio Companhia de Seguros* [1993] Lloyd's Rep. 120. The FSA 1986 is significant because it enables a (re)insured to enforce an illegal contract in certain circumstances (see below).
[26] [1995] 1 Lloyd's Rep. 680.

foreign law, but the sub-agency will probably be governed by English law. An English court will take into account various factors weighted differently to determine which law applies, such as the location of the operation of the sub-agency and reinsurance agreements, and where these agreements were concluded. English law will probably govern the rights of the foreign broker against the English broker(s), so that the English broker may not have any privity of contract with the foreign insurer, depending upon the authority given by the insurer to his reinsurance broker, and does not owe any fiduciary duties (save as to secret profits). The relationship between the foreign insurer and the English reinsurer will probably be subject to English law.

Reinsurance disputes do not fall within the ambit of the special rules contained in Arts 7–12A in the Civil Jurisdiction & Judgments Act 1982.[33] However, the broker who has placed reinsurance with an English insurer in England but is sued by his principal reinsured, who is also domiciled in a country which is a signatory to the Brussels Convention 1968 and therefore subject to the Civil Jurisdiction & Judgments Act 1982, will probably be subject to English law and jurisdiction in any dispute concerning his operations as an agent because he will fall somewhere within Art.5 of the Act. Art.5 states that:

(1) in matters relating to a contract, in the courts for the place of performance of the obligation in question [*i.e.* contract of agency];

(3) in matters relating to tort, delict or quasi-delict, in the courts of the place where the harmful event occurred [*i.e.* concurrent duties in tort];

(5) as regards a dispute arising out of the operations of a branch, agency or other establishment, in the courts for the place in which the branch, agency or other establishment is situated;

or under Art.6 "where he is one of a number of defendants, in the courts for the place where any one of them is domiciled".

The distinction between insurance and reinsurance under the rules applying jurisdiction is irrelevant to the contract of agency.

[33] *Arkwright Mutual Insurance Co v Bryanston Insurance Co Ltd* [1990] 2 Lloyd's Rep. 70.

Chapter 15

Regulation of insurance brokers

The problems endemic throughout the insurance broking industry were becoming apparent by the mid 1970s and in January 1977 a Government Green Paper appeared, entitled "Insurance Intermediaries",[1] almost concurrently with a Consultative Document on the Regulation of Insurance Brokers issued by the British Insurance Brokers Council. The result was the Insurance Brokers (Registration) Act 1977 which provided for the self-regulation of insurance brokers through the establishment of the Insurance Brokers Registration Council. The rationale behind the Act was to achieve a "balance between the interests of insurers in maximising their sales outlets and of consumers in knowing that the intermediaries they deal with are experienced and dependable people".[2] **15–001**

The 1977 Act

The Insurance Brokers (Registration) Act 1977 did not attempt to define an "insurance broker", merely the steps that had to be taken to obtain that title. In fact a definition had been used in the Government White Paper, which was that also used by the Council of the EEC[3] for the purpose of facilitating "the effective exercise of freedom and freedom to provide services in respect of the activities of insurance agents and brokers and, in particular, traditional measures in respect of these activities". Member States were asked to abolish restrictions on the freedom of various activities, including "professional activities of persons who, acting with complete freedom as to their choice of undertaking, bring together, with a view to the insurance or reinsurance of risks, persons seeking insurance or reinsurance and insurance or reinsurance undertakings, carry out work preparatory to the conclusion of contracts in insurance and reinsurance and, where appropriate, assist in the administration and performance of such contracts, in particular in the event of a claim". The Insurance Brokers (Registration) Act 1977 created a "better" class of agent, entitled to call itself a broker, and anyone wrongly ennobling himself with this title was subject to the toothless sanction of a modest fine. This system of regulation was, however, further fundamentally flawed[4] because being voluntary it only **15–002**

[1] HMSO Cmmd 6715.
[2] Green Paper para.19.
[3] In Directive 77/92.
[4] And fragmented: not only did the Insurance Brokers Registration Council play a role, but further policing input could come from the Association of British Insurers and the Council of Lloyd's.

regulated those who wanted to be regulated. Ultimately it was felt that the public did not distinguish between brokers and agents, or did not care for the distinction—the standards of care to consumers of the two being substantially the same[5]—and as some überbrokers had quietly removed themselves from the ambit of the Act without any subsequent ill-effect, it was repealed on April 30, 2001.[6] Three elements then became relevant: the General Standards Insurance Council, the Financial Services and Markets Act 2000 and the Insurance Mediation Directive.[7]

General Insurance Standards Council

15–003 GISC is an independent organisation which regulates the sales, advisory and service standards of its Members, who are insurers and intermediaries. Its provenance was government driven and it was intended effectively to replace the IBRC as a more extensive self-regulating function of the insurance market, at least in the sense that it would exert its influence more widely. It has no statutory authority and membership is entirely voluntary. Its main purpose is to ensure that general insurance customers are treated fairly and properly by establishing, monitoring and enforcing standards of good practice for Members and all their dealings with general insurance customers, including the maintenance of an appropriate level of financial planning and the competence of their staff. The basis of its cohesion and effect is a contract between the Member and GISC in the form of the rule book by which the Members agree to be bound. GISC will then regulate all General Insurance Activities carried out from offices or branches in the United Kingdom of that Member, irrespective of the place of incorporation of the Member and irrespective of the location of the risk or the customer.

GISC regulates General Insurance Activities which are defined as one or more of (a) selling; (b) advising; (c) broking (including producing and placing); and (d) any other activity which, when engaged in in connection with a General Insurance Product, is regulated by the Codes.[8]

GISC promulgated two Codes[9] on June 30, 2000 for the benefit of the insured, which cover activities relating to advertising, arranging insurance cover, the provision of an ongoing service to the insured in relation to changes in its policy, renewal, expiry and cancellation. In addition, the Codes cover requirements relating to documentation, claims handling and complaints. These Codes are without statutory force but will either be interpreted by the courts as determining the level of the agent's duty of care[10] and the realistic expectations of the parties, or as terms incorporated into the contract of agency. The latter possibility is unlikely to occur,

[5] *Harvest Trucking v Davis* [1991] 2 Lloyd's Rep. 638.
[6] FSMA ss.416 (1) (c), 432 (3), Sch.22.
[7] Directive 2002/92.
[8] GISC's remit does not extend to all unregulated products, but only to those general insurance contracts originally listed in Sch.2 to the Insurance Companies Act 1982.
[9] Commercial and Private Customer.
[10] On a similar basis to the references to the appropriate Code in *Harvest Trucking v Davis Services* [1991] 2 Lloyd's Rep. 638.

particularly where the standard of care at common law is higher than that expressed in the Code,[11] although the Private Customer Code is addressed to the Customer in the second person and in the language of promise. It does, however, point out in para.10.2 that it forms part of the Member's contract with GISC and that it is not enforceable by any third party—the insured.

The Commercial Code

Under this Code a Member is required to act with due skill, care and diligence, to observe high standards of integrity and to deal openly and fairly with its Commercial Customers. It is expected to take the appropriate steps to identify the extent of its customer's risk awareness. **15–004**

The Code contains similar provisions to the Private Customer Code insofar as Members are required to provide adequate information in relation to their products, to explain the differences in the products on offer and their main features and to deal only in those products in which they specialise. They are also under a similar duty to provide details of related costs.

The Commercial Code sets out eight core principles[12] which attempt to encapsulate the standards of integrity and prudence to which insurance brokers must conform. The Rules give more concrete expression to the duties of an insurance broker to insureds, covering the marketing of the insurance broker's services, arranging insurance on behalf of commercial clients, confirming cover to those clients and providing on-going services and dealing with claims for the clients, and complaints. In summary these obligations are:

Marketing

All advertising and promotional materials must be clear, fair and not misleading. **15–005**

Arranging the insurance

Members will advise their commercial customers of the nature of their service including, in particular, whether they act on behalf of an insurer, act independently, or act as an agent of another intermediary. **15–006**

Where reasonably practical, members will confirm in writing instructions to act on behalf of a commercial customer.

Members will take appropriate steps to understand the types of commercial customers they are dealing with and the extent of their awareness of risk and the insurance available.

[11] A possibility mirrored by the GISC in March 2003 when it attacked the FSA's proposals in CP 160 as setting "a duty significantly below that currently regarded as good practice" which will "require intermediaries to meet lower standards than they are required to meet under common law and the law of agency".
[12] See Appendix 2.

Members will seek from commercial customers sufficient information about their circumstances and objectives to enable them to identify the customer's requirements.

Members will provide adequate information about the proposed insurance in a comprehensive and timely way, advising commercial customers of the key features including the important details of cover and benefits, any significant or unusual restrictions, exclusions, conditions or obligations, and the period of cover. They will explain the differences in, and the relative costs of, the types of insurance available to the commercial customer. In all cases, Members will take into consideration the knowledge held by their commercial customers when deciding the extent to which it is appropriate for the Member to explain have terms and conditions. If Members are unable to match commercial customers' requirements, they will explain the differences in the insurance proposed.

Members should only discuss with or advise commercial customers on matters in which Members are knowledgeable and seek or recommend other specialist advice when necessary.

Members will not impose any fees or charges in addition to the premium required by the insurer without first disclosing the amount and purpose of the charge. This includes charges for policy amendments, claims handling or cancellations.

Members will, on request, or when they are legally obliged to do so, disclose the amount of commission and any other remuneration received for arranging the insurance.

Members will disclose to commercial customers any payment they receive for providing to, or securing on behalf of, their commercial customers any additional services related to the insurance.

Members will explain to commercial customers their duty to disclose all circumstantial material to the insurance and the consequence of any failure to do so. They will make it clear to commercial customers that all answers or statements given on a proposal form, claim form, or any other material document, are the commercial customer's own responsibility. If members believe that any disclosure of material facts is not true, fair or complete, they will request their commercial customer to make the necessary complete disclosure, and if this is not forthcoming, they must consider declining to continue acting on that commercial customer's behalf.

When giving a quotation, members will take due care to ensure its accuracy and their ability to place insurance at the quoted terms.

Members will use their skill objectively in the best interests of their commercial customers when choosing insurers, and will inform and seek from their commercial customers written acknowledgment where they are instructed to place an insurance which is contrary to the advice given by the member.

Confirming cover

15–007 Members will provide commercial customers with prompt written confirmation and details of the insurance effected on their behalf. They will identify the insurer(s) and advise any changes, and will forward full policy documentation without avoidable delay.

Providing on-going service

15–008 Members will deal promptly with any queries and correspondence, or request for amendments to cover. Written confirmation of amendments will be provided. Return premium and charges due to commercial customers will be remitted without avoidable delay. Commercial customers will be notified of the renewal or expiry of their policy in time to allow them to consider and arrange any continuing cover they may need. Members will remind commercial customers at renewal of their duty to disclose all circumstances material to the insurance.

Claims

15–009 Where members handle claims, they will give reasonable guidance in pursuing a claim under the policy, handle claims fairly and promptly and keep commercial customers informed and forward the settlement proceeds of a claim without avoidable delay once agreed. Members will inform their commercial customers with a written explanation if they are unable to deal with any part of a claim.[13]

Complaints

15–010 Members will provide details of their complaints procedure to commercial customers, and details of any dispute resolution facility available to them. Complaints will be handled fairly and promptly.

Commercial Code

15–011 Members will provide, on request, a copy of the Commercial Code to their commercial customers.

The Private Customer Code

15–012 Under the Private Customer Code a Member is under an obligation to ensure that a certain standard of conduct is maintained and that, amongst other things, any advertising is fair and not misleading, the range of products offered and their main features are explained, a genuine attempt to match the cover to the insured's customer's requirements is made and that if it is not practical to match all the requirements, that enough information is given to enable an insured to make an informed choice, the insured is given full details of any costs of the insurance including premiums for each of the products on offer, details of any other fees or charges, including any commission or other fees charged in relation to the arrangement of insurance and/or other services.

Compliance with the Private Customer Code is not onerous. Essentially the Codes do no more than reflect the common law position, save that they

[13] Carefully, if they consider that the insured is not telling the whole truth and want to avoid a libel claim.