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# **Insurance Contract Law**

## **SUMMARY OF RESPONSES TO SECOND CONSULTATION PAPER**

### **Post Contract Duties and other Issues**

#### **Chapter 4: Policies and Premiums in Marine Insurance**

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**This document summarises the responses to Chapter 4 of the Law Commissions' second consultation paper in the joint insurance law project**

**February 2013**

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THE LAW COMMISSION  
THE SCOTTISH LAW COMMISSION

**Joint Review of Insurance Contract Law**

**SUMMARY OF RESPONSES TO  
SECOND CONSULTATION PAPER:  
POST CONTRACT DUTIES AND OTHER ISSUES**

**Chapter 4: Policies and Premiums in Marine Insurance**

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## **Approach taken in this paper**

### **Describing responses**

This paper describes the responses we have received to the proposals on policies and premiums in marine insurance set out in our Consultation: Post Contract Duties and other Issues. This document aims to report the arguments raised by the consultees. It does not give the views of the Law Commission or the Scottish Law Commission.

### **Comments and Freedom of Information**

We are not inviting comments. However, if having read the paper you do wish to put additional points to the Commissions, we would be pleased to receive them.

Please contact us:

By email at [commercialandcommon@lawcommission.gsi.gov.uk](mailto:commercialandcommon@lawcommission.gsi.gov.uk)

By post, addressed to Laura Burgoyne, Law Commission, Steel House, 11 Tothill Street, London SW1H 9HL

We will treat all responses as public documents. We may attribute comments and publish a list of respondents' names.

Information provided, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (such as the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002 and the Data Protection Act 1998). If you wish your information to be confidential please explain to us why and whilst we will take a full account of your explanation, we cannot give assurance that your confidentiality will be maintained in all circumstances.

# **PART 1**

## **INTRODUCTION**

- 1.1 The Law Commission and Scottish Law Commission are carrying out a major review of insurance contract law. As part of that review, in December 2011 we published a joint Consultation Paper on “Post Contract Duties and other Issues”.<sup>1</sup>
- 1.2 The fourth chapter related solely to marine insurance. We looked at two provisions in the Marine Insurance Act 1906, sections 22 and 53, which appeared outdated and problematic, or simply no longer necessary in today’s market.
- 1.3 Section 22 requires a contract of marine insurance to be “embodied in a marine policy”. It dates from 1795 when stamp duty was imposed on marine insurance and a formal policy document had to be stamped. That requirement was abolished in 1970 and evidence shows that section 22 is now widely ignored. We proposed repealing it. However, section 22 is not an isolated provision. We examined the implications of removing the requirement for a marine policy on the rest of the 1906 Act. The 1906 Act uses the word “policy” or “policies” 166 times. On most occasions, the word “policy” simply means an enforceable contract, but in four provisions the word “policy” is used to refer to a document rather than a contract. These are sections 2(2), 30, 50(3) and 52, which we considered in turn.
- 1.4 Section 53 of the 1906 Act deals with policies effected through brokers. Section 53(1) makes a marine broker liable to pay premiums to the insurer. It is a complex provision. It appears to reflect the common law position, in which the insured was *not* liable to pay premiums to the insurer. This could have surprising consequences if a marine broker were to become insolvent. We suggested that the position should be clarified, to state that policyholders are liable to pay premiums to the insurer. We proposed a default rule to state that the broker was *a/so* liable to pay the premium to the insurer for marine insurance, as this reflects current practice. However, we thought that it should be easy for the broker and insurer to contract out of this provision if they wished to.
- 1.5 Section 53(2) gives the broker a lien over the marine policy. We looked at whether this provision needed to be updated.

### **RESPONSES**

- 1.6 We received 20 responses to this section of our consultation, as shown in the table below.

<sup>1</sup> Insurance Contract Law: Post Contract Duties and other Issues, the Law Commission and the Scottish Law Commission, LCCP 201 / SLCDP 152 (December 2011) (hereinafter referred to as the “Consultation Paper”).

| Type of respondent                            | Number    |
|---|-----------|
| Insurers and insurance trade associations     | 5         |
| Lawyers, legal associations and the judiciary | 7         |
| Brokers and brokers' associations             | 6         |
| Academics                                     | 1         |
| Other   | 1         |
| <b>Total</b>                                  | <b>20</b> |

## THANKS

- 1.7 We would like to thank all the consultees who responded to our Consultation Paper, or who met with us or contacted us to express their views. Whilst we are unable to directly quote all consultees' submissions in this brief summary, those views are important to us as we put together our recommendations for the final report. A list of all the consultees is contained in the Appendix.

## **PART 2**

# **THE NEED FOR A MARINE POLICY DOCUMENT**

### **ENFORCEABILITY OF MARINE INSURANCE CONTRACTS**

- 2.1 We asked whether consultees agreed that a marine insurance contract should be enforceable even if it is not embodied in a formal policy document. All 14 consultees who responded to this question (100%) agreed.

- 2.2 The Association of British Insurers (ABI) agreed that marine policies should be “treated no differently from other general insurance business”:

General insurance contracts’ policy terms should be complete and final before inception of the contract, in accordance with the ABI’s Contract Certainty Code of Practice. No statutory requirements specific to marine policies are required, and the normal rules of contract should apply.

- 2.3 The International Underwriting Association (IUA) echoed the view of several respondents that “section 22 does not reflect current insurance market practice in either the marine or non-marine classes of business and is not relied upon by insurers”. IUA stated that:

In the London market the insurance slip is usually used as the evidence of cover and a policy is therefore not needed or produced. In practical terms the Market Reform Contract performs the same function as a policy and should therefore be given the same legal standing.

...

The general rules on contract formation should apply ... [to] allow other documentation in addition to the insurance policy to be admissible to prove evidence of a contractual arrangement - such as a copy of the slip, a certificate of insurance or a schedule of cover.

### **FORM OF MARINE INSURANCE CONTRACT**

- 2.4 We asked consultees if they agreed that statute should not require a marine insurance contract to be in any particular form. Twelve consultees responded to this question of whom 11 (92%) agreed and one (8%) marked “other”.<sup>2</sup>

- 2.5 Many agreed without further comment, or referred to their responses to question one above. Several favoured leaving the issue to market practice, citing the Market Reform Group pro forma slip and the Contract Certainty Code of Practice in their responses. The IUA expanded further on this point:

<sup>2</sup> The response form provided tick boxes, namely “agree”, “disagree” and “other”.

The Contract Certainty Code of Practice, adhered to by the London market and agreed with FSA, clearly identifies the rules around the timely agreement of terms and production and submission of contract documentation to the insured. The administration around insurance contract production is best left to the market, underpinned by the legal rules relating to contract formation and evidence that a contract has been formed. Non-marine insurance works effectively in this way and we do not see any reason to differentiate marine risks in this regard.

- 2.6 Mark Wibberley agreed on the proviso that the contract be in “writing in some format or other (eg print, electronic)”. The Bar Council, marking “other”, was split on this issue. The majority was of the view that there should be “no statutory requirement” concerning the form of a marine policy, while the minority wished to retain a requirement that the contract “be contained in or evidenced in writing”.

### **MARINE INSURANCE ACT 1906**

- 2.7 We proposed that several sections of the Marine Insurance Act 1906 should be repealed, namely:

- (1) Section 22 (Contract must be embodied in policy)
- (2) Section 23 (What policy must specify)
- (3) Section 24 (Signature of insurer)
- (4) Section 89 (Slip as evidence)
- (5) Section 52 (When premium payable)
- (6) Model Policy referred to in section 30 and contained in the First Schedule of the Marine Insurance Act 1906

- 2.8 There was unanimous agreement from those who responded to these proposals, as set out below.

### **Marine Insurance Act 1906, section 22 (Contract must be embodied in policy)**

- 2.9 We proposed the repeal of section 22, which provides that a contract for marine insurance is inadmissible in evidence unless “embodied in a marine policy”. All 12 consultees who responded to this question supported the proposal, many without further comment.
- 2.10 British Insurance Law Association (BILA) said:
- It is undesirable that a section which is out of step with modern law and practice and which is routinely ignored should remain on the statute books.
- 2.11 The majority of the Bar Council agreed but cited their split on the issue of requirements of formality (see paragraph 2.6 above).



**Marine Insurance Act 1906, section 23 (What policy must specify)**

- 2.12 Section 23 as currently enacted provides that the policy required under section 22 must specify the name of the insured or of the person effecting insurance on behalf of the insured. All 12 consultees who responded to this question agreed with the proposal to repeal it.
- 2.13 The IUA agreed, saying “this is better left to market practice”. The majority of the Bar Council also agreed but again cited their split on the issue of requirements of formality.
- 2.14 Mark Wibberley agreed but said that:

there should be a requirement for the Assured’s name to appear in the insuring agreement, if only as a means of identifying one of the parties to the contract. It is equally important with current day concerns over trade sanctions that apply to individuals as well as countries.

**Marine Insurance Act 1906, section 24 (Signature of insurer)**

- 2.15 Section 24 provides that the policy required under section 22 must be signed “by or on behalf of the insurer”. All 12 consultees who responded to this question agreed that it should be repealed along with section 22, mostly without further comment. Again the Bar Council cited the split position on the issue of requirements of formality.
- 2.16 The IUA provided the following comment:

Again this is better left to market practice, which ensures that however the contract is drafted – via paper or electronically - there are established and secure means of ensuring that the insurer has signed the contract document and that an audit trail of it exists. Moreover, the insurance market continues to advance in the placement of risks and contract production via electronic means, in particular via the use of the Insurer Market Repository and the Market Exchange which facilitates the placement and production of electronic policies and endorsements. Removing section 24(1) would also have the ancillary benefit of treating marine and non-marine risks in the same way going forward.

**Marine Insurance Act 1906, section 89 (Slip as evidence)**

- 2.17 Section 89 provides that a court may consider a slip or covering note only where there is a duly stamped policy. All 12 consultees who responded to this question agreed to its repeal without additional comment, apart from the Bar Council who cited their split on the complete abolition of requirements of formality.

### **Marine Insurance Act 1906, section 52 (When premium payable)**

- 2.18 Section 52 states that the insurer is not bound to issue a policy until the insured pays the premium. All 12 consultees who responded to this question agreed to its repeal, most without additional comment. Once the requirement for a marine policy has been removed, the insurer will no longer be bound to issue a policy at all.
- 2.19 The Bar Council again agreed subject to their split on the issue of requirements of formality. The City of London Law Society agreed on the proviso that it be “understood that ‘policy’ in section 52 is used to mean a specific document.”

### **Model policy referred to in section 30 and contained in the First Schedule of the Marine Insurance Act 1906**

- 2.20 Section 30 introduces a schedule to the 1906 Act, which is in two parts. The first part of the schedule contains a model policy, written in an archaic style, which is no longer used. We proposed that this should be repealed and again, all 12 consultees who responded to this question agreed. We did not propose to repeal the second part of the schedule, which sets out rules of construction and which continues to be relevant.
- 2.21 Several consultees agreed with the removal of the model policy but stressed that the rules of construction should be retained. The British Insurance Brokers’ Association (BIBA) said that they are “widely used and helpful”. The Bar Council thought:

The First Schedule should be repealed but only in circumstances which make it clear that the rules of construction are not by the repeal alone intended to be discounted as guides to the construction of the terms defined. Numerous cases on the Institute Clauses frequently refer to the rules of construction in the First Schedule in interpreting the Institute Clauses. See, *eg*, recently *Global Process Systems Inc v Syarikat Takaful Malaysia Berhad* [2011] UKSC 5; [2011] 1 All ER 869; *Melinda Holdings SA v Hellenic Mutual War Risks Association (Bermuda) Ltd* [2011] EWHC 181 (Comm); [2011] Lloyd’s Rep IR 470.

- 2.22 The ABI said that:

The normal contract rules of contract formation should apply to marine insurance contracts. Contract certainty should be left to the market and backed by market regulation.

### **WHERE POLICY MEANS CONTRACT**

- 2.23 We asked whether most references to policies in the 1906 Act should be interpreted as references to marine insurance contracts. All 12 consultees who responded to this question agreed. Only two made additional comments.
- 2.24 The Bar Council agreed in principle but pointed out some advantages of the current position:

One of the advantages of the current distinction between “policy” and “contract” is that the former refers to the documentary evidence of the contract and the “contract” refers to the legal concept. It is this distinction which allowed the Court to conclude that a breach of the duty of utmost good faith by one co-assured under a composite policy entitled the insurer to avoid the contract with the co-assured in breach, and not any contract with any innocent co-assured (see *New Hampshire Insurance Company v MGN Ltd* [1997] LRLR 24). That said, the Court has also been astute to protect the position of the innocent co-assured even though the relevant provision referred to “policy”, rather than “contract” (see *Eide UK Ltd v Lowndes Lambert Group Ltd* [1999] QB 199).

- 2.25 BILA agreed “that the matter should be put beyond doubt”, and suggested that an amendment to the definitions provided in section 90 of the 1906 Act would be “the ‘tidiest’ approach”.

### **ACTIVITIES ANALOGOUS TO A MARINE ADVENTURE**

- 2.26 Section 2(2) states that ship building, ship launches and “any adventure analogous to a marine adventure” may be treated as marine insurance “if it is covered by a policy in the form of a marine policy”, and in so far as the provisions of the 1906 Act are “applicable”. This is a problematic section, as a marine policy does not need to take any particular form. Nor is it clear which provisions might be applicable. As one judge put it, “what these words mean, I do not know”.<sup>3</sup>
- 2.27 We proposed that, where an insurance contract covers shipbuilding, a ship launch or “any adventure analogous to a marine adventure”, the parties should be able to include an express term to designate the insurance as marine insurance for the purposes of the 1906 Act.
- 2.28 Twelve consultees responded to this proposal. Seven agreed, and only one disagreed. However, four consultees marked “other”.

### **Agreement**

- 2.29 Marsh Limited (Marsh) identified the problem with the current law:

The fact that there is no legal definition of the phrase “any adventure analogous to a marine adventure” is problematic. In practice, if a policy is written by a marine underwriter the parties tend to regard it as a marine policy, leading to potential exposure for brokers as regards premium – unless of course s53(1) is repealed. We think s2(2) should be repealed or, failing that, should be defined by statute.

<sup>3</sup> Mr Justice Mustill in *Continental Illinois National Bank and Trust Co of Chicago and Xenofon Maritimes SA v Alliance Assurance Co Ltd, “Captain Panagos DP”* [1989] 1 Lloyd’s Rep 33 CA.

- 2.30 The IUA stated that it did not have strong views on the question, but on balance favoured the proposal. The IUA also suggested that:

There would also be some potential value in developing a non-exhaustive list of activities that would be deemed to be marine insurance – for example to include oil rigs, inland watercraft and laid up vessels. However, these should not impinge upon the contractual terms of the policy or judicial discretion where applicable.

***Disagreement / “other”***

- 2.31 Marking “other”, ACE and the Lloyd’s Market Association (LMA) proposed the introduction of a non-exhaustive list of marine business but also allowing for contractual provisions, in line with the IUA’s suggestion.
- 2.32 The Judges of the Court of Session, marking “other”, as well as BILA, marking “disagree”, preferred wholesale repeal of section 2(2), though the Judges of the Court of Session added that they had no strong views on the point. BIBA, marking “other”, said “section 2(2) [is] not used in practice but its existence creates room for doubt”.

**Repeal of section 2(2)**

- 2.33 As an alternative, we asked whether consultees thought that section 2(2) should be repealed, leaving the parties free to apply any specific provision of the Act to their policy.
- 2.34 Eleven consultees responded to this proposal. Only two consultees (18%) agreed, compared to seven (64%) who disagreed. Two consultees marked “other” while providing comments inclining towards repeal.

***Agreement***

- 2.35 Marsh agreed with this proposal on the basis that section 2(2) “causes confusion”. BILA expanded upon this:

The scope of this section is very uncertain and repeal or reform certainly seems advisable. It is not clear to us that the proposed reform adds anything to the common law – surely parties could include an express term to designate the insurance as marine insurance for the purposes of the 1906 Act as a matter of contract or adopt particular provisions, without an Act to permit them. And a provision which stated that the Act would then apply “in so far as applicable” has the potential to create disputes, as well as to impinge on the parties’ freedom of contract.

Given the other uncertainties to which the section has given rise (in particular as to the definition of “activities analogous to a marine adventure”), we would favour repeal and leave it to the parties to particular “quasi-marine” contracts to incorporate the Act or terms of it specifically, and they can then do this expressly to the extent which is appropriate in given cases.

### ***Disagreement / “other”***

- 2.36 The Judges of the Court of Session marked “other” but stated that, whilst they did not have strong views on the point, on balance they favoured repeal because section 2(2) would serve “no useful purpose” after removal of the policy/contract distinction. Also marking “other”, the City of London Law Society wondered whether “at some point, the removal of so many provisions of marine insurance contract law leaves the remainder anachronistic and scarcely viable”.
- 2.37 Several consultees disagreed on the basis that they preferred the first option, as set out in paragraph 2.26 above.
- 2.38 The Bar Council argued against the proposal:

The Marine Insurance Act 1906 should apply to all contracts for marine insurance. Hence, an amended section 2(2) will serve a purpose to broaden the class of marine insurance contracts to which the Act applies. Although it is open to parties to non-marine insurance contracts to agree that the provisions of the Act should apply to their contract, it is more prudent for contracts which are truly analogous to marine insurance contracts to attract the Act irrespective of whether the parties have so agreed.

### **SECTION 21: WHEN CONTRACT IS DEEMED TO BE CONCLUDED**

- 2.39 Section 21 states that a contract is concluded when the insured’s proposal is accepted, even if the policy is issued later. We asked consultees whether the following words should be removed from section 21 of the Marine Insurance Act 1906:

whether the policy be then issued or not; and, for the purpose of showing when the proposal was accepted, reference may be made to the slip or covering note or other customary memorandum of the contract.

- 2.40 Twelve consultees responded to this question, of whom 11 (92%) agreed with the proposal. The remaining consultee (constituting 8%) marked “other”.
- 2.41 LMA gave the following comment:

Agree – the Slip would now evidence the contract of insurance in many cases and a separate policy document would not be issued.

Note: managing agents/brokers have the option of agreeing that a policy document be produced by Xchanging (as the outsource provider).

- 2.42 The ABI agreed with removing the words, but also suggested that “the section should be repealed”. BILA suggested that repeal:

... might also avoid arguments that the remaining wording is intended to mean something different and distinct from the normal contractual rules as regards acceptance.

## **ASSIGNING A POLICY**

- 2.43 Section 50(3) states that “a marine policy may be assigned by indorsement thereon or in other customary manner”. We asked consultees whether it should be amended to say simply that a marine insurance contract may be assigned in any customary manner or as agreed between the parties to the transfer.
- 2.44 Most consultees (10 of 12 who responded to this question) agreed with the proposal. Two consultees marked “other”.

### ***Agreement***

- 2.45 The IUA agreed, saying that while they were not aware of any problems with section 50(3), the amendment would “be beneficial and logical in the light of the other proposals”.
- 2.46 The Law Society of Scotland gave a brief summary of the Scots law of assignation<sup>4</sup> and queried whether, for Scots law, “it is acceptable to say that the parties can, for example, choose their own formalities” because “in Scots law, intimation is an essential requirement for transfer of the assignor’s rights under the policy”. On this basis they said that assignation:

probably has to be in writing because, without writing, there is nothing to intimate. ... So too in English law: would the amendment to s 50(3) allow the parties to conclude a legal assignment without writing? That is not for us to say, but it is a surprising consequence.”

- 2.47 They also wondered “whether an amendment to s 50(3) would affect the Policies of Assurance Act 1867”, although that Act “probably does not apply to Scotland”.

### ***“Other”***

- 2.48 Marking “other”, the Bar Council voiced concerns about allowing the parties to agree methods of assignment:

In the absence of section 50, a policy could be assigned legally only if it complied with section 136 [of the Law of Property Act 1925] (which requires an absolute assignment in writing). Accordingly, the subsection should retain the reference to customary methods of assignment. Adding an open-ended provision allowing for the parties to decide how to assign is in essence open-season for any sort of assignment (which is the case in equity in any event), but if it is intended to be a legal assignment, it probably should require some formal requirements (namely, in writing and/or by a method recognised by a custom of the market).

<sup>4</sup> The Law Society of Scotland explained that “assignation” in Scotland is the term given to (i) the contract to transfer rights under a policy, and (ii) the juridical act whereby that obligation is implemented.

- 2.49 On the other hand BILA, although marking “other”, were in favour of providing for assignment as agreed between the parties but were concerned at the proposed retention of “customary”:

The use of the word “custom” has the potential to open up arguments as to the meaning of “customary” – and in particular to arguments that what is required is a practice which is “notorious, certain and reasonable” (see Chitty paragraph 12-129) as distinct from a trade practice. This is particularly so as it appears from the consultation that what is intended to be achieved is to allow assignment in modes which the market practice now regards as acceptable.

**Other matters relevant to section 50(3)**

- 2.50 We asked whether there were any other issues or related matters which we should take account of in relation to our proposal to amend section 50(3). Of the nine consultees answering this question, five responded that there were no other issues which should be taken into account; the remaining four supplied substantive comments.

- 2.51 The City of London Law Society observed that:

changing methods of communication may render even electronic commerce obsolete in the lifetime of the new Act. The introduction of “or as agreed between the parties” at least reduces the likelihood of obsolescence.

- 2.52 Mark Wibberley said that:

It should not be assumed that electronic Certificates of Insurance have completely replaced physical documents. Lloyd’s Certificate Office still issues many thousands to brokers for use by Assureds.

- 2.53 BILA urged caution about amending the section and queried:

whether anything more than a deletion of this subsection is required. The question of how the law of assignment generally would operate in the context of modern practices absent any such provision would seem to be a question which should be thoroughly considered before an amendment to the section which would create disputes as to the ambit of that section’s wording is put in place.

- 2.54 The Bar Council suggested additional considerations:

Any amendment to section 50(3) should be reflected in section 29(2) (declarations under a floating policy). In addition, clarification should be obtained as to whether the assignment of a marine policy operates to assign only the assured’s rights under the policy or also the assured’s obligations (eg the obligation to pay premium).

## **PART 3**

### **THE BROKER'S LIABILITY FOR PREMIUM**

- 3.1 Section 53(1) of the Marine Insurance Act 1906 is a complex and difficult provision. It appears to embody the common law rule that the insured is not liable to pay premium to the insurer, but instead is liable to pay the broker who receives the money in its own name and has a separate debt to the insurer.

#### **THE POLICYHOLDER'S LIABILITY FOR PREMIUMS**

- 3.2 We thought that section 53(1) might cause problems if a marine broker became insolvent. Currently, when a marine policyholder pays the broker, it appears that the premium is owned by the broker beneficially, and is not held on trust for either the policyholder or the insurer. We think that the section requires the policyholder to pay the broker even after the broker has become insolvent and it is clear that the money will never be passed on to the insurer.
- 3.3 We contrasted this with the position for non-marine insurance. Here under the CASS<sup>5</sup> rules, the broker normally holds the money on trust for the policyholder until it is passed to the insurer ("non-risk transfer TOBA").<sup>6</sup> However, the broker and insurer may agree that the broker receives the premium as agent for the insurer ("risk transfer TOBA"). This means that the policyholder is deemed to have paid the insurer when it pays the broker, and the money is usually held on trust for the insurer. Once a broker has become insolvent, policyholders would terminate the relationship and pay the insurer by other means.
- 3.4 We proposed that the same rules should apply to marine insurance. In other words, the policyholder's primary liability should be to the insurer. Normally where the policyholder pays the broker, the broker would receive this as agent for the policyholder. However, the broker and insurer may agree that the broker receives the premium as agent for the insurer. Below we look separately at each element of this approach.

#### **The policyholder's primary liability to the insurer**

- 3.5 First we proposed that, where marine insurance is effected on behalf of an insured by a broker, the policyholder should be liable to pay the insurer. We asked consultees whether they agreed. Fifteen consultees responded to this question, of whom 13 (87%) agreed with our proposal. The remaining two (13%) marked "other".

#### ***Agreement***

- 3.6 BILA said that the proposals reflected "a fairly strong majority position throughout the market" and emphasised that:

<sup>5</sup> CASS (Client Assets Sourcebook) is a set of FSA rules which provide special protection to policyholders who pay money to a broker as their agent.

<sup>6</sup> In Scotland, the CASS rules (CASS 5.3) provide that the broker holds clients' money as agent rather than on trust.



... the benefits of reform will be limited unless it is at the same time made clear that the common law fiction on which it is based is thereby also abolished. If this is not done it is absolutely inevitable (not least because the issue has been “flagged” in articles) that parties will argue that the underlying common law authorities still hold good.

3.7 The IUA commented that:

Insurers, both non-marine and marine, generally look to rely on the terms of the policy, contractual relations with brokers (developed through slip provisions and TOBAs) and market mechanisms to control the payment of premium (such as the Deferred Account Scheme for instalment payments) and remedies for non-payment. FSA also maintain strict controls around the holding of client monies in trust accounts which afford the contractual parties greater protection against broker insolvency. These mechanisms more easily lend themselves to the principle that the insured should have a responsibility in law and under the contract for the payment of premium.

3.8 Ms A Awofeso also thought that the proposal would represent an improvement:

Although this might lead to the insured having to pay the premium twice where the broker is insolvent prior to paying the insurer, this will be less problematic than at present, as the insured should generally be able to recover the premium from the broker irrespective of insolvency under the FSA and CASS rules. Of course, the parties are free to agree otherwise.

**“Other”**

3.9 Marking “other”, Direct Line Group (Direct Line) agreed that the policyholder should not be liable to pay the premium twice:

if they have paid the broker (who generally acts as agent for the insurer for the collection of premium) in good faith and the broker has failed to pass this on or become insolvent and the Policyholder can demonstrate this then the Policyholder should not be liable to pay again.

3.10 The Bar Council, also marking “other”, said that our proposal “makes obvious legal sense” but continued:

... the broker’s traditional liability to pay the insurer reflects a long-established practice which brings the benefit of liquidity to the market and insulates the insurer from the credit risk associated with the assured (introduced to the insurer by the broker). Accordingly, there may be commercial reasons why the current arrangement should remain. However, if the proposal is adopted, it is suggested that:

- (1) the broker's liability to pay premium to the insurer should arise only if there is an agreement to that effect between the insurer, the broker and the assured;
- (2) provision be made for the assured's liability to pay commission to the broker (subject to contrary agreement).

### **The broker as agent**

- 3.11 We asked whether, when the broker collects the premium, policyholders should pay the broker as an agent. Fifteen consultees answered this question and 14 of those (93%) agreed. One consultee marked "other".
- 3.12 Several consultees agreed without additional comment. Direct Line stated that this was already the usual position under Terms of Business Agreements (TOBAs).
- 3.13 LMA agreed that this should be the default position, unless the broker is "specifically an agent of the insurer under a delegated authority agreement or other agency agreement." The IUA and ACE made similar points. ACE also said:

Where the broker holds premiums as agent for the policyholder these monies should be held as client monies in a CASS account. Where risk transfer is adopted the terms of the TOBA should apply as to how insurer monies must be held.

- 3.14 Longmore LJ was concerned:

(1) That there will be circumstances where an insured may have to pay the premium twice eg

(a) in cases where CASS will not apply, see para 18.47 of [the Consultation Paper];

(b) where a broker fails, in breach of CASS and/or his duties, to keep a client's money separate as per the recent Lehman Brothers case; and

(2) that an insurer, if there is a premium warranty clause and a claim, will be able to avoid paying a claim by relying on the clause.

I am not sure it is possible to do much about the first concern which will just be a possibly unfortunate result of an otherwise beneficial reform. But could the second concern be met by having a specific provision that, provided the insured does in fact pay the premium, any condition precedent or warranty default clause will cease to have effect?

### **Agent subject to contract**

3.15 We proposed that, as a general rule, the broker should hold the premium as agent for the policyholder, but said this should be subject to a contract between broker and insurer. We asked if consultees agreed. Fifteen consultees responded to this proposal, of whom 11 (73%) agreed. Three (20%) disagreed and one consultee (7%) marked "other".

3.16 The City of London Law Society agreed:

...that the capacity in which the broker holds the premium should be subject to variation by contract between the broker and the insurer but, if so, the consent of the policyholder should first be obtained.

3.17 The LMA noted that the:

usual position is that there would be a written TOBA between broker and insurer setting this out or agreeing to "risk transfer".

3.18 Direct Line disagreed:

It is unusual for the Broker to act on behalf of the insured for the purposes of premium collection. Where risk transfer is involved this is held in trust for the insurer.

### **THE BROKER'S LIABILITY FOR PREMIUMS**

3.19 Section 53(1) states that where a marine policy is effected on behalf of the assured by a broker, "the broker is directly responsible to the insurer for the premium". This is a controversial provision. We were told that it was rare for an insurer to demand payment from a broker where the policyholder is insolvent. Instead insurers usually respond to non-payment by cancelling the policy. However, the section is invoked occasionally. Insurers felt that they needed this protection particularly for short-term policies which could not be cancelled, or when dealing with unknown policyholders who might be located anywhere in the world.

3.20 We proposed that the issue should be subject to a contract between the insurer and the broker. The most controversial issue was the default rule. Should this state that brokers are liable to pay premiums, unless they contract out - or not liable unless they contract in? There were strong arguments in both directions. On balance, we proposed a default rule that brokers are liable to pay premiums (alongside policyholders). We thought that this most closely resembled market practice and would cause the minimum disruption in the market. The parties should be free to contract out of the default rule without difficulty.

### **The broker's liability should be subject to contract**

- 3.21 Section 53(1) appears to be subject to contract: it states that it applies “unless otherwise agreed”. We noted, however, that it was difficult for a broker to contract out of its liability to the insurer, as all three parties would need to agree to such a change. As the law currently stands, if the insurer and broker agree that the broker is not liable, this does not make the policyholder liable to pay the premium. The result of such a two-party contract would be that no-one is liable for the premium.
- 3.22 We thought that this was unsatisfactory. We asked consultees if they agreed that a broker's liability to pay premiums to the insurer should be a matter of agreement between broker and insurer.
- 3.23 Fifteen consultees responded to this question, and 10 (67%) agreed. Three consultees (20%) disagreed and two (13%) marked “other”.
- 3.24 The ABI agreed, saying:
- Parties should be unrestricted in negotiating contracts to tailor policies to the individual needs of the customer, especially in commercial contracts. Providing flexibility in the market to underwriters will encourage innovation and offer more value to the policyholder in the long term.
- 3.25 Marsh and Ms Awofeso both said that liability should only arise where the broker and insurer expressly agree to it.
- 3.26 Mark Wibberley disagreed, saying:
- It would be too much of a temptation to insurers for them to penalise the Assured if they are not happy with the agreement with the broker. The Assured should have a part in any agreement, it is after all their money.

### **A default rule that marine brokers are responsible for premiums?**

- 3.27 We asked whether, where a marine insurance contract is effected on behalf of a policyholder by a broker, the default rule should be that the broker is jointly and severally liable with the insured to pay the premium to the insurer. 17 consultees responded to this question. Six (35%) agreed that the default rule should make the broker jointly and severally liable for the premium. Seven (41%) disagreed and four (24%) marked “other”.

### **Agreement**

- 3.28 The ABI said:

In the marine insurance market ... section 53(1) protects the insurer from relatively unknown insureds, particularly where the broker is the sole channel of communication between them. This situation is common in marine insurance business. Additional protection for the insurer in this context is justifiable, given that the insured values can be exceptionally high, the assets insured are highly mobile, and business is often on a short-term basis, with little scope for long-standing commercial dealings.

3.29 LMA also commented that:

... the broker is in the better position to make a credit assessment and if necessary insist on payment of premium before inception. It would be fairer for the broker to be jointly and severally liable, rather than solely liable. The joint and several liability will encourage the broker to make a proper credit assessment in the circumstances mentioned, where it is difficult for the insurer to do so.

3.30 The IUA said this policy:

... also offers useful protection for carriers in open cargo cover and lineslips, which are broker-led, and in policies such as cargo stock throughput (whereby cover is provided in respect of a product's transit from its raw state until being delivered as a finished product), which can include numerous forms of transit and storage through different operators and therefore requires a heavy reliance on the broker in the placement process and knowledge of the insured's various operations.

Section 53 is also useful in ensuring that brokers remain vigilant towards their premium collection responsibilities, in particular how quickly premium is paid and in respect of payments through a chain of brokers, which is difficult for the insurer to manage.

3.31 ACE said:

For marine (re)insurance the default position should be that the broker is liable to pay the premium to the insurer whether or not it holds the premium as agent for the insured or the insurer and whether or not it has received the premiums from the policyholder.

3.32 Marking "other", Direct Line proposed an alternative arrangement:

We are of the view that where the Broker has used their best endeavours to collect the premium and can demonstrate as such, then they should not be liable for the premium. However, where the broker has failed in their duty as an agent of the insurer to collect the premium then they should take some liability for the premium.

**Disagreement**

3.33 Newman Martin and Buchan LLP (NMB) said:

There is at best confusion and at worst suspicion of the relationship between brokers and underwriters, particularly in the London market, where a broker may be acting for an insured or an underwriter at different stages in the life of the contract ...

Section 53 forces brokers to include within each contract a broker's cancellation clause, to protect them against their potential liability to underwriters in the event that the insured does not pay all or an instalment of premium due. This puts the broker in a position of conflict with its client ... Given that all marine policies will undoubtedly include a broker's cancellation clause, and underwriters will usually include provisions for their own rights to cancel, which clause should be operative in the event of non-payment of premium could be unclear to the insured and makes the contract uncertain. The potential liability also means each broker making provision in their accounts for amounts that may be claimed by underwriters ...

The practice was perhaps more understandable when it was the case that the underwriter did not know the policyholder, which is certainly no longer the case as underwriters undertake greater due diligence to comply with legislation such as the Bribery Act and global sanctions ...

Section 53 seems to be unique, and the burden it places on brokers is out of step with international custom and practice. The majority of our clients are based in North America, where an insurance broker is not distinguished from other brokers or agents, having no additional liability in respect of premium or claims payments.

3.34 London and International Insurance Brokers' Association (LIIBA) said:

It would be difficult for a Managing Agent or Underwriter who participates in both non-marine and marine business to explain or justify the differing stance taken for each discipline vis a vis responsibility for premium payments, especially if the business came from the same client. This might happen for example, where a fleet and dockside storage facility is placed with the same insurer ... We can find little evidence of occasions when brokers have failed and that policy holders have suffered as a result.

3.35 Miller Insurance Services Limited approved LIIBA's comments. Marsh pointed out that:

... during the periods of Lloyd's R&R<sup>7</sup> underwriters agreed to waive brokers' responsibility for premium and that for five years the default position was that brokers were not liable for premium. We see no reason why that arrangement should not be reflected in law.

<sup>7</sup> Reconstruction & Renewal.

- 3.36 The City of London Law Society said that the arguments were finely balanced, but on balance regarded the broker's liability as better left to contract, commenting:

We do not regard it as necessarily for the good of society that the uncreditworthy of the 21<sup>st</sup> century should receive insurance on the back of their brokers.

#### **Contracting out of joint and several liability**

- 3.37 We asked whether consultees agreed that the broker and insurer should be able to contract out of the proposed default position that broker and insured are jointly and severally liable. 16 consultees responded to this question. 11 (69%) agreed that the default rule should be subject to contract. One (6%) disagreed and four (25%) marked "other".

- 3.38 The IUA:

would maintain the 'unless otherwise agreed' flexibility of section 53, which suitably reflects the commercial nature of the relationship.

- 3.39 A few consultees agreed with the contracting out proposal but repeated that they did not agree with the proposed default position.

- 3.40 Several consultees said that contracting out may not be easy in practice. NMB said that they:

always try to include a clause stating that s53 does not apply to a contract, and this is invariably removed by the underwriters.

#### **Initial and adjusted premiums**

- 3.41 We asked consultees whether the default rule should apply equally to initial and adjusted premiums. 15 consultees responded to this question, of whom 11 (74%) agreed that the default rule should apply equally to initial and adjusted premiums. Two (13%) disagreed and two (13%) marked "other".

- 3.42 The IUA agreed, saying:

The general principle and proposed default rule relating to broker responsibility would work equally well in relation to the operation of original, additional or adjusted premium. It also makes sense to have the same legal rules covering all premium received throughout the duration of the contract.

- 3.43 Direct Line also agreed, but wished the parties to be able to contract out:

We agree with the above view; unless any of the parties have specifically contracted out, all payments should be subject to the same principle.

- 3.44 Ms Awofeso said that the proposal (and the proposal to apply the default rule irrespective of the law of the insurance contract):

would reduce the current limitations on the applicability of s53(1) and will be welcome if this becomes the default rule, but again this will only be scant consolation, as the broker's liability for premium should not arise by default in the first place.

- 3.45 Several consultees agreed that the same rule should apply to all premiums, but did not agree with the proposed default rule.
- 3.46 Marsh disagreed with the proposal, saying that this “would make the broker the credit insurer of the policyholder throughout the life of the policy.” BIBA also disagreed, saying this would be “unduly onerous for brokers in terms of initial and adjusted premiums.”

#### **Applicable law**

- 3.47 We asked whether the default rule should apply whenever the broker/insurer relationship is governed by English or Scots law, irrespective of the law under which the insurance contract is written. 14 consultees responded to this question. 10 (72%) agreed that the default rule should apply whenever the broker/insurer relationship is governed by English or Scots law. One (7%) disagreed and three (21%) were classed as “other”.
- 3.48 The LMA agreed, noting that “the London market model TOBA is governed by English law”, and Mr Wibberley agreed that “any rule should apply equally to all insurances”.
- 3.49 Marsh disagreed on the basis that they did not agree with the default rule. BIBA ticked “other” for the same reason.



## **PART 4**

# **THE BROKER'S LIEN AND OTHER PROVISIONS**

### **SECTION 53(2): INTRODUCTION**

- 4.1 Section 53(2) gives the broker a lien over the policy for any unpaid premium or charges. At one stage, the policyholder needed access to the policy document before making a claim. Although practice has changed, the lien may still be useful to a broker because case law has held that a broker who has a lien over a policy also has a right to set off any unpaid premium against any proceeds they hold.
- 4.2 We identified various problems with this section. First, it is unclear whether the section applies only to marine insurance or to all types of insurance. Secondly, it appears that the lien only arises if the broker holds a paper policy document. Thirdly, the lien appears to extend to all the policyholder's unpaid debts to the broker, even those related to other policies. This may give rise to difficulties where third parties have an interest in the policy proceeds.

### **A NEW SECTION?**

- 4.3 In the Consultation Paper we said that there was a need to clarify the law in this area, to ensure that the same rules apply to marine and non-marine insurance and to take account of the fact that we are proposing to repeal the requirements for a marine insurance policy document.
- 4.4 We asked whether consultees agreed that section 53(2) should be repealed and replaced by a new provision which applies to both marine and non-marine insurance. 12 consultees responded to this question. Nine (75%) agreed that section 53(2) should be repealed and replaced by a new broker's lien applying to both marine and non-marine insurance. Three (25%) marked "other".
- 4.5 ACE agreed and commented:

In respect of marine and non-marine (re)insurance contracts, brokers should be able to set off claims proceeds and unpaid premium but only in respect of the same insured under the same (re)insurance contract.
- 4.6 The LMA agreed on the same basis, and further commented that:

...the lien should be in respect of the claims proceeds and not just a right of the broker to hold the policy document (or other evidence of cover).
- 4.7 Marsh and BIBA agreed that the broker should have a lien, but only where it had contracted into liability for paying the premium.
- 4.8 The IUA agreed but commented:

We are not aware of any significant problems in practice on the operation of section 53(2) and it appears that it is invoked rarely by the broker, perhaps used mostly as a deterrent against the insured to encourage their good practices. We do not have any objections for a new provision to apply equally to non-marine and marine risks on the basis that, unlike in the discussion on section 53(1), there are no distinguishing features in relation to marine risks for this specific aspect of the contract.

- 4.9 Mr Wibberley, marking “other” thought that “if the law changes so that the broker is not responsible for the premium there is no need for this agreement.” Also marking “other”, the ABI said:

if section 53(1) does not apply to non-marine insurance, the normal rule of agency would apply. This would require the insurer, rather than the broker, to pursue the policyholder for the unpaid premium. It would not, therefore, make sense to permit the broker to operate a lien over the policy in these circumstances.

#### **RIGHT OF BROKER TO EXERCISE INSURER’S RIGHTS**

- 4.10 We asked consultees if they agreed that, where the broker is obliged to pay any premium to the insurer and has done so, the broker should be entitled to exercise the insurer’s rights to recover the debt from the policyholder.
- 4.11 Out of the 12 consultees who responded, 11 (92%) agreed with this proposal. One consultee marked “other”.
- 4.12 BILA agreed “subject to the proviso that the lien should only be exercised where the claims monies are due to the same party which owes the premium” and set out an example involving a composite insurance policy.
- 4.13 Direct Line agreed, saying:

The intention of any statute should not be to financially disadvantage any party but merely to ensure that remedies are available for financial short fall.

- 4.14 The ABI, marking “other”, thought that “s53(2) is unproblematic and not in need of reform”.

#### **BROKER’S RIGHT OF SET OFF**

- 4.15 We asked whether the broker should have a statutory right to set off any premium or commission against the proceeds arising from that policy. All 12 consultees who responded to this question (100%) agreed with the proposal.
- 4.16 LMA agreed:

... in relation to the same insured. Where the insurance contract covers separate insureds, ie a composite contract, then the right of set off should only be in relation to the same insured and not all parties benefiting from the cover ... ie the broker should not set off claims monies it holds due to one insured party against unpaid premium due from an unrelated insured party.

Subject to the above, we agree the lien should be in respect of claims proceeds and not just a right of the broker to hold the policy document against unpaid premium.

- 4.17 The ABI said they agreed for marine insurance.

#### **GENERAL RIGHT TO SET OFF DEBTS**

- 4.18 We asked if consultees agreed that, where no third party interests are involved, the broker should have a general right to set off any debt owed to it by the insured against any money held by the broker on behalf of the insured.

- 4.19 Of 12 consultees who responded to this question, 10 (83%) agreed with this proposal. Two (17%) disagreed.

#### **Agreement**

- 4.20 ACE and the LMA again agreed on the same provisos as above<sup>8</sup>. The ABI agreed for marine insurance.

- 4.21 The IUA agreed, saying the proposal:

... provides suitable, necessary protection for third parties whilst slightly extending the general right of set off (though still correctly limited to the specific insured's monies).

#### **Disagreement**

- 4.22 Direct Line disagreed, urging for:

...further consideration on this point if this is the preferred option to protect all parties involved and comply with FSA client money rules. We would like to argue that this could potentially become very complicated if Risk Transfer, for example, is involved as there could be potential for misuse.

- 4.23 Mark Wibberley was:

...concerned with the broker being able to off-set any monies. If the money was to pay for statutory insurances, such as employers' liability or third party motor insurance, the Assured could find themselves in conflict with the law.

<sup>8</sup> See paragraphs 4.5 and 4.6.

### **THIRD PARTY INTERESTS**

- 4.24 We invited views on how third party interests should be defined. Ten consultees responded, with eight providing substantive comments.
- 4.25 ACE suggested that the definition “could follow/be based on that set out in the Contracts (Rights of Third Parties) Act 1999.” BIBA said that “Third Party interests should be in accordance with definition in Policies.”
- 4.26 The Judges of the Court of Session found it “difficult to identify circumstances in which third party interests would militate against this general right of set off.” On the other hand, the City of London Law Society commented:

We foresee that an investigation of this subject will lead to the conclusion that only the widest possible definition will work, ie that any action by the broker must not affect the rights of any third party, since otherwise the dividing line will be too complicated to express in any way that will assure a fair balancing of the respective rights and interests.

- 4.27 Similarly, the Bar Council proposed a wide definition:

A third party should be defined to refer to any person other than a person who is both (a) liable to pay premium, commission or the relevant debt to the broker and (b) entitled to the sums paid under the marine insurance contract and held by the broker.

- 4.28 The IUA said:

It would seem sensible to define third parties in terms of those who have an interest in the policy - the ultimate beneficiary. This would likely include insureds, co-insureds, financiers, mortgagees and potential third party claimants such as employees and, in the case of public liability, members of the public, visitors, sub-contractors etc. There is some attraction to leaving the discretion of ‘third parties’ to the courts to decide on a case by case basis. However, a non-exhaustive list of potential third parties might also be a useful reference point for practitioners and courts alike.

### **SECTION 54 (EFFECT OF RECEIPT ON POLICY)**

- 4.29 Section 54 concerns the effect of the policy acknowledging receipt of the premium. In the Consultation Paper we noted that this provision was confusing and suggested that it was no longer relevant in modern insurance law. We proposed that it should be repealed and asked consultees whether they agreed. Twelve consultees responded and all agreed (100%) that it should be repealed.
- 4.30 Direct Line confirmed that the section “is out of step with current practice and should be repealed.”

# APPENDIX

## LIST OF RESPONDENTS

Association of British Insurers (ABI)  
ACE  
Adebowale Awofeso  
British Insurance Brokers' Association (BIBA)  
British Insurance Law Association (BILA)  
City of London Law Society Insurance Law Committee  
Direct Line Group (formerly RBS)  
International Underwriting Association (IUA)  
Judges of the Court of Session  
The Law Reform Committee of the Bar Council of England and Wales (the Bar Council)  
The Law Society of Scotland  
Geoffrey Lloyd  
Lloyd's Market Association (LMA)  
London & International Insurance Brokers Association (LIIBA)  
Rt Hon Lord Justice Longmore  
Mark Wibberley  
Marsh Limited  
Miller Insurance Services Limited  
Newman Martin and Buchan LLP (NMB)  
Norton Rose LLP