QBE Business Insurance

PROPERTY MATTERS

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Contents

Introduction

Welcome to the June edition of Property Matters

With the outcome of the Brexit referendum dominating the headlines, and having split opinion across the UK, there is a sense of uncertainty and unease as to what the future holds. It is too early to say what will happen. The potential impact for insurers and other financial institutions, has been widely debated, with little agreement, save for the fact that business models will now need to be reviewed to ensure continuity across Europe. If you would like to read about some the issues further, QBE has created a guide to the possible implications "What Brexit Means for Business". It provides a useful review of the key issues and a copy can be found at: http://www.qbeeurope.com/events/2016-biba/brexit.asp

In this month's edition, we focus on the changing legal landscape for commercial property insurance. Set against the backdrop of the introduction of the Insurance Act (12 August 2016), two other important pieces of legislation have recently received Royal Assent and will have direct application for property insurers and their customers. Insurers, brokers and insureds will understandably be focused on the new demands and requirements of the Insurance Act, but should be mindful of the impact of this other legislation. We provide you with a review, and consideration, of the key changes and what it might mean for the industry.

Firstly, the Enterprise Bill will introduce a right for an insured to claim damages for late payment of their insurance claim. Whilst this doesn't come into force until 4 May 2017, and similar provisions already exist in of other jurisdictions, the change will need to be understood, applied and embedded into claims processes and procedures. Applying to 1st party claims, the reform is a good opportunity for an insurer to bring into focus its claims proposition and to follow-through with a promise to proactively manage the claims process and promptly pay valid claims.

Secondly, the Third Parties (Rights Against Insurers) Act 2010 finally comes into force on 1 August 2016 and looks to simplify and streamline the claims process involving an insolvent third party. The necessity for such legislation is heightened following economic uncertainty and a changing culture of businesses being more routinely dissolved. Whilst the reform is more finesse than fundamental change, insurers (and insureds with large deductibles/retentions) will need to understand the impact of the changes and to consider their options when faced with a claim involving an insolvent insured – pursuing or defending.

We also review a decision of the European Court of Justice regarding outsourced insurance claims service and the VAT position. The decision could well have a significant impact for insurers who employ such services and the outcome of the Brexit referendum will be relevant to how this might be applied by the Government and HMRC.

We then conclude this month's edition with reviews of two relevant reports that have been recently published. The first is the Environmental Audit Committee's report "Flooding: Cooperation across Government" and the second is the Financial Ombudsman Service's "Annual review of consumer complaints 2015/2016". Both reports include interesting comments on their respective current state of affairs and indicate the ongoing work that is required from all concerned.

We are undoubtedly going into a period of significant uncertainty for insurers and their customers. Some have predicted that will lead to a busier time for courts, but the hope must be that the parties to a commercial insurance contract will be able to resolve any disputes without recourse to legal advice. Whilst there are likely to be some test cases, a more sensible and less adversarial approach should be embraced by the many interested stakeholders.

The Enterprise Bill receives Royal Assent on 4 May 2016

The Enterprise Act introduces legislation that will allow an insured to claim damages for late payment of a claim

As a result, a new section 13A will be inserted into the Insurance Act 2015, implying a term into insurance (and reinsurance) contracts that an insurer must pay a claim within a reasonable time. There will be a 12 month transition period before the legislation comes into force, allowing insurers and brokers to prepare for the changes.

In England & Wales, under existing law, an insured is entitled to an indemnity up to the sum insured, but cannot claim in for additional losses caused by an insurer's failure to pay the claim within a reasonable time. Following review, consultation and recommendations from the Law Commission, proposals for reform were subsequently incorporated into the Enterprise Bill.

The key points:

- The new rules will apply to insurance contracts agreed from 4 May 2017 and will apply to consumer and commercial insurance.
- Damages should place the insured in the position they would have been in, had the claim been paid within a reasonable time. There is no cap on the amount of damages that can be awarded.
- A "reasonable time" for payment of a claim is not defined. It will depend on the "relevant circumstances". Section 13A expressly provides for a "reasonable time" to investigate and assess the claim.
- For commercial insurance, contracting-out is an option, either entirely or by imposing a limit on liability, subject to the transparency requirements contained within the Insurance Act.
- A one-year time limit (from the date all sums due are paid), will apply for bringing a claim against the insurer.

Unsurprisingly, the Bill provides no "hard and fast" rules regarding what amounts to a "reasonable time". The factors to consider will include; the type of insurance, the scale and complexity of the claim, compliance with statutory rules and any other factors outside the insurer's control. The insurer will not be in breach of their implied duty, if they can show "reasonable grounds" for the dispute. Their general conduct throughout the lifecycle of the claim will become relevant, if an insured pursues a claim for late payment damages.

Prompt payment of valid claims is a central part of QBE's Customer Value Proposition and Claims Philosophy. We welcome the introduction of the Act, which will provide a further opportunity for QBE to distinguish their product via a market-leading claims proposition.

Our Australian colleagues have had similar provisions in place for a number of years and their experience suggests the impact on the majority of insurers will be limited. Most delays are avoidable and with the aid of computerised case management systems and effective diary reminders, there are few excuses for late payment of damages for the vast majority of claims. For the less straightforward claims, clear communications, timely interim payments and regular updates, will help to avoid any dispute or allegation of delay and resultant damages.

The Third Parties (Rights Against Insurers) Act 2010

The long-awaited Third Parties (Rights Against Insurers) Act 2010 (the new Act) will finally come into force on 1 August 2016 and replace the 1930 Act, of the same name (the old Act). It is intended to address some of the perceived shortcomings, uncertainty and unfairness of the old Act.

Under the old Act, a claimant had to successfully obtain judgment against the insolvent third party, before bringing a claim against their insurer. This meant that claimants had to bring two actions, thus increasing the legal costs, whilst protracting and complicating the process. A claimant may have been told by the insurer that policy indemnity had been declined, but had no entitlement to receive sufficient information to allow them to make an assessment of the validity of their decision. The new Act seeks to streamline and simplify the process, which should have a practical and positive impact when we are pursuing a subrogated recovery on behalf of our insured.

> For 2015/16, the FOS received 4,777 complaints made by small businesses – approximately 5% more than the previous year.

The key changes under the new Act allow a claimant to:

- Issue proceedings against the insolvent third party insurer directly and without having to sue the third party. This will mean that a claimant will not have to restore the insolvent third party to the Registrar of Companies (a reasonably complex and expensive procedure).
- Ask the same court to determine the third party (breach of duty) and their insurer's (coverage) liability. A claimant will be able to seek a declaration in respect of legal and policy liability under the same legal action.
- Obtain the insolvent third party policy information with regard to the terms of cover, the limits of indemnity and details of any eroding payments made by the insurer. The request can be made direct to the insurer, broker or other intermediary (i.e. former directors) and a response must be forthcoming within 28 days, failing which an application can be filed at Court.

As above, a key benefit will be the obligatory policy information sharing prescribed by new Act and the Civil Procedure Pre-action protocols. Insurers will be obliged to engage at an earlier stage and any questions of policy cover can be discussed at an early stage. That will give a claimant greater certainty, which will help them to decide whether a claim is worth pursuing and being better placed to challenge an insurer's policy declinature.

The new Act should make it quicker, easier and less expensive to bring claims against insolvent third parties, thereby reducing the likelihood of a claim being abandoned due to insolvency (as opposed to the merits of the claim). The likely knock-on effect will be an increase in the number of claims being pursued against their insurers. Claims handlers should evaluate any such claims in light of these changes and decide whether litigation is the best course of action.

The new 28 day deadline for responding to any request for information will be a major advantage when pursuing a claim. In default, an application can be made to the court to compel a response, with likely costs penalty. This may result in additional claims being made against the policy due to the more readily available information.

Outsourced insurance claim settlement services subject to VAT

In the Aspiro judgment (C-40/15), the European Court of Justice (CJEU) was asked to consider the VAT liability for outsourced claims handling services. The ruling could have a significant impact for many UK insurers who currently outsource these services in the rest of Europe and will normally have a limited right to recover input VAT, meaning charged VAT will normally be a cost.

Aspiro SA, a Polish company, provided claims handling and settlement services for insurance claims, in the name and on behalf of an insurance company. In this regard, Aspiro entered into a contractual agreement with an insurance company. The services provided by Aspiro included:

- Receiving and processing insurance claims
- Registering claims in an IT system
- Corresponding with the client
- Preparation and processing of damage reports
- Claims investigation and the decision-making behind settlement

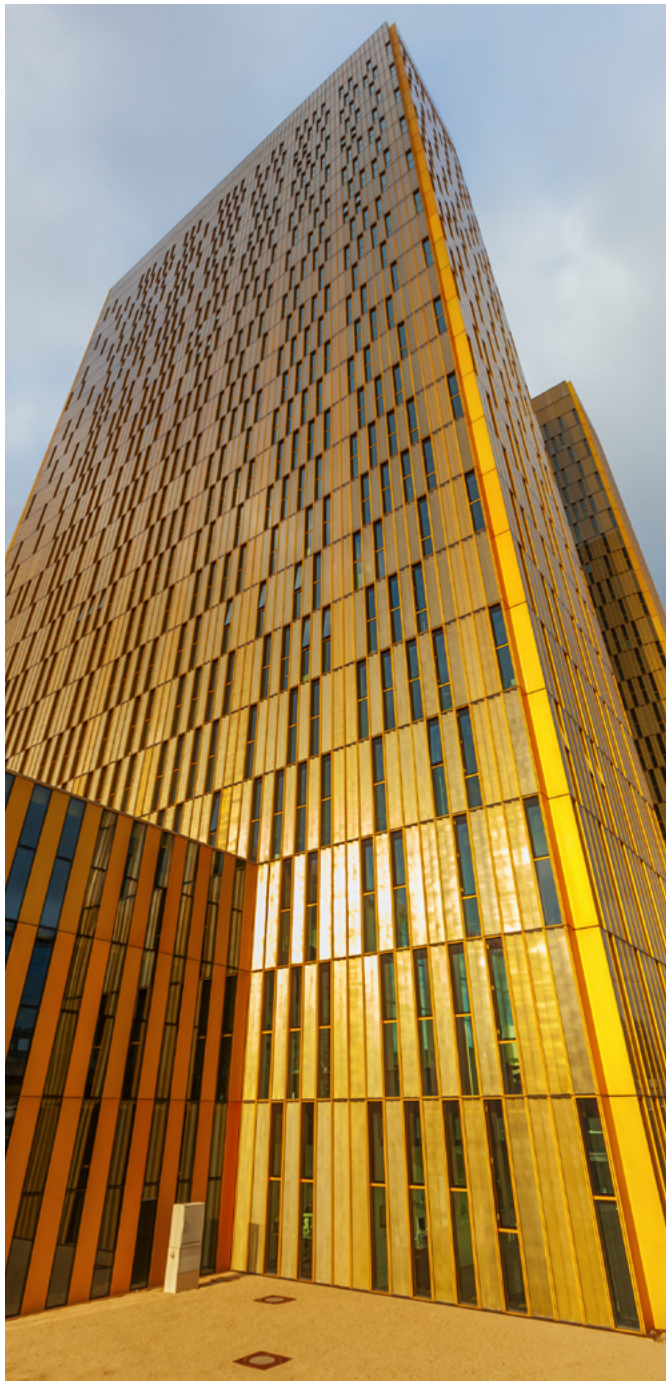
Aspiro's position was that services it provided were exempt from VAT, as they merely provided insurance intermediary services and constituted only an element of a single supply of insurance services. The Polish tax authority accepted that settling of the claims was an insurance activity. However, it concluded that all the other services performed by Aspiro, although linked to the settlement of the claims, did not constitute insurance services. Accordingly, Aspiro should not benefit from the exemption. The decision was referred to the CJEU.

The CJEU referred to decided case law and highlighted two conditions for the VAT exemption to apply for insurance activities, detailed in the following scenarios:

1. If Aspiro engaged in insurance and reinsurance activities. Such activities are characterized by the fact that the insurer receives a payment of a premium from the insured to cover a risk. Once that risk is materialized, the insurer provides the insured with the service agreed upon in the contract, i.e. in most cases payment of an amount. The CJEU ruled that this was not the case with Aspiro.
2. If Aspiro had acted as insurance brokers/agent, engaging in activities "related to" insurance and reinsurance. This would be the case if Aspiro had a relationship with both the insurer and the insured party and the activities would cover the essential aspects of the work of an insurance agent (such as finding or the introduction of prospective clients). Although Aspiro had a relationship with the insurer as well as with the insured party, the CJEU ruled that claims settlement services are not essential aspects of the activities of an insurance agent.

As a result, the CJEU ruled that the VAT exemption for insurance and reinsurance activities could not apply to the claims settlement services provided by Aspiro. They would not be considered an insurance intermediary within the meaning of the VAT Directive and could not benefit from the insurance exemption.

The decision confirms that the scope of the exemption for insurance activities is narrower than that for other financial services. It will be interesting to see how the decision will be applied, particularly in the UK, where the exemption under UK law is wider than the strict EU position. The position will need to be reviewed by the Government and HMRC, but in the event of a vote to leave the EU, the impact for UK insurers is still unknown.



Environmental Audit Committee Report: Flooding: Cooperation across Government

The publication of this report underlines the continued focus on the Government's response to the floods. We are now approaching 6 months post-floods, and despite many claims having been settled, businesses continue the multifaceted process of recovering fully. Short-term fixes will help in the event of repeat flooding this coming winter, but mid-long term solutions are vital for the sustainability of infrastructure in areas at risk of flooding. As this report highlights, there is not a 'one size fits all' solution to the problem, so it is incumbent on all interested parties to keep an open-mind and consider all available options as part of an overall response.

The Environmental Audit Committee is appointed by the House of Commons to consider to what extent the policies and programmes of government departments and non-departmental public bodies contribute to environmental protection and sustainable development.

Their latest report follows a review of the storms Desmond, Eva and Frank. A copy of the report can be found at: http://www.publications.parliament.uk/pa/cm201617/cmselect/cmenvaud/183/18302.htm

The report makes a number of criticisms:

1. A lack of effective long-term strategic planning about how to manage flood risk. Despite efforts to improve, the Government appears to be reactive rather than proactive.
2. Nationally significant infrastructure is not currently protected to a consistent standard. Infrastructure companies should be mandated to report their target resilience level, why this target is appropriate and what progress they are making to achieve it.
3. The Government should, in the short term, provide more support to local authorities to enable them to adopt a plan and, in the medium term, support and encourage local authorities to develop joint local plans that properly take account of flood risk management.
4. Despite sustainable urban drainage systems being widely acknowledged to be an efficient way of dealing with surface water, successive governments have been reluctant to mandate them as the default option in new developments.
5. It is critical that the Government undertakes its current review in an open and transparent way to allow stakeholders, including Parliament, to monitor its progress and hold it to account.

The report also highlights the impact felt by businesses, and in particular SMEs, with reference made to the Calderdale region and estimated costs of £47 million, plus indirect costs totalling £170 million. Concerns about the availability and affordability of business insurance in the effected regions were cited, alongside the lack of flood protection, with a combined risk that businesses might not be able to recover or might decide to leave the area.

Planning and strategy is a key issue, with a consistent and robust approach recommended, with a focus on protecting local infrastructure and improving flood resilience of larger critical assets. The importance of a local flood risk management strategy, as well as a Government overview, is vital to guarantee that local authorities are preparing for the appropriate risk level.

Financial Ombudsman Service annual review of consumer complaints 2015/2016

The Financial Ombudsman Service (FOS) has recently released its annual report, which contains facts, figures and information about the work they have done regarding complaints made about financial businesses.

The report identifies trends and reviews year-on-year statistics. A full copy of the report can be found at: http://www.financial-ombudsman.org.uk/publications/annual-review-2016/index.html

As well as resolving disputes between private consumers and financial businesses, the FOS' remit also includes complaints made by small businesses. To qualify as a small business, the annual turnover can be up to €2 million and they should have fewer than 10 employees (defined as a 'micro-enterprise' under EU rules).

For 2015/16, the FOS received 4,777 complaints made by small businesses – approximately 5% more than the previous year. 69% of those complaints were about the banking sector, 22% about insurance and 9% about investments.

The FOS dealt with 219 complaints about commercial property insurance. Commercial vehicles and property insurance totalled 1215, which was a 5% increase on the previous year. That number equates to 4% of the complaints about insurance (including PPI which accounts for 86%).

Looking more generally at insurance, the biggest contributor to complaints (excluding PPI) was motor insurance with a share of 27.5%. The next biggest share was buildings insurance with 13%. Most other products were below 5%. Poor communication at both the point of sale and during the claims process was a significant driver of complaints in this sector.

Overall, the FOS annual review suggests that the complaints environment for 2015/16 was very similar to the previous year. The total volume of complaints is slightly higher and the banking sector appears to be the main reason. PPI remains a major driver of the volume, even if the peak appears to be behind us, whilst packaged bank accounts are now a significant contributor to the new growth in complaint activity. Of particular importance to the insurance sector, the FOS message is that improvements need to continue, which should then reduce the number of complaints.

The FOS annual report follows the Financial Conduct Authority (FCA) Thematic Review of Handling of insurance claims for Small and Medium-sized Enterprises (SMEs) published last May. There are similarities in the findings – poor perception of claims experience and poor channels of communication, leading to delays. Insurers in the SME sector must address these issues and implement suitably robust systems to minimise the potential for complaints, if they want to retain business and distinguish themselves in a highly competitive market.

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