

Mactavish

“The fight is won or lost far away from witnesses - behind the lines, in the gym, and out there on the road, long before I dance under those lights.”

Muhammad Ali

DESIGNING AND DRIVING BEST-IN-CLASS BUYING PRACTICES: THE MACTAVISH SEVEN-POINT PROTOCOL FOR COMPLYING WITH THE INSURANCE ACT 2015

The seeds of claim success or failure are very often sown during placement where brokers remain routinely undirected and unchecked by the policyholder. Policyholder and broker actions post-loss can also cause significant damage to an unfolding large insurance claim. Policy reliability and compliance are all too often relegated to the bottom of the list of priorities - with very serious consequences if the contracts are ever tested by a large loss.

PUT YOUR PROGRAMME TO THE MACTAVISH TEST



A Board of Directors' primary interest with respect to insurance is to provide mitigation against high severity, low frequency events. Yet the paradox is that this falls down the list of priorities at renewal, with discussions commonly focused on premiums, not the reliability of the contracts and processes in place. Insurance ends up being treated as a commodity when it actually operates as a highly nuanced contract and capital facility.

The dangers of this paradox only become apparent when there is a large loss. In too many cases this means claims are disputed. On average¹:

- **45%** of large or strategically significant claims are disputed
- Disputes take **3 years** to resolve
- Where claims are disputed, settlements average **60%** of the amount claimed.

The seeds of these disputes are often sown in a false understanding of the performance management criteria of the buyer's role, in the management of the broker and during placement. In addition, further significant damage can often be done through actions post-loss and failure to manage a claim.

The Insurance Act 2015 has been rightly welcomed as giving policyholders added protection, but the new legal framework also places further obligations on buyers and their Boards. Courts are expected to interpret the law stringently, and businesses must be alert to these realities. The overall objective of the Act is to professionalise insurance placement. Policy reliability therefore needs to work its way up the list of priorities, and insurance buyers need to put themselves in the mindset of a disputed claim all the way through the placement process.

This guidance note helps businesses do this by working back from a disputed loss. It gives a Seven-Point Protocol detailing key areas to consider, so that insurance policies respond to large losses as intended and businesses do not fall foul of the new environment created by the Insurance Act 2015. For a detailed summary of the specifics of the Act itself we suggest that readers consult the British Insurance Brokers' Association/Mactavish co-produced guide: *Insurance Act 2015: An Introductory Guide*.

Audit the work of your brokers and insurers by putting your insurance governance to the Mactavish test!

¹ Mactavish Research, Mactavish Evidence To Law Commission & HM Treasury Enquiries On: Insurance Contract Law (2014)

1

DEFINE THE PERFORMANCE MANAGEMENT CRITERIA FOR THE INSURANCE BUYER

The Insurance Act 2015 seeks to professionalise the way in which commercial insurance is arranged. It starts with the buyer.

For too long Boards have taken too little interest in the highly skilled role of insurance buying with a once-a-year focus on reducing premiums being the main objective. Yet, when there is a large loss, Boards are quick to reinvent their expectations of the buyer and to hold them to account for an underperforming insurance policy.

All of that is now set to change, triggered by the new statutory duties imposed on Boards by the Insurance Act 2015.

Insurance buyers need to be on the front foot, clarifying with the Audit Committee the extent to which policy reliability is now a key performance management indicator for them. It should become the number one priority.

The Insurance Act 2015 places new statutory duties on Boards. It will be the combined role of the insurance buyer and the legal director to ensure Boards are made aware of these duties. The overriding objective of the Act is to professionalise placement standards. Boards that continue to manage their insurance buyers' performance on price alone will be pursuing a path which guarantees that they breach their new statutory duties. They risk being penalised heavily by the courts when relying on their insurance policies to recover large losses.

2

CLEARLY DEFINE THE BROKER ROLE

Establishing the broker's responsibilities upfront is critical to ensuring policy reliability. If a claim is disputed or repudiated due to placement failings, then it needs to be clear if this is an area of broker responsibility.

As standard, brokers often exclude liability for a wide range of tasks that are essential for contract certainty, and this detail must be worked through in advance to ensure it matches business expectations.

Insurance buyers should, therefore, check their broker Terms of Business Agreement (and associated Service Level Agreements) and have frank discussions around the apportionment of duties in respect of:

- Review of policy wordings
- Advice on and sign-off of disclosure materials
- Notification and claims handling in respect of all markets
- Financial/administrative issues such as tax compliance.

3

RISK ANALYSIS & COVERAGE DESIGN

Mactavish's research shows that by far the most common cause of claims disputes is whether the loss is covered at all. This can vary from underestimation of the scale of potential loss to purchase of the wrong extensions to cover. All stem from similar pre-placement failings. This often reflects the difficulty that insurance buyers can face in getting a complete picture of the risk exposures from business operations, in particular where operational managers do not understand the importance of disclosure or the nuance of what claims scenarios should be covered by insurance.

In advance of renewal, buyers should:

- Forensically examine and challenge the assumptions that underpin the levels of cover in place, focusing particular attention on insurances where a large, business-threatening loss could occur. For example:
 - Is it enough to purchase market-standard levels of cover, when all business operations are unique?
 - Do business continuity plans tally with the insurances in place?
- Arrange focused discussions with senior stakeholders about the detailed risks they expect to be insured and what critical events they are looking to cover
- Review policy exclusions against this understanding: asking the business about standard policy exclusions can often throw up areas of risk exposure that it expects to be insured
- Think through sub-limits and policy extensions: broker benchmarking can provide a useful sense of the market position (i.e. what is available) but can ignore individual business imperatives or expectations (i.e. what is required).



4

SET A ROBUST PLACEMENT PROCESS & AUDIT CONTROLS TO CHECK THE WORK OF THE BROKER

Even before any of the detail of policy wordings is considered, businesses often set themselves up to fail by the manner in which they approach the renewal process, devoting insufficient time and resource to the exercise. The Insurance Act 2015 creates new statutory obligations, which should usher in sweeping changes to how renewals are run.

In planning for renewal, policyholders should be careful to:

- Start the renewal early enough to run, and document, a reasonable search process and to leave time to negotiate terms before inception
- Be clear about the role that the broker should play, using their strengths in managing the transaction without giving them sole control of the process or overly relying on standardised solutions
- Review all risk information before it is provided to insurers to make sure that it is not only accurate but also clearly presented and provides a fair view of the underlying risk as it is understood by the business
- Engage insurers in dialogue about both coverage objectives and risk exposures of concern.

THE MACTAVISH SEVEN-POINT PROTOCOL FOR COMPLYING WITH THE INSURANCE ACT 2015

Claims outcomes are decided far away from the final dispute – in the risk analysis that drives coverage design, in the attitudes taken towards placement, the manner in which policies are negotiated, and actions taken immediately following a loss or receiving a claim. To ensure policies would respond adequately to large claims, buyers of insurance need, therefore, to track back and put themselves in the mindset of a disputed claim before placement even commences.



5 CONTRACTS - REVIEW LEGAL CONSTRUCTION OF THE POLICY

Insurance policies are key historical documents, with bespoke contracts testifying to the evolving risk concerns of a business and insurer/broker wordings evidencing layers of development over many years. However, this creates a challenging position in terms of clarity and certainty, presenting scope for complex and extensive legal disputes over policy application. This can be the case even when cover is adequate and conditions have not been clearly breached.

Businesses should therefore consider:

- Document management and clarity – is the entire contract split over a multitude of different and sometimes conflicting documents (wording, schedule, numerous endorsements, slips, etc.) and how might this affect any dispute?
- How will ambiguities in the wording be interpreted, given the fact that courts will interpret these differently depending on which party drafted the wording – and is the drafting of the contract consistent and clear?

For most buyers, brokers and in-house lawyers without an insurance background, these complexities are difficult to navigate. Getting specialist legal review of key policy wordings may be advisable.

6 CONTRACTS - REALISTIC POLICY TERMS

Insurers need to include conditions to manage their risk, and are entitled to expect certain behaviours from their insureds. But often policy conditions are accepted by both parties simply as standard. Where a policy term is accepted that is ill-suited to the particular policyholder, this can fundamentally undermine the cover purchased – and in the most extreme but surprisingly common cases, creates a policy that is effectively worthless from the day of placement.

At placement, policyholders should therefore consider:

- Core risk management conditions – do these fit with the business's current practices? Is there anything which is just not feasible?
- Notification conditions – do these reflect the reality of how the insurance department or insurance buyer would come to hear of a loss event? Are timescales and requirements for formal notification achievable?
- Aggregation – given the deductibles taken out and the policy structure, will related claims be treated in a way that is appropriate for the risk profile?
- Policyholder protections – does the policy include the most up-to-date and clear protection for non-disclosure, management of conditions/warranties, dispute resolution etc.?

Unrealistic conditions need to be negotiated out of policies.

7 CONTROL THE POST-LOSS PROCESS

Even where policies have been placed with a focus on reliability, it is all too easy for the business to compromise an insurance claim as it tries to deal with the wider implications of the incident.

The business needs to assert control over the entire process from the very outset. An insurance claim following a major loss or incident will frequently run in parallel with legal action commenced by third parties or investigations by a regulator or other body, which may affect the insurance claim, and thus the entire process could come under the lens of litigation or another adversarial process even before any policy coverage issues crystallise. The insurer and broker can be important allies for the policyholder in defending third party claims or responding to a major loss but are also potential counterparties in the event of a coverage dispute, so it is vital that the business recognises this reality even as it begins to deal with the immediate operational fallout of the loss or responds to initial indications of a potential third party claim.

Key areas to think about are:

- Protocols for general business behaviour post-loss to ensure appropriate engagement with insurers and other stakeholders, including to ensure that loss or incident investigations and the documents produced in connection with them are protected by legal privilege where appropriate
- Keeping a clear inventory of any post-loss policy conditions, so that the business is aware if it should not be accepting or admitting liability, incurring costs or responding to correspondence relating to the loss without getting written consent
- Agreeing preferred service providers (loss adjusters, forensic accountants, law firms) with the insurer in advance so that the business can use them without the risk of conflict issues.

WHEN AND HOW MACTAVISH CAN HELP

There are two principal ways in which Mactavish can help:

1. We can make sure that your insurance policies have been properly placed by independently auditing every aspect of the placement through our **Insurance Governance Service** and fixing any problems arising with our execution services; and
2. We can make sure that you control events immediately post loss with our leading edge **Claims Governance Service**.

We build market-leading, best-in-class insurance governance into your placement. And we do the same when you have a large loss.

We give you the skills and expertise to manage the insurance industry, instead of being managed by the insurance industry.

Mactavish

Mactavish is the UK's leading expert on insurance governance

The business specialises in the analysis of commercial risk, coverage analysis, insurance policy reliability, disclosure, placement procedures and conduct, and insurance governance standards. Mactavish is expert on the implications of the Insurance Act 2015, contributing heavily to the law reform process. We publish widely acclaimed research into the corporate insurance landscape and work with buyers, brokers and insurers to deliver improved insurance solutions. Mactavish is licensed by the Bar Standards Board of the Bar Council to access barristers directly, for both contentious and pre-contractual legal work in the field of insurance. We believe the business is unique in the UK in this regard.

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