Law Commission
Reforming the law

Scottish Law Commission
promoting law reform

Insurance Contract Law
Issues Paper 4
Insurable Interest

This paper should not be quoted as representing the fixed policy of either Commission.

The paper has been drafted by the teams working on the insurance contract law review at the English and Scottish Law Commissions and is intended simply to promote discussion before the formal consultation process begins. It has not been subject to formal scrutiny by Commissioners.

14 January 2008

The Law Commission
and
The Scottish Law Commission

INSURABLE INTEREST

Issues Paper 4

14 January 2008

SUMMARY

1.1 This paper sets out the Law Commission's and the Scottish Law Commission's preliminary thinking on reforming the law of insurable interest. We put forward some initial, tentative proposals, and seek views by **11 April 2008**. Details about how to respond are at page 1 of the paper.

THE CURRENT LAW

What is insurable interest?

1.2 The law states that in order for an insurance policy to be valid, the policyholder must have a sufficient interest in the subject matter of the insurance. Broadly speaking, the doctrine requires that a policyholder must gain a benefit from the preservation of the subject matter of the insurance or suffer a disadvantage should it be lost.

1.3 The rules are complex. They date back to the eighteenth century, and are imposed partly by statute and partly by the common law. The legislation is not always consistent, so it is often difficult to work out the present position. There are differences between types of insurance, and between English and Scots law.

The distinction between indemnity and non-indemnity insurance

1.4 The law differs between indemnity and "non-indemnity" insurance (also described as "contingency" or "valued" policies). In indemnity policies, the insured may only recover the amount they have lost (the "indemnity principle"). In "non-indemnity" policies the insured receives a set amount, following a trigger event. Liability and property insurance are examples of indemnity insurance. Life insurance, personal accident and critical illness policies are examples of non-indemnity insurance.

1.5 The rules on insurable interest are much stricter for life insurance and other non-indemnity insurance than for indemnity insurance. Generally, for non-indemnity contracts there must be an insurable interest at the inception of the policy. For indemnity insurance the situation is more complicated.

1.6 In Part 3 we set out the law on non-indemnity insurance. In Part 5 we discuss the law on indemnity insurance. A brief summary is given below but for a full discussion of the law readers are encouraged to read the paper.

Life insurance

1.7 In this paper, we use "life insurance" as a shorthand for life insurance and other policies (such as accident and critical illness policies) that pay a set amount following death, injury or illness.

1.8 Policyholders may take out unlimited insurance on their own lives, or on the life of a spouse or civil partner. However, the law does not recognise other classes of natural affection. For example, parents have no insurable interest in the lives of their children and, in England, children have no interest in the lives of their parents. Nor do cohabitees have a general right to insure each other's lives.

1.9 Where life insurance is taken out on the life of someone who is not the policyholder or their spouse, the policyholder must show "a pecuniary interest recognised by law". Here the amount of the insurance must not exceed the value of the interest. This allows joint debtors to take out life insurance on each other's lives, for example to protect a mortgage, but the value of the payment must not exceed the amount of the debt. It also allows employers to insure the lives of employees, but case law suggests that the amount must be limited, possibly to no more than the employee's value during their notice period.

Other non-indemnity insurance

1.10 It is theoretically possible for non-indemnity (that is, valued) policies to be taken out on property. These would pay a set amount on damage to the property regardless of the policyholder's loss. An example would be a contract that paid a sum of £100,000 if a property were destroyed by fire, regardless of the amount of loss. These are unusual products and the law in this area is particularly unclear.

1.11 Under Scots law there is a common law requirement for the policyholder to show insurable interest. Under English law, there may be a requirement for the policyholder to show an insurable interest for marine policies or for those on land or buildings. The position for other policies is unclear. These insurance contracts would bear similarities to credit derivatives if there were no requirement for insurable interest.

Indemnity insurance

1.12 The law on insurable interest in indemnity contracts is also confusing. Before the Gambling Act 2005, the law required that anyone taking out property insurance had a legal or equitable interest in the property or a right to it under a contract. Without that interest, the insurance contract became unenforceable and policyholders could not have claims paid under it. In England, this requirement for insurable interest appears to have been removed by the Gambling Act 2005, though the change may have been more by accident than design. It would seem that under English law indemnity insurance contracts without insurable interest are now enforceable.

1.13 However, under Scots law, the requirement remains: the policyholder must show a pecuniary interest in the subject matter of the insurance at the time of inception.

PROBLEMS WITH THE LAW

1.14 The law on insurable interest is complex and we have often found it difficult to analyse. This makes it difficult for both insurers and policyholders to understand and apply the law.

1.15 For life insurance, the rules appear overly restrictive. In particular:

(1) Cohabitants and other family members may find it difficult to obtain insurance on each other's lives. Parents who, for example, are dependent on their adult children paying their nursing home fees may find it difficult to insure the lives of those adult children.

(2) Some of the problems are currently solved using assignment. For example, children may take out policies on their own life and assign them to their dependent parents. However, this adds an unnecessary level of complexity.

(3) Employers may be unduly limited in the amount for which they may insure the lives of their key-employees.

(4) Interest payable on an open-ended debt may not be insurable, because the liability did not exist at the time of inception.

(5) The Life Assurance Act 1774 requires that the names of all interested parties are listed in the policy. This can make policies illegal on a technicality.

(6) The insurable interest that is necessary for policies of group insurance is particularly difficult to analyse.

1.16 For non-life, non-indemnity insurance, the current uncertainty as to the state of the law may reduce insurers' confidence in offering new products.

1.17 There are also problems with indemnity insurance:

(1) The impact of the Gambling Act 2005 on indemnity insurance is unclear and was not considered when that Act was passed. Now that the Act is in force, it appears that under English law most contracts of indemnity insurance without insurable interest are valid but those made under Scots law are not.

(2) Archaic statutes may trip up the unwary. For example, it remains a criminal offence to take out a contract of marine insurance without interest.

1.18 More detail on these problems can be found in Part 4 (non-indemnity insurance) and Part 6 (indemnity insurance) of this Issues Paper.

DO WE NEED A DOCTRINE OF INSURABLE INTEREST AT ALL?

1.19 The doctrine is said to serve two purposes: to define insurance and to prevent undesirable social effects.

Defining insurance

1.20 Different regulatory and tax regimes apply to insurance than to other commercial risk transfer products or to gambling. It is therefore often necessary to distinguish insurance from (for example) credit derivatives or betting. We therefore consider whether insurable interest is necessary to distinguish insurance.

1.21 In Part 7, we discuss the different ways that insurance is defined. Although most definitions require that the insurable event has some adverse consequence for the insured, this is different from the much narrower statutory and common law concepts of insurable interest.

1.22 We conclude that indemnity insurance can be distinguished from betting and other risk transfer products without preserving the doctrine of insurable interest.

Undesirable gambling and moral hazard

1.23 As we discuss in Part 2, insurable interest has also been used as an instrument of social policy. Before the Gambling Act 2005, all forms of gambling were considered undesirable, but some forms were thought to be particularly pernicious. Thus the Life Assurance Act 1774 described taking out insurance on the lives of strangers as "a mischievous kind of gaming", which might encourage murder.

1.24 Now that gambling contracts are legally enforceable, we have considered whether it remains necessary to prevent insurance on the lives of strangers. The law can only go so far to prevent moral hazard: it is, for example, possible to retain an insurance policy on a divorced spouse, and the traded endowment policies market allow people to benefit from insurance on the lives of strangers. There is an argument that the issue should be left to the market, so that insurers are responsible for not issuing policies which encourage moral hazard. The Australians have taken this approach, and abolished the doctrine of insurable interest altogether.

1.25 However, other jurisdictions have not been as bold as the Australians. Initial consultation suggested that there were real concerns about allowing people to insure the lives of strangers without their consent. For example, a market in insurance on the lives of celebrities would be distasteful – and might, possibly, be dangerous.

1.26 We would be interested to hear views on this issue. Our preliminary view is that the doctrine of insurable interest in life insurance should be retained. However, the categories of interest should be expanded, giving more people rights to insure the lives of others.

1.27 In relation to indemnity insurance, the issues of moral hazard and gambling in the guise of insurance are less important. This is because the indemnity principle also applies to indemnity insurance contracts and it already contains safeguards against moral hazard and gambling in the guise of insurance.

1.28 The indemnity principle requires the policyholder to have suffered a loss before a claim can be made. Policyholders will only suffer a loss if they have a connection to the subject matter of the contract. A company, for example, cannot claim for the destruction of a van it has not lost and therefore the company is already prevented insofar as is possible from deliberately destroying the van or gambling without any interest in its destruction. As the indemnity principle already guards against moral hazard and gambling in indemnity insurance contracts we have tentatively concluded that insurable interest in indemnity insurance, with all its complexities and legal requirements, is unnecessary.

WHAT REFORMS ARE WE PROPOSING?

1.29 Our tentative proposals are discussed in Part 7 and listed in Part 8.

Life insurance

Natural affection

1.30 We think the category of insurable interest based on natural affection should be increased. In particular, people should be allowed to insure the life of a cohabitant. Dependent children and parents should be able to insure each other's lives. The law should not set any limits on the amount of the insurance.

1.31 We ask what should be done about other relationships. In particular, we would also be interested in whether to permit unlimited rights to insure the lives of fiancé(e)s, siblings, grandparents or grandchildren.

Legal pecuniary loss

1.32 We suggest that the category of insurable interest supported by a legal pecuniary loss should be amended to enable insurance to be more readily available. We tentatively propose that insurance should be allowed where the policyholder has a reasonable expectation of pecuniary or economic loss on the death of the life insured. This would extend further than the current limited test, which requires a pecuniary interest recognised by law.

1.33 It would mean that the insured could buy cover to meet reasonable future expenses, such as interest payments on a debt and on the loss of business which would be suffered following the departure of a key employee.

Consent

1.34 We tentatively propose that the consent of the life insured should provide an alternative ground for establishing insurable interest. This will give the system flexibility and the consent provides a safeguard against the creation of a moral hazard.

1.35 We propose that for the category of insurable interest established by consent, the amount insured should be limited to the amount to which the life insured consents.

Group insurance

1.36 Group insurance proved particularly difficult to analyse and insurers have told us that the current law can prevent them from offering insurance in circumstances where it could be beneficial. We therefore ask whether it would assist in the provision of policies both to employees and their wider families if the rules on insurable interest for group insurance were further relaxed. This issue is discussed further at paragraphs 3.61 and 7.81 to 7.86.

The Life Assurance Act 1774, section 2

1.37 This section requires the names of all interested parties to be listed in the life policy. This can serve as an unnecessary technicality. We tentatively propose that it should be repealed.

Remedies for life insurance without sufficient insurable interest

1.38 In most cases where insurance contracts are made without interest, this is an oversight. The policyholder has bought the wrong type of policy. One example is where insurance intended to cover a liability on a death has been written as a life policy rather than a liability policy.

1.39 Thus the consequences of making insurance policies without insurable interest should not be overly harsh. We propose that where a contract is made without the necessary insurable interest it should be void rather than illegal. In the absence of fraud, we would expect that policyholders should have their premiums returned.

Non-life, non-indemnity policies

1.40 It is theoretically possible for valued (that is non-indemnity) policies to be taken out on property. These insurance contracts would bear similarities to credit derivatives if there were no requirement for insurable interest. We ask whether insurable interest is still necessary for these insurance products or whether there is any need for relaxation of the rules on insurable interest in this market.

Indemnity insurance

England

1.41 In England, case law and the Gambling Act 2005 appear to have abolished the requirement of insurable interest in indemnity insurance. However, the indemnity principle requires the policyholder to have suffered a loss. We think this is sufficient to distinguish insurance from gambling and to prevent moral hazard.

1.42 Our tentative view is that it would be difficult to justify reintroducing a statutory requirement for insurable interest for indemnity contracts. This could lead to renewed confusion and would bring little benefit.

1.43 We also tentatively propose abolishing the criminal penalties imposed by the Marine Insurance (Gambling Policies) Act 1909 for making a marine policy without insurable interest.

1.44 We also ask whether there should be a requirement on insurers to inquire whether there is sufficient possibility of indemnity loss before the contract is made. Most, we understand, would do this already for underwriting purposes.

Scotland

1.45 In Scots law, insurable interest is a common law requirement and it is unlikely that it has been abrogated by the Gambling Act 2005. However, as in England and Wales, the indemnity principle applies too.

1.46 Our tentative view is that the requirement of insurable interest in Scots law should be abolished in so far as it applies to indemnity insurance. We would particularly welcome views on this issue from Scottish respondents.

THE LAW COMMISSION

THE SCOTTISH LAW COMMISSION

INSURANCE CONTRACT LAW: ISSUES PAPER 4 INSURABLE INTEREST

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PART 1
INTRODUCTION

BACKGROUND

1.1 The Law Commission and the Scottish Law Commission are conducting a joint review of insurance contract law. The aim is to ensure that the law balances the interests of insured and insurer, reflects the needs of modern insurance practice and allows both insured and insurer to know their rights and obligations.

1.2 The Commissions published the first of two consultation papers (covering misrepresentation, non-disclosure and breach of warranty by the insured) in July 2007. The second consultation paper will consider insurable interest and post contractual good faith (including fraud and damages for late payment of claims). As with our first consultation paper, we are publishing issues papers setting out our preliminary thinking on each of these topics before the main consultation paper is published.

1.3 This issues paper sets out our preliminary thinking on insurable interest.

1.4 The paper has not been approved by Commissioners. Its purpose is to promote discussion before the formal consultation process on insurable interest begins. The contents should not be quoted as representing the views of either Commission.

1.5 Our tentative proposals for reform and questions are listed within the text and are set out in full in Part 8. We seek views on our tentative proposals and questions by **11 April 2008** and would be grateful if responses could be sent:

> by email to commercialandcommon@lawcommision.gsi.gov.uk; or
>
> by post to: Elizabeth Waller, Law Commission, Conquest House, 37-38 John Street, Theobalds Road, London WC1N 2BQ (tel: 020 7453 1231); or
>
> by fax to: 020 7453 1297, marked for the attention of Elizabeth Waller.

1.6 It would be helpful if, where possible, comments sent by post could also be sent on disk, or by email to the above address, in any commonly used format.

1.7 As the Law Commission will be the recipient of responses, the Freedom of Information Act 2000 will apply and all responses will be treated as public documents. Those who wish to submit a confidential response should contact the Law Commission before sending the response. Automatic confidentiality disclaimers generated by an IT system will be disregarded.

AN INTRODUCTION TO INSURABLE INTEREST

1.8 At its simplest, the doctrine of insurable interest requires that someone taking out insurance gains a benefit from the preservation of the subject matter of the insurance or suffers a disadvantage should it be lost.

1.9 Statutes requiring policyholders to show a requirement of insurable interest in the subject matter they were insuring, began to appear from the mid eighteenth century[1] and it still remains a requirement for many forms of insurance today. Statutory requirements for insurable interest developed as a result of concerns about moral hazard and gambling.[2]

1.10 The requirement for insurable interest for some contracts of insurance is created by statute, but it is usually case law that determines what constitutes a valid insurable interest. Definitions of insurable interest change according to the subject matter of the insurance. In some circumstances policyholders have to demonstrate strict legal and pecuniary interest[3] in the life or matter insured. In others this is not necessary.

NEED FOR REFORM

1.11 The law on insurable interest is complex. It is governed by different statutes depending on the subject matter of the insurance. There is no single rule on whether an interest is required and if so, whether it is required when the policy is taken out or when the loss is suffered. Equally the rules on what constitutes a valid insurable interest vary according to the subject matter of the insurance. There is a real need for clarity in the law.

1.12 There have been calls for reform. In 2002, the subcommittee of the British Insurance Law Association recommended a change to the test determining insurable interest.[4] The majority of respondents to the Law Commissions' scoping paper also agreed that the Law Commission and the Scottish Law Commission should review insurable interest.[5]

1.13 We therefore ask whether a requirement for insurable interest is still necessary in its present form. There are indications that it prevents legitimate insurance being taken out in circumstances where it would be beneficial. However, abolishing the requirement altogether could make it difficult to keep insurance separate from other forms of risk transfer or gambling. We also need to consider the original purpose of the law – the prevention of moral hazard and gambling in the guise of insurance. We ask whether these dangers still exist and whether insurable interest is still necessary to prevent them arising.

1 See Part 2 for a history of insurable interest.

2 Moral hazard is the risk that allowing a person to insure creates an incentive to destroy the subject matter of the insurance.

3 What, in England, are called 'pecuniary interests' are, in Scotland, often referred to as 'patrimonial interests'.

4 British Insurance Law Association, *Insurance Contract Law Reform, Recommendations to the Law Commission, A report of the sub-committee of the British Insurance Law Association* (1 September 2002).

5 Law Commission and Scottish Law Commission, *Insurance contract law, analysis of responses and decisions on scope*, para 3.2.

INDEMNITY INSURANCE AND NON-INDEMNITY INSURANCE

1.14 Insurance contracts can be divided, broadly speaking, into two types – indemnity insurance and non-indemnity insurance.[6] Before discussing the current law and suggestions for reform it is important to explain the distinction between indemnity and non-indemnity insurance. This distinction is crucial to understanding the law on insurable interest.

Type 1 - Indemnity insurance

1.15 Indemnity insurance indemnifies the policyholder for losses suffered. Examples are buildings insurance, liability insurance, business interruption and contents insurance. Following the Gambling Act 2005,[7] it may be that most indemnity contracts no longer require insurable interest in order to be enforceable.

1.16 Indemnity contracts are governed by the indemnity principle. The indemnity principle simply means that insureds can only recover what they have lost. To make a successful claim, policyholders have to show that they incurred loss. They are compensated for the amount of that loss and no more. It follows that in order to suffer a loss, the insured must have had some kind of an interest in the subject matter. This interest is not the same as the strict insurable interest required by statute.

Type 2 - Non-indemnity insurance

1.17 Non-indemnity insurance pays a set amount on the occurrence of a specified event. Most life insurance policies are non-indemnity contracts as they pay a fixed sum on the death of the person insured. Likewise, policies that pay a specified sum on the occurrence of a defined event, such as personal accident policies or valued policies, are also non-indemnity policies.

1.18 Non-indemnity policies are generally subject to a statutory requirement for insurable interest. However, the indemnity principle does not apply to these policies, as payment under the policy is not connected to the loss suffered.

STRUCTURE OF THIS PAPER

1.19 It is conventional to examine insurable interest as it applies to non-indemnity insurance on the one hand and as it applies to indemnity insurance on the other. This paper analyses the law according to the conventional division between the two types of insurance and looks at the need for reform in each.

(1) Part 2 summarises the history of the legislation governing insurable interest.

(2) Part 3 describes the current law for non-indemnity insurance.

(3) Part 4 considers the problems with the current law for non-indemnity insurance.

(4) Part 5 describes the current law for indemnity insurance.

[6] It is possible to have composite policies of insurance which combine elements of the two types. For example a travel policy may both compensate for loss of luggage as well as paying a lump sum on permanent injury to an arm. These are dealt with at para 4.16.

[7] Applicable in England, Wales and Scotland.

(5) Part 6 considers the problems with the current law for indemnity insurance.

(6) Part 7 sets out our tentative proposals to reform the requirement for insurable interest for both indemnity and non-indemnity insurance.

(7) Part 8 contains a summary of our proposals.

THANKS

1.20 The teams working on the insurance project at the Law Commissions would like to thank the following people for their help:

Professor John Birds; Mr Richard Buttle; Professor Malcolm Clarke; Colin Edelman QC; Mr Paulino Fajardo; Mr Enrique Gich; Dr M Macko; Mr Peter Mann; Professor Robert Merkin; Ms Irene Muela; Mr Howard Rayner; Dr Caroline Sijbrandij.

PART 2
A LEGISLATIVE HISTORY OF INSURABLE INTEREST

2.1 The doctrine of insurable interest states, broadly speaking, that in order to have a valid policy of insurance, the policyholder must:

(1) gain a benefit from the continued existence of the subject matter of the insurance; or

(2) suffer a loss on its destruction.

2.2 In Scots law, the requirement of an insurable interest in a contract of insurance is imposed by the common law.[1] The common law requirement of insurable interest is simply that it is an essential element of a contract of insurance that "there shall be a subject in which the insured has an interest".[2] This contrasts with English law where there is no common law rule prohibiting contracts of insurance made without interest.[3] Instead, statute has governed the position.

2.3 Insurable interest was first developed as a statutory requirement for English insurance contracts in the mid-eighteenth century. At the time, there were grave concerns that insurance created an incentive to destroy the insured matter or murder the insured life. This is known as moral hazard. A requirement for insurable interest was developed as the solution. It would ensure that insurance could only be taken out by those who had an independent interest in the continuing existence of the subject matter.

2.4 There were also separate concerns that it was difficult to distinguish between the valid business of insurance and the morally suspect practice of wagering.[4] Contracts of insurance and wagers both specify that payment under them depend on an uncertain event or date. In a wager, however, neither of the parties has an interest in the contract or the event – other than the sum of money or the stake they win or lose.[5] In insurance contracts the policyholder suffers a loss if the subject matter of the insurance is destroyed or dies. Therefore, if insurance contracts require insurable interest, they could be distinguished from wagers. Gambling in the guise of insurance would be prevented.

[1] The Laws of Scotland (Stair Memorial Encyclopaedia) Vol 12, para 848, citing Bell's Principles s 457.

[2] Bell's Principles s 457.

[3] *Williams v Baltic Insurance Association of London* [1924] 2 KB 282 at 288.

[4] A wager is a gambling contract.

[5] A gambling contract was defined in *Carlill v Carbolic Smoke Ball Company* [1893] 1 QB 256 as a contract in which neither of the contracting parties had an interest. It was held that a wager was a contract "by which two persons professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent on the determination of that event, one shall win from the other... a sum of money or other stake; neither of the contracting parties having any other interest in that contract other than the sum or stake he will so win or lose".

2.5 There were concerns about gambling in the guise of insurance when insurance was taken out on lives. By the mid-eighteenth century it had become common for policies to be taken out on the lives of public figures – for example, George II, Admiral Byng[6] and Sir Robert Walpole.[7] Policies were also issued on distant family members and acquaintances. Complaints were made when newspapers started to print the odds of survival of public figures. Many believed that reading the odds hastened the deaths of those who were named.[8]

2.6 The first piece of legislation to create a requirement of insurable interest for insurance contracts was the Marine Insurance Act 1745,[9] which rendered void marine policies made without interest.[10] It aimed to prevent moral hazard and its preamble stated that

> It hath been found by experience, that the making of insurances, interest or no interest, or without further proof of interest than the policy, hath been productive of many pernicious practices, whereby great numbers of ships, with their cargoes, have been fraudulently lost or destroyed.[11]

2.7 Just under thirty years later, the distaste at insurance policies being used to gamble on lives resulted in the Life Assurance Act 1774.[12] It prevents insurance on lives being taken out without a valid interest and declared null and void any contracts of insurance taken without interest. It applies to lives and "other events" but excludes goods, merchandises and ships. Its preamble states:

> Whereas it hath been found by experience that the making of insurances on lives or other events wherein the assured shall have no interest hath introduced a mischievous kind of gaming...

2.8 Next came the Marine Insurance Act 1788.[13] (This has since been repealed for the purposes of marine insurance only.) It required the names of those interested in the insurance to be inserted into the policy. This made it easier to check that those interested people had valid insurable interests in the subject matter.

6 Admiral Byng had an unremarkable career until he was sent to relieve the British-held island of Minorca in 1756, when it was under siege by the French. The British suffered a humiliating defeat, due mainly to his inexperience. He was court martialled and sentenced to death although the court recommended clemency. This was ignored by George II and Admiral Byng was shot by a firing squad in 1757. Those who had insured his life made claims for the sum insured.

7 Geoffrey Clark, *Betting on Lives* (1st ed 1999).

8 Welford, *Insurance Guide and Handbook* (4th ed 1901) at pp 27 and 28 quoted in *Colinvaux and Merkin's Insurance Contract Law* A-0385.

9 Scope extended to all of Great Britain. See Appendix C.

10 It also rendered void policies which provided that the policy itself was to be conclusive of proof of interest, known as PPI policies, and policies that were made "interest or no interest". Both of these phrases developed in insurance contracts following the earlier attempts of the courts to hold policies without interest void.

11 Preamble to Marine Insurance Act 1745.

12 Applicable to England, Wales and Scotland. See Part 3 of this paper and Appendix B.

13 Scope extended to all of Great Britain.

2.9 Therefore, by the end of the eighteenth century, the Marine Insurance Act 1745 and the Life Assurance Act 1774 meant that those taking out either marine or life insurance needed to show an insurable interest in the subject matter of the insurance.

2.10 Insurable interest itself was not defined by the Acts. Instead the classic definition comes from the 1806 case of *Lucena v Craufurd*.[14] It states, at least in the context of indemnity insurance, that insurable interest is:

> A right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party.[15]

2.11 The nineteenth century saw a further hardening of attitudes towards gambling. It was said to promote idleness amongst the lower classes and dishonour and suicide amongst the aristocracy. The courts had become reluctant to enforce wagering contracts as they wasted the courts' time. In 1845 these sentiments led to the passing of a Gaming Act, which held that wagers were unenforceable. Section 18 provided:

> All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing alleged to be won upon any wager.

2.12 As wagers are contracts in which neither party has an interest apart from the contract itself, this section had the effect of making all contracts of insurance unenforceable where no interest could be demonstrated. Section 18 of the Gaming Act therefore created a requirement that the policyholder must be able to demonstrate an insurable interest in the subject matter of the insurance – otherwise the contract is a wager and unenforceable.

2.13 The twentieth century saw the Marine Insurance Act 1906. This repealed the Marine Insurance Act 1745 and 'codified' the law on marine insurance at that stage. Insurable interest is, however, thought to be one of the few areas where the Marine Insurance Act 1906 is limited in its effect to marine insurance. It is the Gaming Act 1845 which is regarded as being the Act that creates the obligation for insurable interest in other non-marine indemnity insurance, not the Marine Insurance Act 1906. Section 4 of the Marine Insurance Act 1906 states that:

> (1) Every contract of marine insurance by way of gaming or wagering is void.
>
> (2) A contract of marine insurance is deemed to be a gaming or wagering contract
>
> (a) where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest... .

2.14 The Marine Insurance Act 1906 defined insurable interest in terms of a marine adventure. A person has an interest in a marine adventure where:

[14] *Lucena v Craufurd* (1806) 2 Bos & PNR 269.

[15] As above, at 321.

> he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof.[16]

2.15 Three years later Parliament considered it necessary to strengthen the sanctions against those who took out marine policies without insurable interest. The Marine Insurance (Gambling Policies) Act 1909 made it a criminal offence, punishable by a fine or prison for up to six months.[17]

2.16 Therefore, by the beginning of the twentieth century the situation was that for the various types of indemnity insurance, the Gaming Act 1845 indirectly created a requirement for the policyholder to show an insurable interest in the subject matter. In relation to marine risks, the requirement was directly created by the Marine Insurance Act 1906. For non-indemnity insurance the Life Assurance Act 1774 governed the position.[18]

2.17 After 1909, the legislation remained unchanged for nearly one hundred years, until the Gambling Act 2005. The object of this Act was to strengthen and improve the existing laws on gambling to take account of the internet and new technology. In addition, the Government wanted to provide rigorous and effective protection for the public by creating a regulatory regime for gambling.[19] Further protection was given by declaring gambling contracts enforceable, this allowed consumers to take bookmakers to court if they refused to pay on an otherwise valid wager. In order to do this the Gambling Act 2005 repealed section 18 of the Gaming Act 1845[20] and in its place stated that "a fact that a contract relates to gambling does not prevent its enforcement".[21] This provision came into force on 1 September 2007.[22]

[16] Marine Insurance Act 1906, s 5. Although the 1906 Act applies to Scotland, England and Wales, the concept of "equitable relation" is unknown in Scots law.

[17] There has never been a prosecution under this Act.

[18] See para 1.12 for an explanation of the difference between indemnity and non-indemnity insurance.

[19] Government Response to the First Report of the Joint Committee on the Draft Gambling Bill, session 2003-2004, (June 2004) p 2.

[20] Gambling Act 2005, s 334(1)(c).

[21] Gambling Act 2005, s 335.

[22] SI 2007 No 1157.

2.18 What was not discussed at the time this Act was passed was the effect this would have on insurable interest in indemnity insurance contracts. Under the Gaming Act 1845 and Marine Insurance Act 1906, insurance contracts without interest were deemed to be wagers and therefore unenforceable.[23] Under the Gambling Act 2005, contracts by way of gaming or wagering are now enforceable. As a result, the need for any formal distinction between indemnity insurance and wagering agreements for the purposes of enforceability has disappeared. As we shall see later, it appears that for the purposes of enforceability at least, insurable interest is no longer necessary in non-marine indemnity insurance in England and Wales, although it remains a common law requirement in Scotland. There is some debate over whether the Gambling Act 2005 has abolished the need for insurable interest in marine insurance.[24] This aside, it remains a criminal offence to take out marine insurance without an interest. The position will be described in more detail in Part 5 of this paper.

2.19 For most non-indemnity insurance (and certainly for life and protection insurance) the Gambling Act 2005 has had no effect. The Life Assurance Act 1774 directly requires insurable interest.

2.20 The result of this complicated history is that we are left today with a confusing series of Acts. The law needs to be clarified. We ask whether insurable interest is necessary to identify insurance for regulatory, tax or other purposes.[25] We also ask whether the prevention of moral hazard and gambling in the guise of insurance are best achieved by a requirement of insurable interest for either indemnity or non-indemnity insurance.

[23] But not necessarily void.

[24] R Merkin, "Insurable interest, the repeal of the prohibition on gambling" [December 2005] *Insurance Law Monthly*, p 4-5.

[25] This is discussed in Part 7 of this paper.

PART 3
LIFE AND OTHER NON-INDEMNITY INSURANCE: THE CURRENT LAW

INTRODUCTION

3.1 Non-indemnity insurance pays a set sum on the occurrence of a defined event. It includes life insurance, personal accident insurance and critical illness insurance. It would also include valued policies on land, goods and marine insurance.

3.2 Most non-indemnity policies are life, critical illness and personal accident policies. These types of insurance are governed by the Life Assurance Act 1774.

3.3 In this Issues Paper, we use the term ‘life insurance’ as shorthand for life, personal accident and critical illness insurance. In this Part we look first at how the Life Assurance Act 1774 applies to these forms of insurance.

3.4 Other types of non-indemnity insurance will be discussed later in the chapter.

THE LIFE ASSURANCE ACT 1774

3.5 The Life Assurance Act 1774 states that it applies to insurance on the life of any person or “on any other event or events whatsoever, except ships, goods and merchandises”.

3.6 The 1774 Life Assurance Act comprises four sections.

(1) Section 1 bans the making of insurances where there is no interest, and renders any policy issued in such circumstances null and void.

(2) Section 2 requires the names of those interested to be noted in the policy document.

(3) Section 3 limits the amount of any recovery to the value of the interest.

(4) Section 4 provides that the 1774 Act does not apply to "ships, goods, or merchandises".

THE REQUIRED INTEREST

3.7 Section 1 of the 1774 Act does not indicate what type of interest is required. Subsequent case law and statutes have established four categories

(1) interest arising out of natural affection;

(2) interest arising out of a potential financial loss which is recognised by law and can be shown at the time of the contract;

(3) interest arising out of statutory provisions; and

(4) interest recognised by the courts that does not fit into any of the above categories.

(1) INTEREST ARISING OUT OF NATURAL AFFECTION

Own life and life of spouse

3.8 Natural affection enables a person to insure their own life[1], or the life of their wife[2] or husband.[3] The class is therefore extremely limited. Anyone who falls within these classes of natural affection will not need to prove that they have a pecuniary interest recognised by law in the life insured.

3.9 In cases of interest established by natural affection, there is no legal limit on the sum insured. In practice, of course, sums insured are limited by an insurer's willingness to accept the risk and the policyholder's ability to pay the premium.

Other family relationships

3.10 Other family relationships do not – in the absence of potential financial loss, or statutory provision – give rise to a right to insure. In English law there is no general right for children and parents to insure each other's lives.[4] There is also no insurable interest based on natural affection between siblings, persons related by marriage or between cousins, nephews, nieces, uncles or aunts.

3.11 In Scots law, the obligation of aliment gives rise to an insurable interest in certain relationships where none exists in England or Wales.[5]

The position in English law

3.12 It is clear that a child who is a minor could suffer a financial detriment on the death of a parent. However, there is no general statutory right under English law for children to receive maintenance from their parents.[6] An insurance policy taken out by a child on a parent's life would require some sort of specific obligation on the parent to pay money, for example a maintenance order. Such an obligation is often difficult to establish.

3.13 Likewise, a parent does not have an insurable interest in the life of a child. In England and Wales, children have no legal duty to maintain their parents and parents are said to have no insurable interest in the life of their offspring on the grounds of natural affection.

1 *Wainewright v Bland* (1835) 1 Moo & R 481.

2 *Griffiths v Fleming* [1909] 1 KB 805.

3 *Reed v Royal Exchange Assurance Co* (1795) Peake Ad Cas. 70. See para 3.36 below for the law on civil partners.

4 *Halford v Kymer* (1830) 10 B & C 724.

5 See paras 3.15 - 3.18 below.

6 In the case of *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558 an adult child insured the life of his mother who cooked and kept house for him. The insurance was said to be for the purpose of funeral expenses. The court found that the policy was void for lack of interest. There was no obligation for a son to incur financial expense in burying his mother (the council would cover such expenses, if necessary) and there was no legal obligation for the mother to keep house for her son.

3.14 The leading English case on this subject is the case of *Halford v Kymer.*[7] A father took out a policy of life insurance on the life of his son. When the insurance company refused to pay on the grounds that the contract was void for lack of insurable interest, the father argued that he had an insurable interest because if his son died his chances of receiving care and maintenance would be reduced. The judge stated that, as the parish was bound to maintain him, it was a matter of indifference to the father whether he were maintained by the parish or by his son. He ruled that the father did not have an insurable interest in the life of his son.[8]

The position in Scots law

3.15 In Scots law aliment is a maintenance obligation to "provide such support as is reasonable in the circumstances".[9] The Family Law (Scotland) Act 1985 provides that the obligation of aliment is owed only by:

(1) spouses and civil partners to each other;

(2) a father or mother to his or her child;

(3) a person to a child who has been accepted by him or her as a child of his or her family.[10]

3.16 For the purposes of establishing insurable interest, a child will have an insurable interest in the life of their parents to the value of the obligation of aliment. The duty of aliment ceases when the child reaches 18 years of age, or 25 years of age if in education or training for a trade, profession or vocation.[11] The insurable interest will exist only for as long as the obligation of aliment is owed. This applies equally to a child accepted as a child of the family.

3.17 A child owes no obligation of aliment to their parent; therefore, in Scotland as in England and Wales, a parent has no insurable interest in the life of their child.

3.18 As spouses and civil partners[12] are presumed by law to have an unlimited insurable interest in the lives of each other, the obligation of aliment has no additional effect for establishing an insurable interest.

7 (1830) 10 B&C 724.

8 There is, however, one case dating from 1892 which found that an adult had an insurable interest in the life of her child step-sister. This was on the grounds that the woman had promised her mother she would take care of her step-sister and had incurred expenditure doing so. Later cases have criticised the finding (*Anctil v Manufacturer's Life Insurance Co* [1899] AC 604. See also the comments in *Griffiths v Fleming* [1909] 1 KB 805 at 819 and in *Harse v Pearl Life Assurance Co* [1903] 2 KB 92 at 96) and it is therefore doubtful, especially given the principles outlined above, that this represents good law.

9 Family Law (Scotland) Act 1985, s 1(2).

10 Family Law (Scotland) Act 1985, s 1(1) as amended by Civil Partnership Act 2004 Sch. 28(2) para 11.

11 Family Law (Scotland) Act 1985, s 1(5) (a-b).

12 See para 3.35 below.

Statutory provisions relating to children

3.19 There is a small exception, in England and Wales and in Scotland, to the general rule that parents do not have insurable interests in their children's lives. Section 99 of the Friendly Societies Act 1992[13] states that a parent can take out insurance with a friendly society on a child's life without insurable interest. However, if that child is under the age of 10 the amount recoverable is limited to £800.[14]

3.20 Other acts make it clear that people who stand in the place of parents have no right to insure the lives of the children they look after. The Children Act 1989[15] and the Foster Children (Scotland) Act 1984[16] provide that a person who maintains a foster child for reward shall be deemed for the purposes of the Life Assurance Act 1774 to have no interest in the life of that child. Likewise, the Adoption Act 1976[17] provides that a person who maintains a protected child shall be deemed for the purposes of the Life Assurance Act 1774 to have no interest in the life of that child.

3.21 As can be seen, special restrictions exist in respect of children. No doubt this is the result of fears regarding increased moral hazard where the potential life assured is more vulnerable than an adult.

Cohabitants and fiancé(e)s

3.22 In the absence of any pecuniary and legal interest, there is no right to insure the life of a cohabitant. Nevertheless, some insurers will offer life insurance in these circumstances, and in 1990 the Insurance Ombudsman indicated that he would enforce such contracts.[18] In 1992, the Scottish Law Commission recommended that a cohabitant should be given a statutory interest in the life of his or her partner, with no qualifying period of cohabitation.[19] These recommendations have not been implemented and it remains the case in Scots law that cohabitants have no insurable interest in the lives of each other.[20]

[13] Applicable in England, Wales and Scotland.

[14] Friendly Societies Act 1992, s 99.

[15] See Appendix C.

[16] See Appendix C.

[17] See Appendix C. This Act does not apply to Scotland, where the Adoption and Children (Scotland) Act 2007 applies and does not contain any provisions relating to an insurable interest in the life of an adopted child.

[18] Insurance Ombudsman Bureau Annual Report 1990.

[19] Scottish Law Commission (No 135), Report on Family Law, para 16.41, recommendation no. 85.

[20] The Family Law (Scotland) Act 2006 implemented some of the Scottish Law Commission's other proposals from the same report regarding a definition of cohabitation (s 25), rights in certain household property (s 26), rights in certain money and property (s 27), financial provision where cohabitation ends otherwise than by death (s 28) and application to court by survivor for provision on intestacy (s 29).

3.23 It would follow from the cases that fiancé(e)s have no interest in each other's lives. However, the Insurance Ombudsman stated in 1990 that he would allow an engaged couple to have an insurable interest in each other's lives on the grounds of natural affection.[21]

(2) INTEREST ARISING OUT OF A POTENTIAL FINANCIAL LOSS WHICH IS RECOGNISED BY LAW AND CAN BE SHOWN AT THE TIME OF THE CONTRACT

3.24 Where there is no interest in the life insured based on the grounds of natural affection, the insured must show an interest in the duration of the life insured which is pecuniary and recognised by law at the time of the contract. However, unlike the category of natural affection, discussed above, case law and section 3 of the Life Assurance Act 1774 limit the sum payable to the economic value of that interest.

3.25 Typical examples include:

(1) A creditor in the life of a debtor, to the amount of the loan.

(2) A joint debtor in the life of a joint debtor, to the amount of the debt. For example cohabiting friends buying a house together who are declared to be jointly and severally liable for the mortgage will be able to insure each others' lives to the amount of the whole of the mortgage debt.

(3) An employer in the life of an employee, to the value of the period of notice. If the employee is a 'key person' it may also be possible to insure the costs of recruiting and training a replacement, and any loss of profits in the meantime.

3.26 However, the concept of an interest recognised by law has proved notoriously difficult to define. In his judgment in the case of *Feasey v Sun Life Assurance Co of Canada,*[22] Lord Justice Waller concluded that "it is difficult to define insurable interest in words which will apply in all situations. The context and the terms of a policy... will be all important". In that case Lord Justice Waller and Lord Justice Ward (dissenting) quoted the definition given in MacGillivray on Insurance Law.

> All previous editions of this work have provided the following "good working definition" applicable to all risks under the Life Assurance Act 1774: Where the assured is so situated that the happening of the event on which the insurance money is to become payable would, as a proximate cause, involve the assured in the loss or diminution of any right recognised by law or in any legal liability there is an insurable interest in the happening of that event to the extent of the possible loss or liability.[23]

3.27 The key elements are therefore that the interest must be pecuniary and recognised by law.

[21] Annual Report 1989, para 2.31. In Scotland it is expressly enacted that engagement to marry and engagement to enter into a civil partnership have no legal effect. See Law Reform (Husband and Wife) (Scotland) 1984, s 1 and Civil Partnership Act 2004, s 128.

[22] [2003] EWCA Civ 885, [65].

[23] *MacGillivray on Insurance Law* (10th ed 2003), 1-49.

3.28 A pecuniary interest is merely one that is capable of valuation. The amount that can be insured is limited to the pecuniary interest of the insured, a point emphasised by the case of *Hebden v West*.[24] In this case, a bank clerk insured his employer's life with two separate insurers. The first policy was for £5,000 and the second was for £2,500. The clerk's annual salary was £600 a year and he had a contract of employment for 7 years. He also had a loan from his employer of £4,700 which the employer promised him would not be called in during the employer's lifetime. After the employer's death, the bank clerk received £5,000 from the first insurer. However, the second insurer refused to pay the claim on the basis that the clerk's pecuniary interest in the life had already been met. The second insurer argued that the clerk had an insurable interest in the life of his employer to the amount of £4,200, because he stood to lose this amount (£600 x 7 years) when the employer died. The agreement not to enforce the loan during his lifetime was, the second insurer argued, not a binding contract and could not create an insurable interest. As the amount of £4,200 had already been more than covered by the first insurer, the second insurer refused to pay the clerk's claim. The Court agreed. This is arguably an unfair result, especially as the second insurer had presumably collected premiums from the clerk and it was clear that he was not gaming or wagering.

3.29 Cases such as *Hebden* and section 3 of the Life Assurance Act 1774 seem to align policies of life insurance with indemnity contracts, in that the amount that the insured can recover appears to be linked to the value of his loss. However, this is not correct. The sum paid under a contract of life insurance is dependent on the value of the interest when the policy was taken out, not on the actual amount that the insured loses as a result of the death or accident.

3.30 Further difficulty is caused by the requirement that the interest must be recognised by law. For example, a binding agreement not to enforce a debt during the lifetime of the creditor gives the debtor an interest in the life of the creditor. However, if the agreement is not legally binding, it does not give rise to an insurable interest – even if there is a reasonable expectation that it will be respected.[25]

3.31 In the USA it is sufficient if a beneficiary has "a reasonable expectation of pecuniary advantage from the continued life of the insured".[26] In the UK this is not enough and MacGillivray states

[24] (1863) 3 B&S 579.

[25] The case of *Hebden v West* (1863) 3 B&S 579 illustrates this. The court held that the employer's promise was not legally binding.

[26] M A Clarke, *The Law of Insurance Contracts* (5th ed 2006), 3-6B.

> a mere expectancy or hope of future pecuniary benefit from the prolongation of the life insured or of the fulfilment by him of moral obligations owed to the assured, are insufficient to sustain an insurable interest.[27]

3.32 It is, however, possible for an interest recognised by law to be contingent. A person with a right, the enjoyment of which is dependent on the duration of a human life, has an insurable interest in that life.[28]

3.33 Therefore, in order to establish a valid insurable interest in a life, the insured must demonstrate a right recognised by law to a pecuniary amount. However, as will be shown later, in complex cases it is not always easy to tell when a valid insurable interest exists.

(3) INTEREST ARISING OUT OF STATUTORY PROVISIONS

3.34 It is possible for an insurable interest in a life to be created, or the requirement waived, by statutory provisions.

Civil partners

3.35 The law for registered civil partners has been, in effect, brought into line with the presumption of natural affection that applies to married couples. Section 253 of the Civil Partnership Act 2004[29] gives a person an insurable interest in his or her civil partner and that interest is deemed to be unlimited.

Section 11 of the Married Women's Property Act 1882

3.36 This section of the Married Women's Property Act 1882[30] does not simply apply to married women. It states that a policy of insurance taken out by a husband for the benefit of his wife or children, or by a wife for the benefit of her husband or children creates a statutory trust of the policy in the hands of the executors. The proceeds therefore do not fall within the estate of the deceased person who took the policy out and the benefit can be paid directly to the beneficiary.

3.37 This is relevant to insurable interest because it means that parents can take out a policy on their own lives and declare that the benefits are payable to the children. It side-steps the need for children to insure their parent's lives in which, as we have seen, they would have no automatic insurable interest. In Scotland the Married Women's Policies of Assurance (Scotland) Act 1880 sections 1 and 2[31] contain provisions equivalent to section 11 of the Married Women's Property Act 1882.

[27] *MacGillivray on Insurance Law* (10th ed 2003), 1-75.

[28] In the case of *Law v London Indisputable Life Policy Co* (1855) 1 K&J 223, a father bought from his son a legacy that the son had inherited. That legacy was contingent on the son reaching 30 years of age. The father was therefore held to have an insurable interest in his son's life. In *Parsons v Bignold* (1843) 13 Sim 518 a father had a right to enjoy property during his son's lifetime. His benefit would end when his son's life ended. The father was held to have a valid insurable interest in his son's life.

[29] See Appendix C.

[30] See Appendix C

[31] The Civil Partnership Act 2004, s 132, extends these provisions to civil partners.

3.38 The Law Commission considered the 1882 Act in its 1996 report on privity of contract.[32] At that time it concluded that there was no need to extend the provision to all life policies where there is a named beneficiary, so the provision remains of use simply to children and spouses.

Other statutory provisions

3.39 Other statutory provisions also "create" an automatic insurable interest. These are the Local Government Act 1972, the Local Government (Scotland) Act 1973, the Land Drainage Act 1991[33] and the Police (Northern Ireland) Act 2003.[34]

3.40 These Acts give local authorities or councils the right to insure the life of members of the authority or the council or the district policing partnership whilst engaged on the business of the authority or council.

(4) INTEREST RECOGNISED BY THE COURTS THAT DOES NOT FIT INTO ANY OF THE ABOVE CATEGORIES.

3.41 The fourth category of interest was first described in 2003 by Lord Justice Waller in the case of *Feasey v Sun Life Assurance Co of Canada*.[35]

3.42 In this case a P&I Club, Steamship Mutual, insured its members against liability claims brought by employees and other persons injured on board members' vessels. Steamship then reinsured that risk with Lloyd's Syndicate 957. In 1995, instead of entering into the usual reinsurance contract, Steamship entered into a first party personal accident and illness policy with Syndicate 957. This change was made to suit Syndicate 957 as it wanted to bring the policy within a short-tail risk code for audit purposes.[36] When a dispute arose, Syndicate 957's reinsurers and subsequently Syndicate 957 itself turned down the claim, relying on the lack of insurable interest.

3.43 The question to be answered by the court was whether Steamship had an insurable interest in the subject matter of the personal accident and illness policy.[37]

3.44 Lord Justice Waller's judgment analyses the case law on insurable interest and divides those cases into groups, which results in a fresh categorisation of types of insurable interest. The second and fourth categories are relevant to life.

[32] Privity of Contract: Contracts for the benefit of third parties (1986), Law Commission No 243. The Law Commission's proposals on privity were implemented by the Contracts (Rights of Third Parties) Act 1999 (Not applicable to Scotland).

[33] This Act does not apply in Scotland.

[34] Copies of the relevant parts of these statutes are contained in Appendix C.

[35] [2003] EWCA Civ 885.

[36] Bringing a policy within a short-term risk code means that it is treated as short-term insurance. The reserving requirements for insurance companies are different for long-term and short-term insurance.

[37] The policy was a complicated one in which Syndicate 957 agreed to pay a fixed sum to Steamship in respect of death or disablement suffered by persons using its members' facilities. Lord Justice Waller categorised this as a hybrid policy of insurance. The amount to be paid was not tied to the loss suffered by Steamship but instead was fixed. However, cover was for losses that Steamship might incur once liability was established. Lord Justice Ward (dissenting) categorised the policy instead as a straightforward reinsurance personal accident policy.

(1) Group 2 are those cases where the court has defined the subject matter as a particular life of a particular person and where the insurance is to recover a sum on the death of that person. Lord Justice Waller's analysis of the cases indicated that a legal and pecuniary interest in the life insured is necessary. The cases dealing with legal and pecuniary interest were discussed at paragraphs 3.24 to 3.33 above.

(2) Group 4 are those cases "in which the court has recognised interests which are not even strictly pecuniary". Here Lord Justice Waller includes the cases where insurable interest is based on natural affection and, importantly, cases where it is not necessary to show a pecuniary or legal interest.

3.45 The last part of Group 4 stretches the concept of insurable interest beyond the strict traditional definition.

3.46 Lord Justice Waller concluded that

> it is not a requirement of property insurance that the insured must have a 'legal or equitable' interest in the property [we shall return to this later when we look at insurable interest on property] and in a policy on life or lives the court should be searching for the same broad concept.
>
> In an insurance of a specific identified life, it will be difficult to establish a legal or equitable relation without a pecuniary liability recognised by law arising on the death of that particular person.
>
> There is however no authority which deals with a policy on many lives and over a substantial period [as was the case with Steamship] and where it can be seen that a pecuniary liability will arise by reference to those lives and the intention is to cover that legal liability.[38]

3.47 The result of his judgment is that in some policies on lives (in particular those where the policy is on many lives and over a substantial period) it will not be necessary to show a strict pecuniary loss recognised by law. This is an unexpected result and has been received with caution by many commentators. In this fourth category of insurable interest, the concept goes well beyond the traditional definition that we have discussed above.

OTHER REQUIREMENTS OF THE LIFE ASSURANCE ACT 1774

When must the interest exist?

3.48 The 1774 Act does not offer any indication as to when the insurable interest must exist. However, *Dalby v India and London Life Assurance Company*,[39] established that the interest only had to exist at the inception of the contract and not at the time of loss.

[38] *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885, at para 97.

[39] (1854) 15 CB 365; see also *Turnbull & Co v Scottish Provident Institution* (1896) 34 SLR 146 (OH).

3.49 Once the policy has been properly created, the policyholder does not need to continue to hold an insurable interest in the life insured. The contract is still legal if the policyholder has no insurable interest at the time of the death. It is, for example, possible to hold an insurance policy on the life of a divorced spouse. This finding has enabled life policies to be assigned, bought and sold on the Traded Endowment Policies ("TEPS") market.

Naming interested persons

3.50 Section 2 of the 1774 Act requires the person or persons interested in a policy, or for whose benefit the policy is effected, to be named in the policy document. If the interested person is named, it can be established whether or not he or she has an insurable interest. Of course, the person interested will commonly be the policyholder. However, in some cases the documentation will be a sham, and the policy will in truth be for the benefit of an unnamed interested person. In such cases section 2 would be breached and the policy would be rendered unlawful.

3.51 The assignment[40] of policies and the practice of trading them on TEPS appears to side-step section 2. It is not uncommon, for example, for a cohabitant to take out an own-life policy with the intention of immediately assigning it to his or her partner.

3.52 Special legislation had to be passed to prevent section 2 from rendering group policies illegal. If, for example, an employer wishes to take out a policy providing death benefits for its employees, section 2 would require all those employees to be named in the policy document. With the turnover of staff, this is impractical. Section 50 of the Insurance Companies Amendment Act 1973 therefore allows policies to be for the benefit of unnamed members of a stated class, provided that the members of that class can be identified at any given time.[41]

AMOUNT OF RECOVERY

3.53 Under section 3 of the 1774 Act, the amount of any recovery is limited to the interest of the policyholder in the life insured.[42]

3.54 The principle that insureds cannot recover a sum greater than their interest does not apply to policies where the interest is based on natural affection, that is policies on one's own life or the life of a spouse.[43] Here the amount of interest is unlimited. In all other cases, however, it does apply and is measured by the potential financial loss at the inception of the policy. For example, as illustrated in *Hebden v West,*[44] the sum insured under a policy effected by a creditor on a debtor will be limited to the amount of that debt.

[40] Assignation in Scots law.

[41] See Appendix C.

[42] This does not easily accord with the theory that life insurance is not indemnity insurance and instead pays a lump sum regardless of the amount lost. However, it can be distinguished from indemnity insurance by the fact that the test is applied at the inception of the policy, not at the date of claim.

[43] See also para 3.35 for the law regarding civil partners.

[44] (1863) 3 B&S 379. See para 3.28 above.

CONSEQUENCES OF NON-COMPLIANCE WITH THE 1774 ACT

3.55 Under section 1 of the Life Assurance Act, policies made without interest are null and void. Section 2 of the Act states that a policy made without the insertion of the names of all interested parties is illegal. Later case law has established that, despite section 1, a contract of insurance created without insurable interest is illegal.[45]

3.56 An illegal contract is unenforceable and therefore the consequence for policyholders is that their claims under the contract will not be paid. Broadly speaking premiums are not repayable under an illegal contract unless the policyholder is able to establish that the insurer bears a greater degree of responsibility for the illegal contract.[46] Until recently policyholders were not permitted to argue that they were ignorant of the law and claim restitution for mistake. The case of *Kleinwort Benson v Lincoln City Council*[47] has however opened the door to allowing a claim of this sort for mistake of law.[48] This might enable policyholders who are ignorant of the law to claim back their premiums.

3.57 The Scots law of unjustified enrichment allows premiums paid under an illegal insurance policy to be returned to the policyholder unless the insurer can show that it is inequitable to do so.[49] The court will consider all the circumstances of the case in deciding whether it is equitable to return the money paid.[50] If both parties were aware of the illegality at the time of contracting it is likely that losses will lie where they fall and the premiums will not be returned.

3.58 The Insurance Ombudsman said in the Insurance Ombudsman Bureau Annual Report for 1989 that he would not hold policies without insurable interest illegal. The policies would be treated as void and premiums will be returned to the policyholder.

[45] *Harse v Pearl Life Assurance Co* [1904] 1 KB 558.

[46] This understates the complexity of the law. The leading case on the subject, *Hughes v Liverpool Friendly Society* [1916] 2 KB 482 states that:

> It is clear law that where one of two parties to an illegal contract pays money to the other, in pursuance of the contract, it cannot be recovered back... Unless there can be introduced the element of fraud, duress or oppression, or difference in the position of the parties which created a fiduciary relationship to the plaintiff so as to make it inequitable for the defendants to insist on the bargain.

[47] [1998] 4 All ER 513.

[48] The earlier Scottish case of *Morgan Guaranty Trust Co of New York v Lothian RC* 1995 SC 151, 1995 SLT 299, decided on similar facts and referred to in *Kleinwort Benson v Lincoln City Council,* allowed for the recovery of money paid under a void contract which was erroneously thought to be valid.

[49] H MacQueen and J Thomson, *Contract Law in Scotland*, (2nd Ed, 2007), para 7.20.

[50] *Dowling and Rutter v Abacus Frozen Food Ltd* 2002 SLT 491.

3.59 In practice it seems that insurers do sometimes issue policies that are technically illegal for lack of insurable interest.[51] Whilst insurers would no doubt honour such policies, it is always open to them to refuse to do so[52] and the administrators or liquidators of an insolvent insurer may be obliged to refuse. As in *Feasey*,[53] the attitude of re-insurers may also cause difficulties.

EXAMPLES

3.60 As we have seen, the law on insurable interest is complex. Whilst it is possible to see the basis of insurable interest for most common forms of insurance, there are some areas where it is normal to take out life insurance, but where the grounds for insurable interest do not immediately fit within the categorisation set out above. We thought it would be useful to list a few examples and would be grateful for comments on them.

3.61 Example 1: A group life policy taken out by an employer on the life of an employee which pays four times the employee's annual salary.

(1) This type of policy typically underpins the contractual promises made by employers to their employees to pay a set amount should that employee die. The promise to pay an amount on death is usually known as a death in service benefit.

(2) In order to pay the death in service benefit, the employer takes out an insurance policy on the employee's life which will pay out the amount of the death in service benefit promised, should that employee die.

(3) The insurance policies are often set up by way of trust.[54] The employer creates a discretionary trust and that trust takes out the insurance policy on the employee's lives. On the death of the lives insured the trustees then have a discretion over who receives the benefit, but not over the amount paid.

(4) At first glance there is an obvious problem with section 3 of the Life Assurance Act 1774, in that four times salary is clearly more than the amount of interest the employer has in the life of his employee. The case of *Simcock v Scottish Imperial Ins Co*[55] indicated that the value of an employee's life to his or her employer was limited to that employee's notice period.

[51] Most often for cohabitants, or for parents and children.

[52] See, for example, *Fuji Finance Inc v Aetna Life Insurance Co Ltd* [1997] Ch 173.

[53] *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885.

[54] Although where there is a stand-alone death in service benefit that is unconnected to a pension scheme, the insurance policy which supports the death in service benefit does not have to be set up by way of discretionary trust.

[55] (1902) 10 SLT 286, 288.

(5) However, these group policies are similar to those described by Lord Justice Waller in his fourth category of insurable interest in *Feasey.*[56] They are for many lives over a substantial period and it is clear that a pecuniary liability will arise by reference to those lives and the intention of the parties is to cover that legal liability. Lord Justice Waller indicated that it would not be necessary in these circumstances for the policyholder to show a strict pecuniary loss recognised by law. It is therefore suggested that according to Lord Justice Waller's fourth category of insurable interest, employers taking out group schemes are deemed to have an insurable interest in their employee's lives for more than the amount of their notice period.

(6) Aside from this, there are two, less straightforward, theories on how the problem of insurable interest is solved in these circumstances. The first would be for employers to insure their contractual liability to pay their employees a multiple of salary on their death. This would be indemnity insurance which is described in Part 5 and the employer's insurable interest in their contractual liability to pay that amount is clear. However, insurers and employers do not use this method.

(7) The second method is based on a trust analysis. As we have seen, employers enter into a trust deed with a trustee company that effects the policy for the employees. Some have argued that employees are deemed to be insuring their own lives through the trust.[57] This solves the problems with insurable interest as employees can insure their own lives for an unlimited amount. However, as above, this is not a solution that is recognised by insurers and employers working with these schemes. It also could interfere with the trustee's discretion over who the benefit of the policy is payable to should an employee die.

(8) We should be grateful for comments on this analysis.

3.62 Example 2: Company A is negotiating to buy a start-up company, B, whose main asset is Mr Whizz, the director of B and a computer expert. Can company A insure the life of Mr Whizz whilst it is attempting to buy company B?

(1) Company A has no insurable interest in the life of Mr Whizz. It is not his employer, nor does it have any other legal relationship with him which if broken would result in a pecuniary loss. An expectation of benefit should he continue to live is not enough to support insurable interest.

[56] *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885.

[57] *Bowskill v Dawson (No 2)* [1955] 1 QB 13; see also J Birds, *Bird's Modern Insurance Law* (7th ed 2007), p 358.

(2) Company A may be able to take out a different type of insurance. As we will see,[58] it may be possible to take out indemnity insurance on the outcome of an 'adventure',[59] if that adventure is properly defined.[60] The insurance would not be life insurance but insurance of the whole process of purchasing company B and the loss that would result should that process fail. The mere hope of deriving material benefit from the employment of Mr Whizz would probably not in itself provide the basis for insurable interest although abortive transactional costs could be insured. We should be grateful for information from insurers on whether they would cover Mr Whizz's life in these circumstances.

3.63 Example 3: A parent buys a travel policy for the family (2 parents, 2 children) which provides a lump sum of £25,000 should any of the party die or become seriously injured. Will the policy pay out if one of the children dies?

(1) As we have seen the class of natural affection only includes one's own life and the life of a spouse.[61] It does not give parents an insurable interest in their children's lives. Instead, the parents need to establish a legal and pecuniary interest in their child's life. It is clear that, under both English and Scots law, children have no obligation to maintain their parents[62] and whereas in Scots law, parents owe an obligation of aliment to their children,[63] in English law parents have no obligation, it seems, even to bury their children.[64] It is difficult to see what legal and pecuniary interest the parents have in the continuance of their child's life.

(2) We have heard from insurers that as a result of insurable interest they tend to limit the damages to be paid on a child's death in travel insurance to repatriation and funeral expenses. Insurers say that they offer lesser sums on the death of a child than they might wish to and they would not allow a child's life to be insured for £25,000. In their analysis, the doctrine of insurable interest will only allow them to pay a small lump sum on the death of a child, which represents the costs that the parent would incur in dealing with the death. Whether this is the correct analysis (especially given the case of *Harse v Pearl Life Assurance Co Ltd,*[65] which found that no-one was under a legal obligation to bury another) is unclear.

(3) Others say that a solution can be found in agency law. Adults taking out insurance are regarded as contracting as agent on behalf of their children. The child is in effect insuring its own life for an unlimited amount.

58 See para 5.17(2) below.

59 *Wilson v Jones* (1867) LR 2 EX 139.

60 See Lord Justice Waller's analysis of *Wilson v Jones* in *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885 at [87] to [89].

61 See also para 3.35 above for the law regarding civil partners.

62 *Halford v Kymer* (1830) 10 B&C 724. For Scots law, see para 3.15 above.

63 See paras 3.15 to 3.18 above.

64 *Harse v Pearl Life* [1904] 1 KB 558.

65 [1904] 1 KB 558.

(4) Yet, if this is a solution it does not appear to have been accepted by the insurance market who either offer lesser sums or who state that the contract will offer "up to £2,000,000 on the loss of life" – without making it clear that it will be near impossible for most parents to prove a legal or pecuniary loss of this amount. We should be grateful for views on this.

OTHER TYPES OF NON-INDEMNITY INSURANCE

3.64 So far in this chapter we have discussed non-indemnity insurance on lives. However, it is also possible in theory to take out non-indemnity insurance on property, that is, valued policies that pay out a set amount on the destruction of the property or other specified event without regard to the amount lost.

3.65 The law on non-life, non-indemnity insurance depends on the subject matter of the insurance.

3.66 For non-indemnity insurance of ships, goods and merchandises, the Life Assurance Act 1774 does not apply. Section 4 of that Act excludes these types of insurance from its jurisdiction. However, until the Gambling Act 2005, if such insurance contracts were to be enforceable, they would have had to have shown insurable interest to distinguish themselves from gambling. Now that the Gambling Act 2005 has made gambling contracts enforceable, this requirement may fall away for non-marine insurance in England and Wales,[66] although the residual common law requirement remains in Scotland. Marine insurance may still require insurable interest and it certainly remains a criminal offence to take out marine insurance without an insurable interest.

3.67 For non-indemnity insurance of land and buildings the position is different. The courts have confirmed that the Life Assurance Act 1774 does not apply to indemnity insurance on land or buildings[67] but they have made no finding in relation to non-indemnity insurance on land or buildings. What insurable interest is required for such policies or whether insurable interest is required at all is unclear.

3.68 We should be grateful for information on non-life, non-indemnity policies. In particular we would be interested to know whether they are offered by insurers and, if so, how often. It is apparent that it is this category of policy which most closely resembles credit derivatives and other forms of risk transfer product.[68]

SUMMARY

3.69 This Part has described insurable interest for non-indemnity insurance.

3.70 For life insurance (which we use as a shorthand for life insurance, personal accident insurance and critical illness insurance) the 1774 Life Assurance Act imposes a requirement for the policyholder to show an insurable interest in the life insured at the time the contract is taken out. This interest can be created in the following circumstances:

[66] The effect of the Gambling Act 2005 is discussed in more detail in Part 5.

[67] Mark Rowlands Ltd v Berni Inns Ltd [1986] 1 QB 227. See para 5.26 below for further details. Non-valued, or indemnity insurance of land and property are discussed in Part 5 of this Issues Paper.

[68] See paras 7.9 to 7.17.

(1) where the policyholder has a relationship of natural affection with the life insured; (In England and Wales this only covers the policyholder's own life or his spouse, not other family members. In Scotland, additionally, children to whom an obligation of aliment is owed have an interest in the lives of their parents.)[69]

(2) where the policyholder will suffer a pecuniary loss recognised by law on the death of the life insured;

(3) where statute 'creates' interest; and

(4) where the policyholder suffers a loss under a policy on many lives which has been taken out for a substantial period of time.

3.71 The interest must exist at the time the policy is taken out. Where the insurable interest is created under categories 2, 3 and 4 above, the amount that can be insured is limited to the amount of interest the policyholder has in the life insured. Where a policyholder cannot show insurable interest in the life insured, the policy is illegal and claims will not be paid under it.

3.72 In the next Part we discuss the problems that the law in this area causes and then look at the possibilities for reform in Part 7.

[69] See paras 3.15 to 3.18.

PART 4
LIFE AND OTHER NON-INDEMNITY INSURANCE: PROBLEMS

INTRODUCTION

4.1 The law on insurable interest in non-indemnity insurance creates problems. It is complex and unclear. It can prevent insurance being taken out in circumstances where the objects of that insurance are valid and do not offend against the public policy principles on which the Life Assurance Act 1774 was based. In this section of the paper we list the practical problems that are caused by the current law on insurable interest.

THE LAW IS DIFFICULT TO ANALYSE

4.2 Lack of an insurable interest renders the contract of insurance illegal. However, judges recognise that "it is the duty of the Court always to lean in favour of an insurable interest, if possible".[1] This leads to confused law. The case of *Feasey*[2] is a good example. Here, Lord Justice Ward in his dissenting judgment analysed the case law along traditional lines, looking for a pecuniary interest recognised by law. He failed to find one and reluctantly concluded that the insurance did not show sufficient interest. His frustration was plain:

> I am extremely disgruntled at having to come to that conclusion for it does scant justice in a case of this kind… I have to struggle to find that the contract was null and void. Why it also has to be illegal baffles me. Although Parliament has had the opportunity in comparatively recent years to consider the 1774 Act, it may not be overdue to look at it again. If this case reaches their Lordships' House, their Lordships may have more power than regrettably I feel I have to change the unhappy result which I have reached.

4.3 Lord Justice Waller's analysis of the case law was along less traditional lines. Many commentators have argued that he stretched the concept of insurable interest to find that, in the circumstances, Steamship Mutual did have an insurable interest in the lives of those that used its members' facilities. He created a category of insurable interest which allows contracts of insurance for many lives over a long period of time, without the requirement to show a strict pecuniary interest recognised by law. Arguably this was done so that a fair result could be reached and the contract could be upheld. However, following *Feasey* it is now unclear whether and in what circumstances it might be possible to dispense with the strict requirement of a pecuniary interest recognised by law.

4.4 If the law on insurable interest is unnecessarily complicated and prevents parties from being bound to legitimate contracts that they have negotiated freely then it is difficult to see the justification for it in its current form.

[1] *Re London County Commmercial Reinsurance Office Ltd* [1922] 2 Ch 67, 69.

[2] *Feasey v Sun Life Assurance Co of Canada* [2003] AC 619.

LIFE/PERSONAL ACCIDENT INSURANCE AND LIABILITY INSURANCE – THE BOUNDARY HAS BECOME BLURRED

4.5 A further problem created by *Feasey* is that the boundary line between life and liability insurance has become blurred. The main issue in *Feasey* was that, for the convenience of the Lloyd's syndicate, Steamship's insurable interest for reinsurance purposes was expressed to be in the lives of injured persons, not (as would be expected) in its liability to members. The result was that the court had to struggle to find that Steamship had an insurable interest in the lives of the injured persons. Had it been asked whether Steamship had an insurable interest in its members' liabilities, the answer would have been plain. In order to be able to find an insurable interest, the Court of Appeal stretched the concept of insurable interest on lives and found that "a policy which was expressed to be on a specific subject matter, e.g. lives or property, was capable of being construed as *extending to the assured's liability* in relation to those lives or property".[3]

4.6 If this were to apply to all contracts of insurance, there is a possibility that insurers could be held responsible for liability losses when they have only calculated for life/personal accident losses. Alternatively, the case could encourage insurers or brokers to sell the 'wrong' policies to insureds, telling them that their pure life or personal accident policies would extend to cover a liability loss. The problem is especially acute for reinsurance. There is an ongoing dispute as regards reinsurance, as to whether a reinsurance agreement is a liability policy or a further policy on the insured subject matter. The answer has consequences for insurable interest. Unless the subject matter of the policy is clear, it is impossible to tell whether an insurable interest exists. There is a need for clarity in the law here and we would be grateful for views from insurers and reinsurers on this debate.

DEPENDANTS CAN FIND IT DIFFICULT TO OBTAIN INSURANCE

4.7 Under current law, support given to a dependant does not give that dependant an insurable interest in the supporter's life, unless it can be shown that the supporter was under a legal obligation to maintain the dependant. The result of this is that anyone who is dependent on the life of another for support or education cannot automatically insure that life.

4.8 This has, amongst others, the following results:

(1) Insurance is unavailable for parents wishing to insure the lives of their children or for children wishing to insure the lives of their parents, even where those parties are dependent on each other for support. The same applies to other relationships where one party is dependent on the other and there is no legal duty on one party to look after the other.[4]

(2) Cohabitants cannot insure each other's lives. They are not included within the class of relationships where an unlimited interest is deemed to arise automatically and they have not been given the statutory rights awarded to civil partners.

[3] *Colinvaux & Merkin's Insurance Contract Law*, A-0575 (emphasis added).

[4] In Scotland the obligation of aliment provides a legally recognised pecuniary obligation from a parent to a child, giving the child an insurable interest in the life of their parent. See para 3.15 above.

(3) School fees insurance needs to be taken out by the parent as an endowment policy or decreasing term life insurance on the life of that parent (or his or her spouse or civil partner) in order to be valid. Simple insurance taken by a child on the life of the parent would not work on the ground that the insurance does not cover the performance of obligations at law to the child. In Scotland, the obligation of aliment owed by a parent to a child has been held to extend to the payment of school fees in certain cases.[5] Section 3(1) of the Family Law (Scotland) Act 1985 specifically provides that a court may make an order for alimentary payments of a special nature, including payments in respect of educational expenses. Where the alimentary obligation extends to the payment of school fees the child will have an insurable interest in the life of their parent and will be able to take out life insurance corresponding to the obligation to pay school fees. However, whether the obligation extends to school fees will depend upon the circumstances of each particular case,[6] and this is likely to lead to uncertainty as to whether a child has the necessary interest to insure the life of a parent to pay school fees.

(4) Travel insurance taken by a parent in respect of a child can also cause difficulty.[7]

SECTION 2 OF THE LIFE ASSURANCE ACT CAN BE USED TO AVOID THE POLICY ON A TECHNICALITY

4.9 Section 2 of the Life Assurance Act 1774 states that the name of the person interested must be inserted into the policy. Yet this does not affect the requirement imposed by section 1 of the Act that the insured must have an insurable interest. If a person has no insurable interest in the life insured then the policy is rendered void by section 1 even if that person is named in section 2. Section 2 appears superfluous.

[5] See *Winter v Thornton* 1993 SCLR 389. Under the Family Law (Scotland) Act 1985, s3(1)(b), the court held that a father of a child whom he had never met was required to pay aliment to enable the child of 5 years to attend a private school. See also *Macdonald v Macdonald* 1993 SCLR 132 in which the court ordered aliment of a specific sum to cover school fees under s3(1)(b). The defender had previously insisted on private education which was taken into account under s4(1)(c) of the 1985 Act.

[6] Section 4 of the Family Law (Scotland) Act 1985 provides that the court shall have regard to a) the needs and resources of the parties, b) the earning capacities of the parties, c) generally to all the circumstances of the case.

[7] See para 3.63 above.

4.10 The problem is that section 2 adds nothing to the concept of insurable interest whilst providing opportunities for the contract to be avoided using technicalities. The case of *Evans v Bignold*[8] demonstrated this. In that case the policy was avoided because the husband's name was not written into it. Whilst this case was heard in the latter half of the nineteenth century and it does not appear that any modern insurer would take the point, the fact remains that the law would allow it.[9]

INTEREST ON A DEBT MAY NOT BE INSURABLE AND KEY EMPLOYEE INSURANCE IS UNCERTAIN

4.11 Section 3 of the Life Assurance Act 1774 states that the insured will not receive a greater sum than the amount of value of his interest. This appears to align life insurance with indemnity insurance, albeit that the amount of interest must be calculated at the time the contract is made rather than, as with true indemnity insurance, when the loss is suffered.

4.12 Section 3 leads to practical problems. As the section limits the amount recoverable to the amount lost, those taking out insurance cannot simply name a lump sum on which they will then pay premiums but instead a calculation must be carried out to show that the amount insured is equal to the amount of value in the interest. This can be difficult and, were insurers to insist on it, lays extra risk on the policyholder if the amount insured is questioned, which is usually at the claims stage. It leads to two particular problems:

(1) Interest owed on a debt sometimes cannot be insured.

It is clear from the case law that creditors can insure the life of their debtors to the extent of the debt. However where the loan is not of a fixed term, the sum insured cannot take account of the interest that may accrue after the insurance is taken out as this amount is uncertain. As we have seen, case law and section 3 of the Life Assurance Act states that the pecuniary value of the interest is calculated at the time the contract is made. The amount of interest due in the future is a mere expectancy. This is not enough to create an insurable interest. Therefore, the costs of servicing the debt and future interest cannot be covered by insurance, as they are not supported by insurable interest. Fixed term loans, such as hire purchase agreements would not suffer from this problem. Any interest capable of certain calculation at the time of insuring should be insurable.

(2) Key employee insurance is uncertain.

An employer may wish to insure the life of certain of its key employees. However, the amount that can be insured by an employee is limited. Case law states that "the value of the interest as at the date of the policy must be calculated with some reference to the legal relation subsisting between the parties".[10] A butcher insured his long-standing assistant's

8 (1868-69) LR 4 QB 622.

9 In Australia the case of *Davjoyda Estates Ltd v National Insurance Co of New Zealand* (1967) 65 SR (NSW) 381 solved the problem by finding that section 2 only applies when the insured has no interest to satisfy section 1 but is insuring on behalf of another with an interest who must therefore be named.

10 *Simcock v Scottish Imperial Ins Co* (1902) 10 SLT 286, 288.

life but it was held by the court that because the butcher's assistant was on a weekly contract, the value of the assistant's life to the employer was only one week's employment.

Nowadays it is typical to value a key employee at a figure of up to 10 times annual salary. It could be argued that the value of the work on which the key employee is engaged together with the goodwill, the clients and the business generated would add up to a value of more than a 3-months notice period. However, the key employee's future work and business that may be brought in through the key employee's contacts would be classed as expectation interest, which will not form the basis for a valid insurable interest. As a result it appears that the current practice of insuring key employees for the amounts of up to 10 times their salary could be contrary to the Life Assurance Act 1774.

IT HAS ALWAYS BEEN POSSIBLE TO SIDE-STEP THE REQUIREMENTS OF THE LIFE ASSURANCE ACT 1774 THROUGH ASSIGNMENT

4.13 Assignment provides a method of outflanking the Life Assurance Act 1774. For example, the Act prevents cohabiting partners from effecting valid policies on each other's lives. However, partners can effect policies on their own lives and immediately cross-assign their own-life policies to their partner. Insurable interest has therefore become a complex provision that trips up the unwary and those without proper legal advice.

THE LIFE ASSURANCE ACT 1774 NO LONGER REDUCES MORAL HAZARD OR GAMBLING IN THE GUISE OF INSURANCE

4.14 This point arises as a result of the ease of assignment for most policies. In addition to being able to assign policies, policyholders can also trade their policies on the Traded Endowment Policies (TEPS) market. Investors in this market purchase the benefits of policies from the original policyholders. Having taken an assignment of the policy benefits, an investor becomes responsible for the payment of premiums, and in due course will receive either the maturity value or the death benefit. The advantage for the policyholders is that the sums paid on assignment are higher than the available surrender values. However, the result is that the investor is left with what is in effect a policy on the life of a stranger, the early death of whom will bring a windfall gain. This could be argued to be in conflict with both objectives of the Act.

4.15 In any event, since the requirement of insurable interest in non-indemnity insurance exists only at inception, it is possible for a life policy to have effectively become a gambling contract by the time of a claim. For example, a lender may maintain a life policy on a debtor even if there has been early repayment of the loan. A policy can be maintained in situations where the risk of moral hazard is perhaps increased. For example, a married couple may divorce in acrimonious circumstances, yet one may maintain an existing life insurance policy on the other.

COMPOSITE POLICIES OF INSURANCE CAN BE THREATENED

4.16 There is a potential problem with composite policies – that is policies covering a range of risks. For example, a travel insurance policy is primarily one of indemnity, yet it may contain non-indemnity elements such as life insurance benefits. The Life Assurance Act 1774, enacted before such policies existed, provides that "every assurance" is void if made without insurable interest. The question therefore arises as to whether the whole policy would be held to be void due to a lack of insurable interest for the purposes of the Life Assurance Act 1774 or whether the policy is severable and the risk divisible.

4.17 Professor Clarke suggests that implicit in Lord Mansfield's judgment in *Tyrie v Fletcher*[11] is the notion that risk in insurance policies is divisible, not entire. It follows that, if a policy was comprised of life insurance as well as other forms of indemnity insurance, then merely the life insurance part of it would be held void due to the absence of insurable interest. The remaining parts of the insurance which do not require such an interest could still be upheld.

4.18 The recent case of *Swiss Reinsurance Company and Others v United India Insurance Company Limited*[12] took a different view. In this case the court looked at how the policy was constructed and since the premium was said to be a single figure paid for the whole policy it was held not to be severable.

THE REMEDY FOR BREACH IS UNCLEAR AND PENALISES ONLY THE POLICYHOLDER

4.19 The consequence of a lack of insurable interest is that the policy is held to be void. If the contract is also declared illegal, policyholders will not have their claims paid and their premiums may not be returned.[13]

4.20 Whilst the predecessor to the Financial Ombudsman Service said in 1989 it would no longer allow insurers to retain premiums in these circumstances, not all cases are covered by this. The Financial Ombudsman Service can only make binding recommendations of up to £100,000; it cannot hear cases in which third party evidence is necessary; and it cannot assist in cases of business insurance where the business' turnover is more than £1,000,000. This leaves some policyholders exposed to having neither their claims paid, nor their premiums returned if a policy is found to be illegal. The insurer suffers no loss, apart from the administrative burden of dealing with the claim.

4.21 The law currently allows insurers to write risks, collect premiums and then refuse to pay claims on the grounds of lack of insurable interest. No penalty is imposed on an insurer who does this. Further, under English law, the doctrine of illegality states that a court cannot consider an illegal contract, even if illegality for lack of insurable interest is not pleaded by the parties.

[11] (1777) 2 Cowp 666.

[12] [2005] EWHC 237.

[13] See para 3.55 above.

4.22 The court is bound to set the contract aside for illegality whether it was asked to consider that point or not.[14] This fact could prevent cases being brought by either insured or insurer where they want the court to consider other matters. In Scotland, the courts will entertain an action as to who is entitled to the proceeds of a policy without insurable interest where the insurer has chosen to honour it.[15]

4.23 Insurers usually take great care to ensure that they do not allow those without insurable interest to take out policies of insurance. Those with whom we have spoken say that once they have concluded a contract they would not refuse to pay for lack of insurable interest at a later stage. However, an insurer in financial difficulties or a closed book in run-off without a reputation to maintain might not take the same approach given its conflicting duty to shareholders. The cases of *Hebden v West*[16] (the bank clerk who paid premiums to two insurers on the life of his employer but one refused to pay for lack of insurable interest) and more recently *Feasey v Sun Life Assurance Co of Canada*[17] (where Lord Justice Ward described the insurer's and reinsurer's position as morally bankrupt)[18] shows that the point is sometimes taken.

CONCLUSION

4.24 There are clearly problems with the concept of insurable interest. Two questions need to be addressed:

(1) Do we wish to restrict the availability of insurance at all?

(2) If so, what form should the requirement take?

4.25 When developing our tentative proposals for reform we have considered the position in other jurisdictions. A review of the law on insurable interest in Australia, Canada, New York, Spain, Slovakia, France and Germany is contained at Appendix A.[19]

[14] Although the case of *Worthington v Curtis* (1875) LR 1 Ch D 424 may cast doubt on this proposition by stating that if the insurance company waives the defence of no insurable interest, the question in front of the court must be determined as if the 1774 Act did not exist.

[15] *Haddon v Bryden* (1899) IF 710 and *Carmichael v Carmichael's Executrix* 1919 SC 636, 1919 2 SLT 89 (revsd 1920 SC (HL) 195, 1920 2 SLT 285).

[16] (1863) 3 B&S 579.

[17] [2003] EWCA Civ 885.

[18] Lord Justice Ward said of the reinsurer, "we none-the-less have the extraordinary position that those who devised the plan to serve their ends now seek to avoid their liability under it on the basis that they failed to overcome the obstacle staring them in the face at all times, and known to be an obstacle, that Steamship might not be able to show they have an insurable interest in the subject matter of this insurance...It is hardly an attractive stance for insurers and reinsurers to adopt. Perhaps an outsider may be permitted to say that where the contract of insurance is supposed to be one requiring the utmost good faith from all parties, this stance betrays the moral bankruptcy of the insurers' and reinsurers' position".

[19] We intend to do further work on our comparative study.

What are the options for reform?

4.26 One option for reform is to abolish the requirement of insurable interest. This is the approach which has been adopted in Australia. There it is possible for anyone (presuming they can find an insurer to write the risk) to take out a life policy on anyone else's life.

4.27 A second option would be to reform the existing rules of insurable interest to relax the restrictions they impose.

(1) The class of natural affection could be extended, producing a list of relationships giving rise to the right to insure. Canada and Spain have taken this approach.

(2) The class of potential financial loss could be amended by relaxing the test applied. Instead of looking for a legal and pecuniary interest, a reasonable expectation of loss could suffice.

4.28 A further option would be to allow insurance on the life of another so long as the life insured consents to the insurance being taken out. Other jurisdictions (notably Spain and Canada and some American states) have adopted this approach. As an alternative, it would be possible to add a requirement for consent to any amendment of the rules governing insurable interest to provide extra security.

4.29 We consider these options in more detail in Part 7.

PART 5
INDEMNITY INSURANCE AND THE INDEMNITY PRINCIPLE: THE CURRENT LAW

INTRODUCTION

5.1 Most forms of property, goods and liability insurance are indemnity insurance. That is, they are contracts which are designed to indemnify insureds against loss suffered. As a result, most property and liability insurance is governed by the common law indemnity principle.[1] The indemnity principle is a contractual requirement that the insured must have suffered a loss in order to recover under the insurance policy. The policyholder therefore requires an interest in the subject matter of the insurance or exposure to legal liability for the loss of another in order to have a valid claim.

5.2 In addition, the traditional position was that, for most forms of indemnity insurance, statute required the insured to have an insurable interest in the subject matter of the insurance – in addition to fulfilling the indemnity principle. Recent case law and legislation has changed this traditional position.

5.3 We will review the definition of insurable interest for indemnity insurance and the indemnity principle before looking at their application to the various types of indemnity insurance. Finally we will ask whether insurable interest in indemnity insurance needs further reform.

THE INDEMNITY PRINCIPLE

History

5.4 The law on the indemnity principle has not been affected by the Gambling Act 2005. The indemnity principle still applies to indemnity insurance. This section describes the indemnity principle.

Description

5.5 The indemnity principle applies to all contracts of indemnity. It states that the policyholder will only be compensated when they have suffered a loss. In order to have suffered a loss, the insured therefore needs to have had an interest in the insured property.

5.6 However, there is a difference between the interest necessary for the indemnity principle and statutory insurable interest. In most forms of insurance pre-Gambling Act 2005, statutory insurable interest had to be demonstrated to prevent the policy from being held unenforceable as a wager.

[1] Non-indemnity insurance, by contrast to indemnity insurance, pays a lump sum on the occurrence of a defined event, regardless of the amount of loss suffered by the policyholder. Non-indemnity insurance is discussed in parts 3 and 4 of this paper.

5.7 By contrast the indemnity principle takes effect as an implied or actual contractual term. It determines whether the insured has suffered an actual loss and can be compensated.[2]

5.8 Where the indemnity principle takes effect as an implied contractual term, the law of the property concerned will decide whether the policyholder has suffered a loss on its destruction. For example, a haulage company will suffer a loss should the goods it is transporting be lost under the law of bailment (or, in Scots law which has no direct equivalent of bailment, under the law of carriage of goods).[3]

5.9 Where the indemnity principle is expressed as an actual contractual term the parties may have more flexibility. However, it is unclear where the boundary of the indemnity principle lies. Where a policyholder has suffered a loss as a result of a defined event happening to the insured property, he can make a claim under that contract of insurance. However, can the indemnity principle stretch to compensate the policyholder for loss as defined under the contract, which may not be a legal/equitable or pecuniary loss?[4]

5.10 At the moment the law is unclear, as the indemnity principle has always been examined before in the context of the statutory definitions of insurable interest. Insurable interest limited the policyholder's recoverable loss to that arising out of a legal or equitable relationship with the subject matter of the insurance. Therefore it was never investigated whether the indemnity principle would enable the policyholder to be compensated for any loss that did not arise out of a legal or equitable interest. However, as a contractual term, the indemnity principle can be amended or waived.[5] In practice the law does appear to recognise losses under the indemnity principle that do not involve legal liability. For example, a reinsurance contract can provide that the reinsurer shall pay a reinsured's claim without forcing it to prove actual legal liability where the reinsured has entered into a bona fide and businesslike settlement.

DEFINITION OF INSURABLE INTEREST

History

5.11 When the Gambling Act 2005 came into force (on 1 September 2007) the law on insurable interest in indemnity insurance changed. Insurable interest is no longer required to enforce most forms of indemnity insurance.[6] This section describes the law on insurable interest before 1 September 2007.

[2] If the insured only expected to gain an interest for the purpose of the indemnity principle in the subject matter of the policy but failed to have that expectancy fulfilled then the policy does not become void or unenforceable (as it would if there was no statutory insurable interest). Instead, the insured will be unable to show any loss on the occurrence of the event insured against and will be unable to recover under the policy.

[3] It is entitled to recover the full value of the goods (even if his liability is less than this) subject to holding the balance for the owners.

[4] See examples set out at paragraphs 5.47 to 5.48.

[5] Not all commentators agree that it can be waived. See Clarke, *The Law of Insurance Contracts* (5th ed 2006) para 4-1D. Birds argues that it can be waived (*Modern Insurance Law* (7th ed 2007) p 62 and cites the cases of *Prudential v Hall* [1947] KB 685 and *Thomas* v *National Farmers' Union Mutual Society Ltd* [1961] 1 WLR 386.

[6] For the relevant Scots law see paragraph 5.49.

The strict definition

5.12 The classic definition of insurable interest in indemnity insurance comes from the judgment of Lord Eldon in the case of *Lucena v Craufurd*.[7] According to this case insurable interest is:

> a right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party.[8]

Some of the Lords had preferred a wider test, that of "factual expectation" of loss. Mr Justice Lawrence said:

> to be interested in the preservation of a thing is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction.

5.13 However, history has preferred Lord Eldon's narrower test, which requires a present right to a legal or equitable interest or a right under contract. It was 'codified' into the Marine Insurance Act 1906. Section 5(2) states that an insurable interest exists where there is

> any legal or equitable relation to... any insurable property at risk... in consequence of which [the insured] may benefit by the safety or due arrival of the insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

The Marine Insurance Act 1906 is likely to represent the position in non-marine (excluding life) as well as in marine insurance.[9] As noted above, equitable relation is not a recognised concept in Scots law. The Scottish Courts have seldom considered how to interpret the words of the 1906 Act and have tended to follow the English authority.[10]

5.14 As a result of Lord Eldon and the Marine Insurance Act 1906, the policyholder needed to show that, when the subject of the contract was destroyed, he or she was in a legal or equitable relation to the subject and suffered a pecuniary loss. This can be illustrated using the case of *Macaura v Northern Assurance Co Ltd*.[11] In this case, Mr Macaura, who was the sole shareholder in a limited company, insured in his own name timber that was owned by the company. The timber was destroyed by fire and Mr Macaura claimed for the value of the timber under the contract of insurance.

7 (1806) 2 Bos & PNR 269.

8 *Lucena v Craufurd* (1806) 2 Bos & PNR 269, at 321.

9 *Colinvaux & Merkin's Insurance Contract Law* A-0397.

10 See *Cowan v Jeffrey Associates* 1998 SC 496 at 502 where Lord Hamilton recognised that the concept of equitable relation was unknown and used English case law to shape his interpretation of this requirement of insurable interest. See also *Arif v Excess Insurance Group* 1987 SLT 473 following *Macaura v Northern Insurance Co.* [1925] AC 619.

11 [1925] AC 619 (Northern Ireland).

5.15 The House of Lords held that he was unable to recover because he did not have an insurable interest in the timber. As a shareholder, he had no right to the property owned by the company.[12] However the insurance contract was not illegal. In the Scottish case of *Cowan v Jeffrey Associates,*[13] on facts similar to *Macaura v Northern Assurance Co Ltd,*[14] Lord Hamilton expressed unhappiness that he could not distinguish the House of Lords' decision in *Macaura* in favour of a test based upon factual expectancy.[15]

The later approach

5.16 In later cases, however, the courts moved away from a strict definition of insurable interest. As Lord Justice Waller put it in *Feasey*, "something less than a legal or equitable interest [in the property] … has been thought to be sufficient"[16] to create an insurable interest.

5.17 Lord Justice Waller categorised the cases on insurable interest into four groups The first, third and fourth groups relate to property:

(1) Group 1 are those cases where the court has defined the subject matter as an item of property, where the object of the insurance is to recover the value of that property. Here Lord Justice Waller's analysis of the cases indicated that the requirement for an insurable interest is strict and the insured must show a legal and pecuniary interest in the property in order for the policy to be valid. He included within this group the cases of *Lucena v Craufurd*[17] and *Macaura*.[18]

(2) Group 3 are those cases where even though the subject matter of the insurance may appear to be a particular item of property, "properly construed the policy extends beyond the item and embraces such insurable interest as the insured has". Lord Justice Waller illustrated this group using the case of *Wilson v Jones*.[19] Here, the plaintiff was a shareholder in a telegraph company. He insured a telegraph cable which was to be laid between Ireland and Newfoundland and insured "every risk and contingency attending the conveyance and successful laying of the cable". When the cable broke during laying the insurer refused to meet the plaintiff's claim stating that the plaintiff as shareholder in the company had no pecuniary interest in the cable.

[12] Followed in the Scottish case of *Arif v Excess Insurance Group* 1986 SC 317 (see commentary by W J Wolffe, *Insurable Interest Time for a Change,* 1989 SLT (News)103).

[13] 1998 SC 496.

[14] [1925] AC 619.

[15] *Cowan v Jeffrey Associates* 1998 SC 496 at 503 per Lord Hamilton.

[16] *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885, p 90.

[17] (1806) 2 Bos & PNR 269.

[18] *Macaura v Northern Assurance Co Ltd* [1925] AC 619.

[19] (1867) LR 2 EX 139.

The court found, however, that this was an insurance on the plaintiff's interest in the adventure and that the subject matter of the insurance had been defined well enough to give him a proper legal and pecuniary interest in that adventure. Had the subject matter been simply "the cable", his interest would not have been enough.

(3) Group 4 are those cases "in which the court has recognised interests which are not even strictly pecuniary". To illustrate this, Lord Justice Waller referred to *The Moonacre*.[20] *The Moonacre* bore similarities to *Macaura's* case[21] – yet an insurable interest was held to exist. Mr Sharp took out insurance on a yacht which was owned by his company. Mr Sharp was the sole shareholder of his company and had no mortgage or charge over the yacht. The High Court found that despite this, Mr Sharpe did have an insurable interest in the yacht. It was held to be sufficient that Mr Sharpe had freedom to use the yacht granted by a power of attorney and owed a duty to exercise reasonable care in respect of it. Lord Justice Waller concluded for this fourth category of cases, "even in the case of property something less than a legal or equitable or even simply a pecuniary interest has been thought to be sufficient [to create an insurable interest]."

5.18 Lord Justice Waller's analysis of the law received criticism from some commentators.[22] However, *Feasey* has remained the leading case on insurable interest. The position was therefore that an insurable interest exists if:

(1) the assured has legal or equitable title to the subject matter; or

(2) if the assured is in possession of the subject matter; or

(3) if the assured is not in possession of the subject matter but may be either responsible for, or suffer loss in the event of, any damage to the subject matter.

5.19 This is a broad definition and one that is remarkably similar to the dissenting view expressed by Mr Justice Lawrence in *Lucena v Craufurd* back in 1806.[23]

THE TIME OF THE INTEREST

5.20 In Scotland, the common law requires an interest to be demonstrated in all indemnity insurance contracts at the time the policy is taken out. In England and Wales the law is less clear-cut. Professor Clarke describes the pre-Gambling Act 2005 position as follows:

> In marine insurance the insured must have an insurable interest at the time of the loss. If so, it matters not that he had no interest at the time of contract or that since the time of the loss his interest has

[20] [1992] 2 Lloyd's Rep 501.

[21] *Macaura v Northern Assurance Co Ltd* [1925] AC 619.

[22] It can be argued that the dissenting judgement of Lord Justice Ward offers a more conventional analysis of insurable interest. He found that the House of Lords' decision in *Lucena v Craufurd* (1806) 2 B & NPR and *Macaura v Northern Assurance* [1925] AC 619 requires the policyholder to have a legal proprietary interest in the subject matter of the insurance.

> ceased. This rule probably applies to other kinds of indemnity insurance, with two qualifications. First, in all other kinds of insurance at the time of making the contract of insurance the person making it must have had a reasonable expectation of acquiring an interest. Second in the case of insurance of real property, it is argued that statute requires that an interest also exist at the date of the policy.[24]

THE CURRENT LAW

5.21 The next section describes the current law, that is the position since the Gambling Act 2005 came into force on 1 September 2007. Different considerations apply according to the subject matter of the insurance, and there are also differences as between English and Scots law.

English law

Insurable interest in goods

5.22 "Goods" and "merchandises" have always been excluded from the Life Assurance Act 1774.[25] Until 1 September 2007, section 18 of the Gaming Act 1845 would have applied to insurance on goods.[26] This stated that wagering contracts were null and void.[27] As a wager is a contract in which neither party is able to show an interest in the subject matter[28] this meant that for an enforceable contract of insurance, an insurable interest in the subject matter had to be demonstrated. This had to be proved at the time of the loss and the policyholder had to show at the outset that they had an expectation of acquiring this interest to prove that the contract is not a wager.[29]

5.23 Since 1 September 2007, section 335 of the Gambling Act 2005 governs wagering. That section states that "the fact that a contract relates to gambling shall not prevent its enforcement". The result is that a policyholder no longer needs to show an insurable interest at any stage to prove that the contract is not a wager. Both gambling and insurance contracts can now be enforced.

5.24 However, as the contract indemnifies the policyholder for loss suffered, the common law indemnity principle applies. If the policyholder cannot prove loss then the principle of indemnity prevents him from recovering. The indemnity principle therefore continues the distinction between insurance and gambling for purposes other than enforcement.

[23] See para 5.12.

[24] MA Clarke, *The Law of Insurance Contracts* (5th ed 2006), para 4-4.

[25] Life Assurance Act 1774, s 4.

[26] Repealed as from 1 September 2007 by the Gambling Act 2005, ss 42(6), 356(3)(d), (4), Sch 17.

[27] Section 18 of the Gaming Act provided, "All contracts and agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law or equity for recovering any sum of money or valuable thing alleged to be won upon any wager".

[28] *Carlill v Carbolic Smoke Company* [1893] 1 QB 256.

[29] MA Clarke, *The Law of Insurance Contracts* (5th ed 2006), para 4-4.

5.25 Policies on goods are still governed by the Marine Insurance Act 1788 which states that the name of the person(s) interested in the insurance shall be inserted into the policy of insurance.

Insurable interest in land and buildings

5.26 For many years, it was believed that the Life Assurance Act 1774 applied not just to life insurance but to all insurances other than those excluded by section 4 (namely to all insurance other than "ships, goods and merchandises"). If the Life Assurance Act 1774 were to apply to buildings and land then the policyholder would have to demonstrate an insurable interest at the inception of the policy in addition to satisfying the common law indemnity principle at the time of loss.

5.27 In 1986, however, the Court of Appeal accepted a submission that "this ancient statute was not intended to apply, and does not apply, to indemnity insurance, but only to insurances which provide for the payment of a specified sum on the happening of an insured event".[30] This approach – which limits the impact of the 1774 Act to non-indemnity insurance – was followed by the Privy Council in 1994 in a case involving employer's liability insurance.[31]

5.28 One key factor in the Privy Council's decision was that indemnity insurance was outside the mischief aimed at by the 1774 Act: "by no stretch of the imagination could indemnity insurance be described as 'a mischievous kind of gaming'".[32]

5.29 The current view, therefore, is that the Life Assurance Act 1774 almost certainly does not apply to insurances of land and buildings although some commentators argue that the matter is not yet conclusively decided[33]. There is also an ancient case, *Sadler's Co v Badcock,*[34] which appears to create a common law requirement for insurable interest at the outset of a policy on buildings or land. However, the case has not been cited since. We therefore assume, for the purposes of this paper, that the Life Assurance Act 1774 does not apply to insurance of land and buildings.

5.30 If these assumptions are correct, then the position for buildings and land post Gambling Act 2005 is as for goods, described above. That is, the Gaming Act 1845 no longer applies to hold contracts without interest unenforceable. Instead the indemnity principle requires the policyholder to demonstrate a loss.

5.31 There is no need for the names of those interested to be inserted into the policy.[35]

[30] *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211, 227.

[31] *Siu Yin Kwan and another v Eastern Insurance Co Ltd* [1994] 2 AC 199 (Hong Kong).

[32] Above, p 211.

[33] John Birds, *Modern Insurance Law* (7th ed 2007), p 53 to 56 and MA Clarke, *Law of Insurance Contracts* (5th ed 2006), para 4-4A.

[34] (1743) 2 Atk 554

[35] *Colinvaux and Merkin's Insurance Contract Law* A-406

Insurable interest in marine insurance

5.32 Marine indemnity insurance policies are governed by section 4(1) of the Marine Insurance Act 1906. This declared that a contract of marine insurance "by way of gaming or wagering" is void.[36] It also required the insertion into a marine policy of the name of the assured "or of some person who effects the insurance on his behalf".[37]

5.33 In addition, the Marine Insurance (Gambling Policies) Act 1909[38] made it an offence to make a contract of marine insurance without an interest. Such contracts are, according to section 1(1) of the Act "deemed to be a contract by way of gambling on loss by maritime perils, and the person effecting it shall be guilty of an offence, and shall be liable, on summary conviction, to imprisonment, with or without hard labour, for a term not exceeding six months or to a fine not exceeding [level 3 on the standard scale]".

5.34 Therefore, until 1 September 2007, marine insurance contracts required the policyholder to show an insurable interest in the subject matter at the time of loss. Commentators disagree strongly as to whether the Gambling Act 2005 has changed this position since 1 September 2007.[39]

5.35 In any event, making a marine contract without an interest remains a criminal offence under section 1(1) of the Marine Insurance (Gambling Policies) Act – even though the reason for imposing the criminal penalty (gambling) is no longer outlawed. As a result, in order to avoid committing an offence any person taking out a contract of marine insurance would need to show

> a bona fide interest, direct or indirect, either in the safe arrival of the ship in relation to which the contract is made or in the safety or preservation of the subject matter insured, or a bona fide expectation of acquiring such an interest.

5.36 As with the other forms of property insurance, the indemnity principle applies at the time of the loss and the insured must demonstrate that he or she has suffered a loss to be able to recover.

Insurable interest in liability insurance

5.37 A liability policy is a policy under which the insurer indemnifies the insured in the event that the insured incurs liability to a third party. For example, a haulage company can take out insurance to cover the goods it is carrying inside its lorry or it can take out a policy that covers the liability it would incur to another should the goods be lost or damaged. The first policy would be goods insurance, the second would be liability insurance.

[36] Section 5(1) defines insurable interest in terms of interest in a "marine adventure". A "marine adventure" is in turn defined at section 5(2). It reads; "in particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival or insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof".

[37] Marine Insurance Act 1906, s 23.

[38] Scope extends to all of Great Britain.

[39] R Merkin, *Insurable interest, the repeal of the prohibition on gambling* in *Insurance Law Monthly* (December 2005), pp 4-5.

5.38 Until the case of *Siu Yin Kwan and another v Eastern Insurance Co Ltd*[40] it was thought that liability policies fell within the words "other events" in the Life Assurance Act 1774 and that the provisions of that Act governed indemnity insurance. However, since the court found in *Siu* that the Life Assurance Act 1774 did not apply to liability insurance, the position for liability insurance is as for goods above. The policyholder does not need to demonstrate an interest at the time of the loss but the indemnity principle applies at the time of loss.

5.39 Now that it has been established that the Life Assurance Act 1774 does not apply, it is unnecessary for the names of those interested to be inserted into the policy.

Summary of the current law in England and Wales

Insurable interest

5.40 For insurance of goods, statute no longer demands that the insured must have an insurable interest in the subject matter in order for the insurance contract to be enforceable. However, the indemnity principle applies and therefore an interest for the purposes of the indemnity principle must be demonstrated at the time of loss in order to have a valid claim.

5.41 For insurance on land and buildings it is likely that the position is as for goods.

5.42 For marine insurance, the position is unclear. Some argue that statute no longer demands that the insured must have an insurable interest in the subject matter at the time of the loss in order for the insurance contract to be enforceable. Whatever the answer to this, it remains a criminal offence to take out marine insurance without an interest. The indemnity principle certainly applies and therefore an interest for the purposes of the indemnity principle must be demonstrated at the time of loss.

5.43 For liability insurance, the position is as for goods.

5.44 For both goods and marine insurance it is necessary for the contract to list the names of those parties who are interested in the insurance. For land and buildings it is likely that it is unnecessary to list the names of those interested. For liability insurance it is unnecessary to list the names of those interested.

Indemnity principle

5.45 The indemnity principle applies to all contracts of indemnity insurance. This requires that the policyholder must have suffered a loss in order to mount a successful claim. It takes effect as either an implied or actual contractual term. As it is a contractual term, it may be possible to amend or waive the requirement for loss.

Examples – England and Wales

5.46 As with non-indemnity insurance above, we thought it would be useful to set out some examples explaining the current law.

[40] [1994] 1 All ER 213 (Hong Kong).

5.47 Example 1: An oil company is operating in a country where there is a strong presumption that anyone who pollutes will make a £500,000 donation to the local community. There is no legal requirement to make the donation but it is a principle of honour. The oil company wishes to insure this risk. Can it do so?

(1) It would have been difficult for a company to do this in an enforceable contract under the law as it stood before the Gambling Act 2005. It is most unlikely that the oil company would have an insurable interest in its liability to pay a voluntary donation.

(2) Today, the same problems may not arise as insurable interest is no longer required at the outset. The indemnity principle requires a loss to have been suffered by the oil company. Therefore, unless the contract deals specifically with this point, a loss suffered as a result of a moral obligation will not be a loss which an indemnity policy would compensate for. However, if the company and the insurer specifically agree that loss as defined by the policy includes a £500,000 payment to the community then would the claim be payable? We would be grateful for views on this.

5.48 Example 2: A mother insures the house contents in her name. However one room in the house is filled with belongings owned by her son who leaves them there while he is at university. The value of these are included within the total value of the policy. The house and all the contents are destroyed by fire. Can the mother recover the value of her son's property?

(1) Under the law as it stood previously the mother could have been deemed to have been acting as agent for her son when arranging the policy. Alternatively the mother could have been said to have an interest in the preservation of the goods as bailee.[41] Both relationships would have given her an insurable interest in her son's property.

(2) Under the law as it stands today only the indemnity principle would be considered. The legal relationship between the mother and her son would be an indication that the mother did, according to the law on agency or bailment, suffer loss when her son's goods were destroyed. However, the Gambling Act 2005 now means that only the indemnity principle would apply to the contract. Is it therefore possible for the contract to specify that loss covers damage to her son's property without the mother having to be deemed to have an interest through agency or bailment? We would be grateful for views.

[41] That is, as the possessor of the goods of another person without transfer of title.

Scots law

5.49 The various statutory provisions referred to in the discussion of English law above also apply to Scotland. In addition, however, there is a common law requirement of insurable interest.[42] The consequence of this seems to be that the practical effect of section 335 of the Gambling Act 2005 is likely to be negligible. Unless it could be argued that the Act has abrogated the Scots common law (which seems unlikely), the section has not abolished the requirement of insurable interest in relation to any category of insurance under Scots law. Additionally, where the policy is one of indemnity, the indemnity principle will require loss, and therefore interest, to be shown at the time of claim as well as the time when the insurance was effected.[43]

5.50 With regard to the examples in paragraphs 5.47 and 5.48 above, it would appear that the common law requirement of insurable interest continues to preclude the possibility of insuring a moral obligation such as the donation in the first example. In the second example, the mother's insurable interest seems to continue to depend upon the law of agency, mere possession being of itself insufficient (there being no direct equivalent of bailment in Scots law).

[42] See paragraph 2.2.

[43] The Laws of Scotland (Stair Memorial Encyclopaedia) vol 12 para 856.

PART 6
INDEMNITY INSURANCE AND THE INDEMNITY PRINCIPLE: PROBLEMS

INTRODUCTION

6.1 The law on insurable interest and the indemnity principle is complex and unclear. This Part lists particular problems with the law as it currently stands.

THE REQUIREMENT THAT INSURANCE CONTRACTS SHOW INSURABLE INTEREST IN ORDER TO BE ENFORCEABLE HAS BEEN ABOLISHED BY ACCIDENT

6.2 The Gambling Act appears to have affected contracts of insurance by accident. The effect of repealing section 18 of the Gaming Act 1845 on the requirement for insurable interest was not discussed in the White or Green Papers or by Parliament when the Gambling Act 2005 was passed. As a result, the situation is confused. Under English law it appears likely that there is no longer any need for a policyholder to demonstrate an insurable interest in non-marine indemnity insurance at the time of the loss in order to have an enforceable contract. Agreement has not been reached on whether marine insurance still needs insurable interest at the time of loss. The position in Scotland is clearer; insurable interest is necessary at the time of the contract as a result of the common law.

6.3 Proper consideration should be given to whether a requirement for insurable interest is necessary for enforceable contracts of insurance in both England and Wales and in Scotland.

DOES THE LIFE ASSURANCE ACT 1774 APPLY TO LAND?

6.4 Section 4 of the Life Assurance Act 1774 clearly states that it does not apply to goods, merchandises and ships. Some commentators believe that a question remains as to whether it applies to policies on land.[1]

6.5 The usual practice of underwriters nowadays is to assume that the Life Assurance Act 1774 has no application to indemnity insurance, including insurance of land or buildings. The uncertainty in the law is unhelpful and should be cleared up.

CRIMINAL PENALTIES FOR MARINE INSURANCE

6.6 Does the Marine Insurance (Gambling Policies) Act 1909 and its criminal penalties still apply to marine insurance?

6.7 As we saw above[2] commentators disagree as to whether the Gambling Act 2005 has removed the requirement for insurable interest in an enforceable marine insurance contract. However, it is clear that the Gambling Act 2005 has had no impact on the Marine Insurance (Gambling Policies) Act 1909.

[1] John Birds, *Modern Insurance Law* (7th ed 2007), p 53 to 56 and MA Clarke, *Law of Insurance Contracts* (5th ed 2006).

[2] Para 5.32.

6.8 Therefore, the criminal penalties for making a contract without interest remain, even though the contract itself may now enforceable. This needs to be resolved to bring the civil and the criminal law in line with each other.

ENTERING THE NAMES OF INTERESTED PERSONS

6.9 The Marine Insurance Act 1788 requires the names of those interested to be inserted into all policies on goods. Section 23 of the Marine Insurance Act 1906 does the same for marine policies.

6.10 The remedy for breach of the Marine Insurance Act 1788 and for section 23 of the Marine Insurance Act 1906 is that the contract is void. Now that statute no longer requires and regulates insurable interest for insurance on property in general, it is unclear what purpose these provisions serve. It is also inconsistent that the requirement applies only to marine and goods policies and not to liability policies or policies on land or buildings.

CONCLUSION

6.11 The methods of reform have been piecemeal, but it appears that there is no longer a statutory requirement in England and Wales for insurable interest for most indemnity insurance to distinguish such contracts from gambling. Is this the right result? Or should the law be the same in England and Wales as it is in Scotland? There are two questions to be discussed:

(1) Is insurable interest necessary at all, or does the indemnity principle cover the position?

(2) Should English law mirror Scots law in requiring insurable interest at the outset of a contract or should it be required at the time of loss?

6.12 We consider these questions in more detail in Part 7.

PART 7
OPTIONS FOR REFORM

INTRODUCTION

7.1 In this Part we consider the options for reform of insurable interest, both in non-indemnity and indemnity insurance. We consider both amendment and abolition, to see whether some of the problems with insurable interest outlined in Parts 4 and 6 can be resolved.

7.2 This Part looks first at whether insurable interest is necessary to distinguish insurance from other contracts. Then it looks at whether it is necessary to prevent moral hazard or gambling in the guise of insurance. Finally we examine the options for reform.

IS INSURABLE INTEREST NECESSARY? DEFINING INSURANCE

7.3 We need to consider whether insurable interest is necessary to identify insurance for regulatory and other purposes. Will a contract of 'insurance' that has no insurable interest remain a contract of insurance? If the concept of insurable interest were to be removed, will the courts and the regulatory authorities be able to distinguish insurance, wagers and other financial contracts, such as credit derivatives?

7.4 The Financial Services Authority ("FSA") thought that it would still be possible to distinguish insurance from other products without insurable interest. Their response to our scoping paper stated:

> The Scoping Paper suggests that there may be a regulatory interest in maintaining requirements for insurable interest "to separate those who are using insurance to order their affairs prudently from those who are merely gambling". The FSA doubts there is a strong regulatory interest in the use to which insurance (or any other financial instrument) is put. The FSA guidance in chapter PERG 6 of the FSA's Handbook of rules and guidance makes clear that the purpose for which a policyholder buys a contract of insurance is not relevant to the identification of a contract of insurance.

7.5 The paragraphs below explore whether insurable interest is necessary for:

(1) defining insurance for the purposes of the Financial Services and Markets Act 2000 and ensuring that other financial contracts (such as credit derivatives) do not become regulated as insurance;

(2) defining insurance at common law; and

(3) defining insurance for accountancy and taxation purposes.

Defining insurance: Financial Services and Markets Act 2000 and other financial contracts

FiSMA

7.6 The current governing legislation for insurance is the Financial Services and Markets Act 2000 ("FiSMA"). It regulates the "effecting and carrying out [of] contracts of insurance". A contract of insurance is defined in the Financial Services and Market Act 2000 (Regulated Activities) Order 2001. However, the definition simply lists those contracts which are deemed to be contracts of insurance:

> "contract of insurance" means any contract of insurance which is a contract of long-term insurance or a contract of general insurance…[1]

7.7 Long-term insurance and contracts of general insurance are defined as being those contracts set out in a Schedule to the Order.[2] The Schedule lists types of insurance contract so, for example, included within the list of general insurance is accident, sickness, land vehicles, ships and liability. Included within the list of long-term insurance is life. A copy of the Schedule can be found at Appendix D.

7.8 As can be seen, FiSMA avoids defining insurance – listing instead only what is to be regarded as types of insurance.

Credit derivatives and FSA guidance

7.9 Particular problems arise with credit derivatives. Credit derivatives are swap or option contracts which are "designed to lay off credit risk on loans, debt securities or other assets in relation to a particular reference entity or country in return for either swap payments or payment of premium".[3] In essence they fulfil many of the common law definitions of non-indemnity insurance. They are contracts whereby one party promises to pay to the other party a sum of money upon the occurrence of a specified event.

7.10 In 1997, the International Swaps and Derivatives Association ("ISDA") asked Robin Potts QC to opine on whether credit derivatives were insurance contracts or insurance business for the purposes of the Insurance Companies Act 1982 and at common law.

7.11 This opinion, commonly known as the Potts opinion, has been widely shared in the market. In response to our scoping paper, the ISDA wrote to us describing Robin Potts QC's opinion and said that "any review of the boundary between contracts of insurance and other types of contract risks damaging [market] consensus and undermining confidence in these economically significant products".

[1] Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, s 3(1).

[2] Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, Schedule 1.

[3] Opinion prepared for the ISDA by Robin Potts QC, Erskine Chambers, 24 June 1997.

7.12 Robin Potts QC was of the opinion that credit derivatives were not contracts of insurance for the purposes of the Insurance Companies Act 1982, which has since been repealed and replaced by FiSMA.[4] He also found that credit derivatives were not insurance contracts at common law.[5] At common law, Robin Potts QC considers that "credit default options plainly differ from contracts of insurance in the following critical respects:

(1) The payment obligation is not conditional on the payee's sustaining a loss or having a risk of loss;

(2) The contract is thus not one which seeks to protect an insurable interest on the part of the payee. His rights do not depend on the existence of any insurable interest".[6]

7.13 As can be seen, insurable interest, or rather the lack of it, is one of the arguments used by Potts to support the conclusion that credit derivatives are not contracts of insurance. If insurable interest were to be abolished as a requirement for insurance contracts, will this make them the same as credit derivative contracts? Or can the first indicator, that of loss, preserve the difference?

7.14 Loss, or the risk of loss is, Potts concludes, necessary for an insurance contract. For policies of indemnity, a loss must be suffered before a claim can be paid. However, non-indemnity contracts like life do not require the policyholder to have suffered a loss. They pay a lump sum regardless of the amount, if anything at all, that is lost. Abolition of insurable interest may therefore have an effect on Potts' distinction between non-indemnity insurance and credit derivatives at common law.

7.15 The FSA commented on Potts' opinion in May 2002. It concluded that "characterisation of a contract as a derivative… or as an insurance contract, is seemingly becoming a tenuous distinction in practice" and indicated that it felt that some credit derivatives would no longer fit within the parameters of Potts' opinion. Two years later it issued a policy statement entitled "the identification of contracts of insurance".[7] That policy statement gives guidance as to how a contract of insurance can be identified. The FSA argues that insurable interest is "not itself a defining feature" of the contract of insurance.[8]

> The guidance does not (and does not intend to) cover all issues relevant to contracts of insurance: – It does not address the requirement for an insurable interest, which is a requirement for a valid contract of insurance and not itself a defining feature of the contract. It follows that the guidance does not refer to Court decisions

[4] Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649).

[5] He also found that credit derivatives were not wagers as, following *Morgan Grenfell v Welwyn Hatfield District Council* [1995] 1 All ER 1, they are bona fide commercial or financial transactions. "A contract is only a wagering contract where both parties to the transaction have the common purpose and interest to wager". Opinion prepared for the ISDA by Robin Potts QC, Erskine Chambers, 24 June 1997.

[6] Opinion prepared for the ISDA by Robin Potts QC, Erskine Chambers, 24 June 1997, para 5.

[7] FSA Policy Statement 04/19, July 2004.

[8] FSA Policy Statement 04/19, July 2004, para 2.10.

or statutes on this issue.[9]

7.16 The guidance note states what is not insurance.[10] In terms of positive guidance, the FSA concludes that:

(1) the 'assumption of risk' by the provider is an important descriptive feature of all contracts of insurance.

(2) a contract is more likely to be regarded as insurance if

(a) the amount payable by the recipient under the contract is calculated by reference to either or both of the probability of occurrence or likely severity of the uncertain event.

(b) if the contract is described as insurance and contains terms that are consistent with its classification of a contract of insurance, for example, obligations of the utmost good faith.

(3) a contract is less likely to be regarded as insurance if it requires the provider to assume a specific risk (that is, a risk carrying the possibility of either profit or loss) rather than a pure risk (that is, a risk of loss only).

7.17 It therefore appears that the FSA does not use insurable interest in order to distinguish insurance from other contracts for the purposes of regulation. However, key to their definition of insurance is the "assumption of risk by the provider". It is of course possible to argue that for a policyholder to be at risk that policyholder must have some kind of interest in the matter insured. However this is different from the statutory requirement of insurable interest as described in Part 3.

Defining insurance: the common law

7.18 In the courts, the traditional definition of insurance is to be found in *Prudential Insurance v Inland Revenue Commissioners,*[11] a case in which the court had to decide whether a particular policy was a life insurance policy. Mr Justice Channell said that a contract of insurance had to demonstrate three things.

> That I think is the first requirement in a contract of insurance. It must be a contract whereby for some consideration you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event.
>
> Then the next thing that is necessary is that the event should be one which involves some amount of uncertainty. There must be either uncertainty whether the event will ever happen or not, or if the event

[9] FSA Policy Statement 04/19, July 2004, para 2.10.

[10] In summary these are (1) contracts under which the provider has an absolute discretion as to whether any benefit is provided on the occurrence of the uncertain event; (2) contracts which appear to be pre-payment for services to be rendered in response to a future contingency, (3) periodic maintenance contracts where the service is carried out regardless of the occurrence of an uncertain or adverse event; and (4) contracts under which in consideration for an initial payment the provider stands ready to provide services on the occurrence of a future contingency provided that those services are charged for at a commercial rate.

[11] [1904] 2 KB 658.

> is one which must happen at some time there must be uncertainty as to the time at which it will happen.
>
> The remaining essential is… that the insurance must be against something. A contract which would otherwise be a mere wager may become an insurance by reason of the assured having an interest in the subject matter – that is to say, the uncertain event which is necessary to make the contract amount to an insurance must be an event which is prima facie adverse to the interest of the assured.

7.19 The leading Scottish case defining a contract of insurance is *Scottish Amicable Heritable Securities Association Ltd v Northern Assurance Co.*[12] Insurance was defined as being a contract in which "the insurer undertakes, in consideration of the payment of an estimated equivalent beforehand, to make up to the assured any loss he may sustain by the occurrence of an uncertain contingency".[13] This definition mirrors the definition of insurance in English common law in requiring payment, uncertainty and interest.[14]

7.20 As can be seen, the third element of Mr Justice Channell's definition and the element of loss in Lord Justice-Clerk Moncreiff's definition require that the assured has an interest in the subject matter. However that interest is not the same as the statutory insurable interest that has been described in Parts 3 and 5, that is, a pecuniary loss recognised by law. Instead it is an interest in something so that one would be adversely affected if it were to be lost.

7.21 Few commentators regard statutory insurable interest as essential to the definition of insurance. MacGillivray states

> A contract of insurance is one whereby one party promises in return for a money consideration to pay to the other party a sum of money or provide him with some corresponding benefit, upon the occurrence of one or more specified events.[15]
>
> A specified event "must be of a character more or less adverse to the interest of the person effecting the insurance".[16]

7.22 Professor Clarke's definition does not require insurable interest but does require an "uncertain and adverse event".

> An insurance contract is commonly described as a contract whereby a person usually but not always in business as such, agrees to pay money (or provide a corresponding benefit) on the occurrence of an

[12] (1883) 11 R 287.

[13] *Scottish Amicable Heritable Securities Association Ltd v Northern Assurance Co* (1883) 11 R 287, at 303 per Lord Justice-Clerk Moncreiff.

[14] This formulation of insurance is also confirmed by Bell; "It is an essential element to the contract of insurance that there shall be a subject in which the insured has an interest, a premium given or engaged for, and a risk run". Bell, *Principles of the Law of Scotland*, s 457.

[15] Nicholas Leigh-Jones, John Birds and David Owen, *MacGillivray on Insurance Law* 10th ed (2003), 1-1.

[16] Nicholas Leigh-Jones, John Birds and David Owen, *MacGillivray on Insurance Law* 10th ed (2003), 1-5.

uncertain and adverse event, in return for a money consideration.[17]

7.23 An adverse event is not the same as a requirement of insurable interest. "If the insured has an insurable interest in the subject matter of the insurance, the event will indeed be adverse to him, but the reverse is not true".[18] A child's mother may die (an adverse event for the child) but that child had no insurable interest in its mother's life.[19] Therefore, a concept of loss or adverse effect is implicit in these definitions but an insurable interest as required under statute is not.

7.24 However, Professor Angelo Forte describes the essentials of the modern contract of insurance under Scots law as follows: (1) the benefit received is money or money's worth; (2) the event insured against must involve some element of uncertainty; (3) there must be an insurable interest; and (4) the event insured against must be outwith the insurer's control.[20] The concept of insurable interest seems to be integral to a contract of insurance in Scots law.

7.25 In attempting to define insurance contracts, the courts are used to taking different factors into account.[21]

Defining insurance: accountancy and tax

7.26 For the purposes of accounting, IFRS 4 defines insurance contracts as

> a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder

7.27 Strict insurable interest (a legal pecuniary loss) as described in Part 3 is therefore not part of this definition, but an adverse effect is.

7.28 By contrast, however, tax guidance does make specific reference to insurable interest in its definition of insurance.

7.29 Notice IPT 1 on Insurance Premium Tax states that

[17] Malcolm A Clarke with Julian M Burling and Robert L Purves, *The Law of Insurance Contracts* 4th ed (2002), 1-1.

[18] Malcolm A Clarke with Julian M Burling and Robert L Purves, *The Law of Insurance Contracts* 4th ed (2002), 1-1E.

[19] See para 3.15 for Scots law.

[20] *The Laws of Scotland (Stair Memorial Encyclopaedia)* vol 12 para 802.

[21] The case of *Fuji v Aetna* [1994] 4 All ER 102 demonstrates this. This case concerned the nature of a single premium capital investment bond taking the form of life insurance. It was held at first instance that the contract was not insurance because there was uncertainty about when the money would become payable and it did not chiefly depend on the length of the insured life. However, the Court of Appeal (*Fuji Finance Inc v Aetna Life Ins Co ltd* [1996] 4 All ER 608, 618) arrived at a broad definition of life insurance – namely that the essence of life insurance is that "the right to benefits is related to life or death". The Court decided that therefore the bond was insurance.

> An insurance contract will display many or all of the [7] features listed below. …
>
> [Feature 3] The insured party must have an "insurable interest" in the subject matter of the insurance (that is, they must suffer a financial or other loss on the happening of the insured event).

7.30 However, it is "a financial or other loss", not statutory insurable interest. Insurance premium tax is payable on short term insurance contracts[22] at 5% or 17.5% where the insurance is sold at the same time as a particular good or service by the supplier of that good or service) whereas gambling has recently been declared "tax free" for gamblers.[23]

Conclusion – is insurable interest necessary to define insurance?

7.31 The conclusion that can be drawn from the paragraphs above is that the boundary between insurance and other contracts is not a precise matter. The FSA, the risk transfer market, tax, accountancy and the common law all concentrate on similar identifiers.

7.32 Scottish common law, the Inland Revenue guidance and Potts list insurable interest as being one amongst several factors that indicate a contract is insurance. However, others define insurance by reference to adverse events. Without some kind of interest in the affected subject matter, an event cannot be adverse to the policyholder. This therefore shows that interest loosely defined does play a role in distinguishing insurance from other contracts although statutory insurable interest as described in Parts 3 and 5 does not.[24] We therefore tentatively conclude that it is possible to define insurance without using the statutory insurable interest described in Parts 3 and 5 of this paper.

7.33 Australia has coped since 1995 without a statutory requirement for strict insurable interest, both for indemnity[25] and non-indemnity insurance. We have found no evidence that this has caused problems there when distinguishing insurance from other contracts.[26]

[22] Insurance premium tax does not apply to long term contracts of insurance. Life and other non-indemnity insurance tend to be long-term contracts. This section will therefore be of more relevance in the context of insurable interest for indemnity policies.

[23] Press release from HM Treasury 5 October 2001. The tax on betting stakes was abolished and replaced with a tax on bookmakers' gross profits.

[24] This is not the same as the indemnity principle which applies at the time of loss and is therefore irrelevant in deciding whether or not a risk transfer contract is insurance or something else.

[25] Which was abolished in 1984.

[26] However, we are told that insurable interest remains relevant in Australia for underwriting purposes. Email from Peter Mann, partner, Clayton Utz, to the Law Commission. Statutory insurable interest is therefore no longer used by the authorities or common law to distinguish contracts of insurance from other forms of business. Instead, it is used by underwriters to assess proposals and to determine risk.

IS INSURABLE INTEREST NECESSARY? MORAL HAZARD AND PREVENTION OF GAMBLING UNDER THE GUISE OF INSURANCE

7.34 We now need to consider the original reasons for the law on insurable interest – namely moral hazard and the prevention of gambling under the guise of insurance. Is insurable interest still necessary in both indemnity and non-indemnity contracts to prevent gambling in the guise of insurance and to reduce the risk of moral hazard, such as inducement to murder?

Non-indemnity insurance

Gambling

7.35 Gambling now seems to be widely accepted. Since November 1994, for example, there has been a National Lottery. The Gambling Act 2005[27] has repealed the Gaming Act 1845, so allowing for gambling contracts to be enforced through the courts. It is no longer public policy to prevent gambling – instead public policy is to regulate it. The original "mischief" that insurable interest was intended to prevent was not gambling itself but gambling in the guise of insurance. Nowadays the Commission set up by the Gambling Act 2005 regulates gambling whereas the FSA regulates both insurance and other financial contracts. The Gambling Commission and the FSA between them have power to govern and distinguish wagers and insurance, a level of regulation that was unthinkable when the original legislation requiring insurable interest was passed.

7.36 Insurers with whom we have had initial discussions are reluctant to part with a requirement for insurable interest. There is a fear that without it the industry could slip to the lowest common denominator and offer policies that look more like wagers than insurance. People are still gambling on the deaths of celebrities as they did in the eighteenth century when the Life Assurance Act 1774 was passed, only nowadays it is often done on the internet.[28] If a stranger could take out a policy of insurance on the life of someone else, they may well do so today. This may be a precautionary argument for retaining a requirement of statutory insurable interest to distinguish gambling from insurance.

Moral hazard

7.37 Moral hazard and the potential inducement to murder or fraud is still an important issue. The question is whether this merits the current restrictions on taking out insurance on another's life.

[27] Sections 334 and 335

[28] See http://www.coffindodgers.co.uk/index.asp and http://www.celebritysweepstake.co.uk .

7.38 The concept of insurable interest in life insurance was intended to prevent contracts of insurance creating incentives to murder. However several factors undermine its effectiveness. First, as policies can be so easily assigned and traded it is common for complete strangers to benefit from policies on other's lives. It does not appear that this has influenced homicide rates. Second, the relationship where murder is said to be most likely, that of marriage, creates an automatic unlimited insurable interest for the husband and wife in each other's lives in any event. These policies can be kept up, even after an acrimonious divorce. The existence of the police, criminal penalties and the Proceeds of Crime Act 2002[29] (which prevents anyone benefiting financially from wrongdoing) do a more effective job at preventing insurance becoming an incentive to murder than the concept of insurable interest.

Conclusion

7.39 In terms of academic argument, therefore, there appears to be little need for a continued requirement that the policyholder show an insurable interest in the subject matter of non-indemnity insurance. However, few other countries have dared to be as bold as Australia. We have discovered when carrying out initial discussions that there is an instinctive dislike of allowing strangers complete freedom to take out a policy on another individual's life.

7.40 Individuals are uncomfortable at the thought that people who do not wish them well can take out policies on their lives. Taking out an insurance policy on someone's life could be used as a threat. The current tests, whilst arguably overly restrictive, do ensure that there is a reason for the insurance – either natural affection or pecuniary loss of a kind recognised by law. This instinctive discomfort may be a precautionary argument to retain some form of statutory requirement for insurable interest in non-indemnity insurance. We therefore tentatively propose that insurable interest is retained as a requirement in non-indemnity contracts on lives. We will look later in this Part at how it can be amended to prevent some of the problems that it creates in its current form

7.41 **We ask whether there should continue to be a requirement for insurable interest in life insurance contracts**?

[29] The Proceeds of Crime (Scotland) Act 1995 applies in Scotland.

Non-life, non-indemnity insurance

7.42 The paragraphs above have concentrated on life insurance. We also need to consider non-life, non-indemnity insurance. As we saw in paragraph 3.64 it is theoretically possible to take out non-indemnity insurance policies on land, buildings, ships, goods and merchandise (that is insurance which pays a fixed sum on the destruction of these items, which does not compensate the policyholder for the amount of loss). At present under English law, only land and buildings (and possibly marine) insurance of this type requires the policyholder to show insurable interest. It is clear that allowing a stranger to insure your house or company buildings could be a threat where there is no clear reason for the insurance. On the other hand, such policies for pre-agreed sums can provide an element of certainty. Do broad social policy concerns mean that statutory requirements for insurable interest should apply to non-indemnity insurance policies on land and buildings? Are the same threats present for non-indemnity insurance of ships, goods and merchandises and should insurable interest be required for non-indemnity insurance of these matters?

7.43 **We ask whether there should continue to be a requirement for insurable interest in other forms of non-life, non-indemnity insurance**?

Indemnity insurance

Gambling and moral hazard

7.44 A requirement of loss will prevent wagering being disguised as insurance in indemnity insurance contracts. The indemnity principle demands some kind of financial interest in the subject matter of the insurance as, without such an interest, the policyholder cannot suffer loss and be compensated for it.

7.45 Likewise for moral hazard, the indemnity principle will ensure that the policyholder suffers a loss should the subject matter of the insurance be destroyed, thus minimising moral hazard.

Conclusion

7.46 In indemnity insurance it is difficult to see what a statutory requirement of insurable interest added to the common law indemnity principle, certainly if insurable interest was only demanded at the time of loss. The indemnity principle enables parties to define the risk and the extent of the policy in a more subtle way than the strict legal or equitable right demanded by the statutory requirement of insurable interest. By contrast the statutory concept of insurable interest appears only to introduce uncertainty. Since the Gambling Act 2005 it is especially uncertain whether it applies under English law. If agency law allows a householder to insure the possessions of the rest of his household and the insurer knowingly accepts that risk, why should the policyholder risk non-payment of his claim for lack of statutory insurable interest?

7.47 In the end, this could be a distinction without a difference. The traditional statutory concept of insurable interest was stretched so far in recent years that it is possible to argue that there was no longer much difference between it and the indemnity principle. If it is not reintroduced, the emphasis will firmly be on the contract that is agreed between the insured and the insurer. The contract would become the sole arbiter of what matter was insured against what risk. If a loss was suffered by the policyholder that fell within the definition of loss in the contract then there would be certainty on both sides that the contract was valid and as to the amount to be paid.

7.48 It appears that the indemnity principle provides a way of judging loss and creating contract certainty. It also provides some protection against moral hazard and the risk of gambling in the guise of insurance. We therefore conclude that the statutory requirement for insurable interest in indemnity insurance should not be reinstated.

7.49 In Scots law, insurable interest is a common law requirement and it is unlikely that the requirement for it has been abrogated by the Gambling Act 2005. Nevertheless, the indemnity principle also applies to Scottish contracts of indemnity insurance and would protect against moral hazard or gambling in the guise of insurance in the same way as it does in contracts of indemnity insurance made under English law. Our tentative view is therefore that the requirement of insurable interest in Scots law should be abolished insofar as it applies to indemnity insurance. If it is not, then problems may arise as to where and under which law the contract is concluded. We would particularly welcome views on this issue from Scottish respondents.

7.50 **We tentatively propose that no requirement of insurable interest should apply to indemnity insurance contracts. Instead, the indemnity principle can and should govern the position. As this will be a greater change for Scots law than for English law we would particularly welcome views on this from Scottish respondents**.

Timing of interest

7.51 There is another point to be discussed, which relates to the timing of the insurable interest in indemnity insurance. In preliminary discussions insurers have expressed concern at the fact that insurable interest is no longer required at the outset of an indemnity contract.[30] However, it is unlikely (with the possible exception of policies on land and buildings) that under English law insurable interest was ever required at the outset of indemnity insurance, even before the Gambling Act 2005 changed the position.[31] Instead the most that could be said is that policyholders had to show that they had an expectation of acquiring an interest to distinguish the contract from a wager.

7.52 Insurers appear to consider, as with non-indemnity insurance, that there is a need to prevent the market slipping to the lowest common denominator and offering products that are more akin to gambling than insurance. This requirement of an expectation of interest prevents their competitors from offering products which will never result in payment and which bring the industry into disrepute. It would also benefit the purchasers of insurance. Insurance contracts which purport to indemnify the policyholder for a loss which he can never suffer are worthless. I can insure my father's car but I have no expectation of suffering a loss should it be stolen. The policy therefore will not compensate me as I will never be able to show a loss for the purpose of the indemnity principle.

7.53 Should there be some legal requirement on insurers to check that there is an expectation that an interest could be created which would give rise to a loss which will satisfy the indemnity principle? Arguably, this is all part of the treating customers fairly initiative and insurers should not be permitted to sell the wrong policy to the wrong person. However, would a legal requirement to inquire about (or a legal requirement for) an expectation or chance of loss at the outset of the contract assist? We should be interested to hear views on this.

7.54 **We ask whether there should be a legal requirement on insurers to check that policyholders have an expectation or a chance of loss at the outset of an indemnity contract of insurance or should such matters be left to regulation**?

[30] On an unrelated point, insurers have also expressed concern that the abolition of insurable interest will lead to an increase in fronting. In the scoping paper concerns were raised about 'fronting'. This is where parents insure cars, which are really for the use of their children, in an attempt to reduce the premiums charged. (The parent insures the car in their name as the first driver and their child as an additional driver, even though the car is only being used by the child). Respondents were concerned that if the rules on insurable interest were relaxed, this practice might be permitted. This will not be the case. Insurers need to be careful to define the policy and to ask questions of the parents when the contract is made. If misrepresentations are made or the family is acting outside the terms of the contract then the insurer would have a remedy for deliberate or reckless misrepresentation or breach of contract. The traditional rules on insurable interest would not add to this.

[31] In terms of the common law in Scotland, interest is required at the outset of a contract of indemnity insurance.

AMENDMENT OF THE STATUTORY REQUIREMENT OF INSURABLE INTEREST IN LIFE INSURANCE CONTRACTS

7.55 We have asked above at paragraph 7.41 whether there should continue to be a statutory requirement for insurable interest in life insurance. If the requirement continues then we consider it is in need of reform. The current classes are restrictive and prevent insurance when it would be socially useful.

7.56 **We tentatively propose that the law relating to insurable interest in non-indemnity life insurance should be amended**.

Natural affection

7.57 It would be possible to expand the current category of natural affection so that it covered more than simply one's own life and the life of a spouse.[32] Appendix A shows how other jurisdictions have done this.

7.58 New York law states that anyone who is closely related by blood or law can establish an insurable interest in that relation's life. Canadian law sets out a list of relationships where an insurable interest is deemed to exist – grandchildren, children and parents, spouses and same-sex partners.

7.59 In Australia insurable interest was abolished in 1995. However before it was abolished the Australian parliament introduced legislation to widen the classes of people who could establish insurable interest. Whilst no longer in force, the 1984 Australian model is instructive when looking at amendment. It widened the category of natural affection to include the relationship of parents, guardians and children.

7.60 As was discussed in Part 4, it is currently difficult for close family members to take out insurance on each other's lives. We therefore propose that the classes of relationship which give rise to insurable interest arising out of natural affection should be widened.

7.61 **We tentatively propose that the category of insurable interest supported by natural affection should be increased, giving a larger class unlimited rights to insure others' lives**.

7.62 **We tentatively propose that the following groups should be deemed to have insurable interest arising out of natural affection**:

(1) **any person – in his or her own life and in the life of his or her spouse or civil partner**;

(2) **any person who is cared for and dependent on his or her parent or guardian – in the life of his or her parent or guardian**;

(3) **any parent - in the life of his or her adult child**;

(4) **any person – in the life of his or her cohabitant**.[33]

[32] See para 3.35 for the law on insurable interest for civil partners.

[33] The Law Commission and the Scottish Law Commission are considering definitions of cohabitant.

7.63 Are the family relationships above broad enough? Would there be any benefit in taking the New York approach of allowing all relationships of blood or law to have the right to insure each other's lives for unlimited amounts?

7.64 **We ask what should be done about other relationships. In particular**:

(1) **should parents have an interest in the lives of their children under 18**?

(2) **should fiancé(e)s have interests in each other's lives**?

(3) **should siblings have interests in each other's lives**?

(4) **should grandparents and grandchildren have interests in each other's lives**?

7.65 At present where there is a relationship of natural affection between the policyholder and the life insured, then insurance can be taken out for an unlimited amount. We tentatively propose that this should continue to be the case for the larger class of relationships in any new category of natural affection. If the amount is limited, then problems will arise in deciding how to value the life insured and, as we have seen in the family context, it is particularly difficult to do this. We ask for views on this.

7.66 **We tentatively propose that where there is a relationship of natural affection between the policyholder and the life insured, then the policyholder should be permitted to insure that life for an unlimited amount**.

Other relationships of economic dependence

7.67 At present, the law states that insurance can be taken out when the policyholder has an interest in the life insured which is pecuniary and recognised by law at the time of the contract. The problem with this is that it restricts both those who can take out insurance and the amount that they can insure for. As we saw in Part 4, a lender may not be able to insure the life of a debtor for an amount which covers future interest payments and key employee insurance is uncertain.[34] There is also some uncertainty surrounding group schemes taken out by employers on the lives of their employees to provide them with, for example, death in service benefits.[35]

[34] See para 4.11.

[35] See para 3.61.

7.68 This was a further area considered by the Australians in their law reform proposals of 1982. They relaxed the test for establishing an insurable interest so that it became pecuniary or economic loss, rather than a strict pecuniary interest recognised by law.[36] As a result any person who is likely to suffer a pecuniary or economic loss as a result of the death of another would have an insurable interest in the life of that person. We propose that allowing an expectation of pecuniary loss to create insurable interest would mean that cover could be bought for reasonable future expenses, such as interest payments on a debt and on the loss of business which would be suffered following the departure of a key employee. It would prevent an employer insuring the life of the office tea-man for £3 million but would allow him to insure the life of a key board member for that amount. However, the nature of non-indemnity insurance is that a set amount is paid regardless of the loss. The responsibility must therefore be placed firmly on both insurer and policyholder to check that the expectation of loss is reasonable at the outset of the contract. If they do not then moral hazard would be created and the contract would in effect become gambling in the guise of insurance.

7.69 **We tentatively propose that the category of insurable interest supported by a legal pecuniary loss should be amended by relaxing the test applied. We tentatively propose that the requirement should be that the policyholder has a reasonable expectation of pecuniary or economic loss on the death of the life insured, rather than a pecuniary interest recognised by law**.

7.70 **We tentatively propose that policyholders with an interest based on this category of pecuniary or economic loss should be able to insure the life for the value that is equivalent to the reasonable expectation of the loss. We ask whether this requirement should be included in legislation or whether regulation would be more appropriate**?

Consent of the life insured

7.71 There are strong arguments for incorporating the consent of the person whose life is insured as a condition of valid life insurance.

7.72 It could be argued that it is not right in principle for someone to take out insurance dependent on another's death without first obtaining that person's consent. It is unlikely to be a matter of indifference to anyone that insurance had been effected on their life.

[36] The wording in the draft bill suggested by the Australian Law Commission was "any person who is likely to suffer a pecuniary or economic loss as a result of the death of some other person has an insurable interest in the life of that other person". It meant that a body corporate could insure the life of an officer or employee and that employers and employees could insure each other's lives.

7.73 In New York, for example, even if the policyholder can establish a "lawful and substantial economic interest in the continued life" of the life insured, that life insured must also consent to the insurance. In Germany, consent of the life insured is necessary before insurance can be taken out on anyone's life for the value of more than it would cost to bury that person.[37]

7.74 However, to impose a requirement of consent in all cases would create other problems. What, for example, should be done about those who refuse to consent to insurance being taken out on their lives, even though there would currently be a valid insurable interest? Should there be some kind of requirement that consent will not unreasonably be withheld?

7.75 It may also be impractical in commercial situations – for example, a bank wishing to insure its debtors or employers wishing to insure the lives of their employees. It would add to the administrative burden in circumstances where there is arguably a low likelihood of an incentive to murder being created. Added to this are the evidential problems. Would the consent need to be witnessed, for example? In domestic situations it may in practice be difficult for a vulnerable life insured to refuse consent. As things already stand, with a sum insured of any size, the life to be insured is likely to become aware of the application in any event because of medical underwriting requirements.

7.76 In the light of these concerns, we do not propose that consent should become the sole requirement or be an additional requirement for insurable interest in the UK. It would involve an unnecessary layer of administration and practical difficulties.

7.77 Other jurisdictions (for example Canada[38] or Spain) use consent as an alternative way of establishing insurable interest when a pecuniary interest or an interest arising out of natural affection cannot be found.

7.78 Using consent as an alternative like this would solve the problems faced by those who have an interest in the lives of others but who cannot establish a pecuniary interest recognised by law, while preventing insurance being taken out without the knowledge of the person insured. We believe that this would ensure that the categories remain flexible.

7.79 **We tentatively propose that consent of the life insured should provide an alternative ground for establishing insurable interest, where the policyholder and the life to be insured do not fit within the categories of natural affection or a reasonable expectation of loss**.

[37] Article 159 of the German Insurance Contract Law provides:

(1) Life insurance may be effected on the person of the policyholder or of another.

(2) If the insurance is effected for the event of the death of another person, and if the agreed payment exceeds the amount of ordinary burial costs, the written consent of the other person is required for the validity of the contract. If the other person lacks legal competency, or if his legal competency is restricted, and if the policyholder is his representative in matters concerning his person, the policyholder may not represent the other person in giving the consent.

[38] Insurance Act 1974 (Quebec) s2508, and Insurance Act (Ontario), RSO 1970 s 255(2)(b).

7.80 **We ask whether policyholders with an interest based on consent should be permitted to insure the life for whatever value the life insured has consented to or whether it should be limited to the value of the expectation of the loss**?

Group life insurance

7.81 It is currently unclear how insurable interest is to be found in group life or critical illness insurance schemes. Such schemes are offered as an employee benefit with the sum insured generally calculated as a multiple of salary. Group insurance schemes covering employee benefits are often written through a discretionary trust that is commonly associated with a pension scheme. However this is not always the case. A significant amount of life insurance and critical illness insurance is written through employer sponsored group schemes. We consider that the law should assist such an important part of the protection market.

7.82 As we saw in paragraph 3.61, *Simcock*[39] held that the value of an employee's life to his or her employer is limited to the cost of that employee's notice period. However that case was closer in concept to "key employee" insurance where the insurance proceeds are paid to the employer rather than an employee benefit scheme where the insurance proceeds are paid (sometimes via a trust) to the employee's estate or another beneficiary. The more recent case of *Feasey*[40] appeared to find that the rules on proving insurable interest for policies on many lives over long periods of time were less strict. This would assist the position of group schemes. Nevertheless the position is less clear than it should be and in addition, there have been suggestions that the current rules prevent employers being able to offer benefits to the families of employees.

7.83 There is also a second issue. The employee's entitlement to the benefits underwritten in the group scheme arises by virtue of their contract of employment. Employers have a clear insurable interest in a *contractual liability* although it is less clear that they have insurable interest in the *lives* of their employees for such large amounts. However the insurers underwriting the group scheme may be unwilling or unable to underwrite what is in effect liability insurance of the employer as opposed to the risk of the lives insured.

7.84 **We ask whether special rules are necessary or would be advantageous for the group life industry**?

7.85 **We ask whether employers taking out group policies should be exempt from showing a reasonable expectation of loss on an employee's death. This would enable them to offer death in service benefit to the employee, to their spouses or other family members, of an unlimited amount**.

7.86 **We tentatively propose that group life schemes should be treated as being insurance on lives rather than insurance of a third party liability**.

[39] *Simcock v Scottish Imperial Ins Co* (1902) 10 SLT 286, 288.

[40] *Feasey v Sun Life Assurance Co of Canada* [2003] EWCA Civ 885

Remedy

7.87 We need to consider the remedy for a contract in which the policyholder cannot show insurable interest in the life insured. In their 1982 reforms, the Australian Law Reform Committee proposed that the consequence of a lack of insurable interest was that the policy was void, rather than illegal. We tentatively propose that this should be adopted in the UK. Policyholders who are found not to have sufficient interest in the life insured will then at least have their premiums returned.

7.88 **We tentatively propose that a contract of non-indemnity life insurance without insurable interest should be void, not illegal**.

7.89 One further question which was discussed in the context of indemnity insurance at 7.53 above is whether there should be an obligation on insurers to check that a valid insurable interest exists. We would be interested in views on whether it there should be an obligation on insurers to check that a valid insurable interest exists at the outset of any contract. Should insurers who fail to inquire be prevented from relying on lack of insurable interest as a defence to a claim? Alternatively, is this already covered by the treating customers fairly initiative?

7.90 **We ask whether insurers should be required to inquire whether a valid insurable interest exists at the outset of any contract of life insurance**.

Composite policies

7.91 Composite policies are those that combine standard indemnity insurance with life or personal accident benefits in one policy. An example would be a travel policy that will repay medical expenditure incurred abroad (indemnity element) as well as paying lump sums for loss of limbs or disablement. At present, if the life or personal accident element is found to be illegal for lack of insurable interest, the whole contract falls.

7.92 To prevent this from occurring we tentatively propose that composite policies should be declared to be separable.

7.93 **We tentatively propose that composite policies should be declared to be separable. If a policy combines indemnity insurance with non-indemnity benefits then, if there is insufficient insurable interest for the non-indemnity part of the policy, only that part of the policy should fall**.

Assignment of policy and lapse of insurable interest

7.94 We have not yet dealt with circumstances when insurable interest lapses, for example on divorce or the end of employment or repayment of debt or with circumstance where the policyholder does not have an interest in the life insured because the policy has been traded. It can easily be argued that the threat of moral hazard or gambling in the guise of insurance are particularly strong in these examples. The lives insured have no control over who will benefit from their deaths. Some argue that a mechanism should be introduced whereby the life insured is given the option of taking over the policy by paying future premiums or a right of pre-emption in favour of the life assured when the policyholder wishes to assign the policy. Alternatively should consent be required from the life insured when the policyholder wishes to assign the policy? We do not put this forward as a tentative proposal as we believe that the consequences of any such reform would cause practical problems in the TEPS market and destabilise insurance products as investment vehicles. However, academically it is hard to justify keeping a requirement for insurable interest at the outset if the policy can be immediately traded to a stranger or continued when the interest has lapsed. We would be interested to receive views on the risks of moral hazard and insurance in the guise of gambling in these circumstances and ask whether there is a need for reform.

7.95 **We ask whether there is a need to reform the law to cover the situation when a policy is assigned or when insurable interest lapses**?

FURTHER POINTS OF REFORM

Marine insurance

7.96 A further question is whether the criminal penalties for making a contract of marine insurance without insurable interest should remain. It is currently unclear whether there is a requirement for insurable interest in contracts of marine insurance. We propose above that the indemnity principle provides sufficient safeguards and that statutory insurable interest is unnecessary. In order to bring the criminal law into line with this, the Marine Insurance (Gambling Policies) Act 1909, which imposes criminal penalties for entering into a contract without insurable interest, needs to be repealed. In any event, the Act has not been used to bring any criminal prosecutions.

7.97 **We tentatively propose that the criminal penalty imposed by section 1(1) of the Marine Insurance (Gambling Policies) Act 1909 should be abolished. It should no longer be an offence to enter into a contract of marine insurance where there is no insurable interest**.

The names of interested parties

7.98 Statute also governs whether the names of those interested in insurance should be entered into the policy. The current position appears to be that it is necessary for life, goods and marine insurance but not for land, buildings or liability insurance.

7.99 Some argue that writing the names of those interested into a policy is essential to enable insurers to deal with the common law rules of undisclosed agency. These allow an agent to purport to contract on his own behalf but in reality to contract on behalf of a principal. The undisclosed principal has the right to assert that he is a party to the agreement at any time. One of the justifications for retaining a requirement for names to be entered is that insurers need to know who is interested in or would benefit from a policy in order to estimate the extent of the potential liability or loss.

7.100 However, this kind of information is fundamental to assessing the risk and will be established through normal pre-contractual enquiries. If it is withheld or misrepresented, then insurers would have a remedy. A reasonable insured would realise that insurers would need to know this information. A statutory requirement to write the names into some policies but not others is unnecessary and inconsistent. Whether interested parties are written on the policy should not determine that a goods policy is void, when an identically worded building policy would be valid.

7.101 **We therefore tentatively propose that the law should not permit insurers to avoid policies only by reason that the names of the persons interested are not specified in the policy document**.

PART 8
LIST OF PROPOSALS

INTRODUCTION

8.1 In this part we have put together all the tentative proposals and questions we have asked in this Issues Paper. We have added the paragraph reference to the place in the text where each question or tentative proposal is discussed. It will often be necessary to look back at the paragraph reference to set the question or proposal in context.

SHOULD THERE BE A REQUIREMENT FOR INSURABLE INTEREST?

Non-indemnity insurance

8.2 We ask whether there should continue to be a requirement for insurable interest in life insurance contracts? (7.41)

8.3 We ask whether there should continue to be a requirement for insurable interest in other forms of non-life, non-indemnity insurance? (7.43) (That is, valued policies on, for example, land or buildings.)

Indemnity insurance

8.4 We tentatively propose that no requirement of insurable interest should apply to indemnity insurance contracts. Instead, the indemnity principle can and should govern the position As this will be a greater change for Scots law than for English law we would particularly welcome views on this from Scottish respondents. (7.50)

8.5 We ask whether there should be a legal requirement on insurers to check that policyholders have an expectation or a chance of loss at the outset of an indemnity contract of insurance or should such matters be left to regulation? (7.54)

IF A REQUIREMENT OF INSURABLE INTEREST IN LIFE INSURANCE CONTRACTS IS RETAINED, SHOULD IT BE AMENDED?

Insurable interest based on natural affection

8.6 We tentatively propose that the category of insurable interest supported by natural affection should be increased, giving a larger class unlimited rights to insure others' lives. (7.61)

8.7 We tentatively propose that the following groups should be deemed to have insurable interest arising out of natural affection: (7.62)

(1) any person – in his or her own life and in the life of his or her spouse or civil partner;

(2) any person who is cared for and dependent on his or her parent or guardian – in the life of his or her parent or guardian;

(3) any person – in the life of his or her cohabitant;

(4) any parent – in the life of his or her adult child.

8.8 We ask what should be done about other relationships. In particular: (7.64)

(1) should parents have an interest in the lives of their children under 18?

(2) should fiancé(e)s have interests in each other's lives?

(3) should siblings have interests in each other's lives?

(4) should grandparents and grandchildren have interests in each other's lives?

8.9 We tentatively propose that where there is a relationship of natural affection between the policyholder and the life insured, then the policyholder should be permitted to insure that life for an unlimited amount. (7.66)

Insurable interest based on economic loss

8.10 We tentatively propose that the category of insurable interest supported by a legal pecuniary loss should be amended by relaxing the test applied. We tentatively propose that the requirement should be that the policyholder has a reasonable expectation of pecuniary or economic loss on the death of the life insured, rather than a pecuniary interest recognised by law. (7.69)

8.11 We tentatively propose that policyholders with an interest based on this category of pecuniary or economic loss should be able to insure the life for the value that is equivalent to the reasonable expectation of the loss. We ask whether this requirement should be included in legislation or whether regulation would be more appropriate? (7.70)

Consent

8.12 We tentatively propose that consent of the life insured should provide an alternative ground for establishing insurable interest, where the policyholder and the life to be insured do not fit within the categories of natural affection or a reasonable expectation of loss. (7.79)

8.13 We ask whether policyholders with an interest based on consent should be permitted to insure the life for whatever value the life insured has consented to or whether it should be limited to the value of the expectation of the loss? (7.80)

Insurable interest in group policies

8.14 We ask whether special rules are necessary or would be advantageous for the group life industry? (7.84)

8.15 We ask whether employers taking out group policies should be exempt from showing a reasonable expectation of loss on an employee's death. This would enable them to offer death in service benefit to the employee, to their spouses or other family members, of an unlimited amount. (7.85)

8.16 We tentatively propose that group life schemes should be treated as being insurance on lives rather than insurance of a third party liability. (7.86)

Remedy

8.17 We tentatively propose that a contract of non-indemnity life insurance without insurable interest should be void, not illegal. (7.88)

8.18 We ask whether insurers should be required to inquire whether a valid insurable interest exists at the outset of any contract of life insurance. (7.90)

Composite policies

8.19 We tentatively propose that composite policies should be declared to be separable. If a policy combines indemnity insurance with non-indemnity benefits then, if there is insufficient insurable interest for the non-indemnity part of the policy, only that part of the policy should fall. (7.93)

Assignment or lapse of interest

8.20 We ask whether there is a need to reform the law to cover the situation when a policy is assigned or when insurable interest lapses? (7.95)

FURTHER POINTS OF REFORM – NON-INDEMNITY AND INDEMNITY INSURANCE

Criminal penalties for marine insurance

8.21 We tentatively propose that the criminal penalty imposed by section 1(1) of the Marine Insurance (Gambling Policies) Act 1909 should be abolished. It should no longer be an offence to enter into a contract of marine insurance where there is no insurable interest. (7.97)

The names of interested parties

8.22 We tentatively propose that the law should not permit insurers to avoid policies only by reason that the names of the persons interested are not specified in the policy document. (7.101)

ADDITIONAL QUESTIONS

8.23 In addition to the specific proposals and questions raised above, we have asked various general questions in the course of this Issues Paper. These relate to areas where it would be particularly helpful to us to have more information.

Non-indemnity insurance

8.24 At paragraphs 3.60 to 3.63 we have set out examples of areas where it is common to take out insurance but where the products offered do not immediately fit within the categorisation of insurable interests discussed at 3.8 to 3.47. The examples relate to group life insurance, prospective key employee insurance and travel insurance. We would be grateful for comments on these scenarios. (3.60 to 3.63)

8.25 We should also be grateful for information on non-life, non-indemnity policies. These are valued policies that, for example, pay a set amount on the destruction of property. We discuss this type of insurance at paragraphs 3.64 to 3.68. In particular we would be interested to know whether they are offered by insurers and, if so, how often. It is apparent to us that it is this category of policy which most closely resembles credit derivatives and other forms of risk transfer product. (3.68)

Indemnity insurance

8.26 At paragraphs 5.47, 5.48 and 5.50 we have also set out examples of indemnity insurance policies that do not fit easily within the categorisations of insurable interest described in that Part or where it is unclear how the indemnity principle applies. The examples relate to insurance of an honour payment and contents insurance. We would be most grateful for any comments on those examples. (5.47, 5.48 and 5.50)

APPENDIX A
COMPARATIVE LAW

INTRODUCTION

A.1 This appendix describes the approach taken to insurable interest in other jurisdictions.

LIFE INSURANCE

Australia

A.2 Before 1984, the Australian legal system applied the Life Assurance Act 1774 to life policies (as well as their own Life Insurance Act 1945, which set out categories of relationships that carried an insurable interest[1]). In 1984, following a report from the Australian Law Reform Committee, the 1984 Insurance Contracts Act was passed. This amended and relaxed the rules on insurable interest on lives. In 1995, the position was changed again when the Insurance Contracts Act was amended to abolish the concept entirely for lives. Both the 1984 and the 1995 reforms are described below.

1984 reforms

A.3 Insurable interest was reformed in the Insurance Contracts Law Act 1984 in four respects.

A.4 First unlimited insurable interests were created for the following classes of people:

(1) Any person – in his own life and in the life of his spouse.

(2) A parent or guardian of a person who has not attained the age of 18 – in the life of that person.

(3) Any person who is likely to suffer a pecuniary or economic loss as a result of the death of some other person – in the life of that other person. For example

(a) a body corporate – in the life of an office or employee of the body corporate

(b) an employer – in the life of his employee and an employee has an insurable interest in the life of his employer; and

(c) any person – in the life of person on whom he depends, either wholly or partly for maintenance and support.

[1] Life Assurance Act 1945 (Australia) section 86(1).

A.5 This in effect broadened the category of natural affection (where it is not necessary to show a pecuniary loss) to include the relationship of parents and children. However, it did not extend to cohabitants or civil partnerships. These two categories would still have needed to show a relationship of economic dependence or a likely economic loss on the death of their partner before they could obtain life insurance.

A.6 Second, the Australians relaxed the requirement for all relationships outside that of natural affection to show a pecuniary loss recognised by law. As in England and Wales, a person wanting to prove an insurable interest in Australia for any relationship that was based on anything other than natural affection had to show a legal pecuniary loss. The Australian Law Reform Committee concluded that this was too onerous a requirement. Instead they advocated a more flexible concept of economic loss. "Insurable interest", they concluded, "exists if the insured, independent of the policy of insurance, will gain economic advantage from the continued existence [of the life] or will suffer economic disadvantage on damage to [the life]."[2]

> Legislation should provide that, where an insured is economically disadvantaged by… destruction [of the life], the insurer should not be relieved of liability by reason only that the insured did not have a legal or equitable interest in the [the life].[3]

A.7 The reason they gave for relaxing the requirement was that it restricted insurance unnecessarily. They gave the following examples of situations where it was impossible to obtain life insurance:

(1) the interest of a beneficiary in the life of a testator (in relation to payment of death duties);

(2) the interest of a business man in the life of his partner (in relation to possible loss of future profits);

(3) the interest of a company in the life of a key person in a related company (in relation to possible loss of future profits);

and concluded that "none of these cases infringes the policy against wagering or the policy against unnecessarily creating a temptation to murder the life insured. To avoid these problems it would be sufficient to restate the general test of interest in terms of reasonably apprehended economic loss rather than, as at present, in terms of strict pecuniary interest". [4] This change could be seen in the Insurance Contracts Act 1984 at section 19:

> any person who is likely to suffer a pecuniary or economic loss as a result of the death of some other person has an insurable interest in the life of that other person.

A.8 Third, they abolished the requirement to name any beneficiary of the policy, as was required under section 2 of the Life Assurance Act 1774.

[2] Australian Law Reform Committee Report No 20, para 120.

[3] Australian Law Reform Committee Report No 20, para 120.

[4] Australian Law Reform Committee Report No 20, para 138.

A.9 Fourth, they stated that the consequence of a lack of insurable interest was that the policy was void, rather than illegal.

1995 reforms

A.10 In 1995 the law in Australia on insurable interest in life policies changed again and the statutory requirement for an insurable interest was abandoned entirely.[5] It is now wholly the decision of insurers which risks are written. We are told that the categories of insurable interest in the life of another remain important for underwriting purposes.

A.11 The reason for the wholesale abolition was that:

> the rationale behind the previous insistence on that requirement – the reduction of the temptation to murder the life insured in the hope of obtaining the proceeds from the life insurance, and the discouragement of wagering and gaming – apparently no longer holds sway.[6]

In addition it appears that even after the reforms, the courts' time was still being taken up with trying to work out whether de facto relationships would count or whether a person was likely to suffer a pecuniary or economic loss as the result of the death of another person.

A.12 The current situation is Australia is therefore that if a person is so minded, and can find an insurer to contract with, that person can insure the life of any other person, prominent or otherwise.

New York

A.13 The New York State Insurance Act requires those taking out life insurance policies to demonstrate an insurable interest in the life insured, unless the benefits of the insurance are payable to the person whose life is insured.

A.14 According to section 3205(1) of the New York State Insurance Act, interest can be divided into the following categories:

(1) in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection;

(2) in the case of other persons, a lawful and substantial economic interest in the continued life, health or bodily safety of the person insured, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the insured.

A.15 The first classification is very similar to the category of natural affection under English insurance law, as the insured does not have to prove any economic or legal interest in the life assured. However, this category is wider than the natural affection category as it would cover most family members who are related by blood or in-laws, as opposed to being confined only to the spouse.

[5] The Life Insurance (Consequential Amendments and Repeals) Act 1995.

[6] Kenneth Sutton, *Insurance Law in Australia* (3rd ed) at para 6.33.

A.16 The second classification is also similar to the English category of an interest arising out of a potential financial loss that is recognised by law. However, unlike English law, the category is restricted to an interest in the continuing life, not one that would arise on death, disablement or injury.

A.17 As long as the policyholder can establish that the benefits of the insurance are payable to the person whose life is insured, the policyholder does not have to establish an insurable interest in that persons life. In contrast a contract will only be legal under English law if the policyholder has an insurable interest in the life of the assured, irrespective of whether or not the person insured will benefit under the policy.

A.18 The consent of the life insured is compulsory under New York law. Where a person takes out life insurance on the life of another person, the other person (provided they are of lawful age and are competent to contract) must give written consent at the time or before the contract is made.[7]

A.19 An employer has an insurable interest in the lives of any of its employees but this is limited. The amount of life insurance cannot exceed the costs of employee and/or retiree benefits that have already been incurred in connection with the employee benefit plan, plus the projected future costs of such benefits as established by the employer.[8]

Canada

A.20 In Canada, each province enacts its own Insurance Act. Each Act includes an almost identical section relating to life insurance, so the law on life insurance is uniform throughout Canada (except Quebec). This is known as the Uniform Life Insurance Act, agreed upon by the Canadian Council of Insurance.[9]

A.21 According to s178, a contract is void if the policyholder cannot demonstrate an insurable interest in the life insured at the time the contract takes effect. However, there are exceptions to this rule – contracts of group insurance[10] do not need to demonstrate insurable interest.

[7] New York State Insurance Act, s 3205(3)(c). The requirement for consent is waived for:

- a person who takes out insurance on the life of their spouse.
- a person who has an insurable interest in the life of a minor under the age of fourteen years and six months or a person upon whom the minor is dependant for support and maintenance, up to a maximum amount of $25,000.
- a person who has entered into group life insurance, group or blanket accident and health insurance, or family insurance.

[8] New York State Insurance Act s3205(3) and (4).

[9] In this memo, references are to the Act in Ontario, (Insurance Act (Ontario) R.S.O 1990 c18) which is almost identical to the Act in other common law provinces.

[10] Under section 171 of the Insurance Act (Ontario) RSO 1990, a group insurance is defined as the following: “Group insurance” means insurance, other than creditor’s group insurance and family insurance, whereby the lives of a number of persons are insured severally under a single contract between an insurer and an employer or other person.

A.22 The Act lists circumstances in which the policyholder would have an insurable interest in the life insured. The purpose of the Act is to give an indication of relationships which indicate that the contract is not a wager. The list is given without limitation and so if other circumstances arise where it is possible to demonstrate that gambling is not involved, then these too could provide the basis for a valid insurable interest.

(1) Any person – in their own life.

(2) A parent or grandparent – in the life of their child or grandchild.

(3) Any person – in the life of their spouse or same-sex partner.

(4) Any person – in the life of any person upon whom they are wholly or in part dependent on, or from whom they are receiving support or education.

(5) An employer – in the life of their employee.

(6) Any person – in the duration of whose life that person has a pecuniary interest.

A.23 Finally, any insurance contract will be valid if the person whose life is insured has consented in writing to being the subject matter of the contract.[11]

Spain

A.24 In Spain, insurance is a contract by which one of the parties seeks to protect against loss deriving from a previously held "intent". This can be contrasted with gambling where interest arises only out of the gambling contract itself.

A.25 According to Article 83 of the Insurance Contracts Act Law Number 50/1980, insurance can be arranged on one's own life or on that of another. If the insured and the person whose life is being insured are different persons, it is necessary to obtain written consent from that other person. However, consent would not be necessary where the policyholder's interest in the existence of the insurance can be presumed.[12]

A.26 Where the person whose life is insured under the contract is a minor, written consent will need to be obtained from their legal representatives. The Act prohibits life insurance being arranged for anyone who is incapacitated or under the age of 14.

[11] Insurance Act (Ontario) R.S.O 1990 c18 s 178(2). In the case of a minor under the age of sixteen, consent has to be provided by one of his or her parent or by their guardian (Insurance Act (Ontario) R.S.O 1990 c18 s 178(3)).

[12] Miguel Seoane and Ricardo Juanes de Toledo, International Insurance Law and Regulation – Spain (2006) at 24. We do not know in what circumstances interest can be presumed.

Slovakia

A.27 In Slovakia there does not appear to be a requirement for the policyholder to have an interest in the life insured. However, gambling contracts cannot be enforced[13] which would imply that insurable interest perhaps plays a role in distinguishing valid insurance from gambling. There is a prohibition on contracts that groundlessly infringe the rights and lawful interests of others.[14]

INDEMNITY INSURANCE

Australia

A.28 The Australians abolished insurable interest for indemnity insurance in 1984. Section 16 of the Insurance Contracts Act 1984, states that a contract of insurance is not void merely because the insured did not have an insurable interest at the time of entering into the contract.

New York

A.29 The New York State Insurance Act,[15] states that no insurance property contract would be enforceable for the benefit of any person who does not have an insurable interest in the property insured. Insurable interest is defined under the provision as:

> Any lawful and substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage.

It is therefore clear that a strict requirement for a lawful and substantial economic interest remains in New York law.

Canada

A.30 Section 7 of the Marine Insurance Act 1993 states that a policyholder can only recover under a contract for a loss (that is, an indemnity contract), if that policyholder had an insurable interest in the subject matter insured at the time of the loss. This appears to be similar to the indemnity principle under UK law.

A.31 A contract by a way of gaming or wagering is void in Canada under section 18 of the Marine Insurance Act 1993. Therefore, to prevent a contract from being void, the insured must either have an insurable interest or an expectation of acquiring an interest at the time the contract is concluded.

A.32 Where the subject matter of the contract is property, a “property rights test” is applied by the courts. This involves an insurable interest being tied to a legal or equitable right in the property, for example, an individual who holds title in a residential property will have an insurable interest.

[13] Paragraph 845 (1) of the Slovak Civil Code.

[14] Paragraph 3(1) of the Slovak Civil Code.

[15] New York State Insurance Act, Section 3401.

Spain

A.33 Insurable interest is an essential element of the insurance contract. Article 4 of the Insurance Contract Act Law Number 50/1980 states that an insurance contract, which covers damage, will be null and void if, at the time of entering in to the contract, the insured did not have an insurable interest in the indemnity for the damage.[16]

A.34 Article 26 of the Act states that an insurance contract cannot be the means to unfair enrichment by the insured. Therefore, if the maximum amount agreed in the policy for the indemnity exceeds the value of the insurable interest, either party may demand that the amount and the premium be reduced. Consequently, if the loss occurs, the insurer will only pay the amount of the damage effectively caused.[17]

Germany

A.35 Under German law, it is clear that the indemnity principle applies. In order to succeed in a claim under an indemnity policy, a German policyholder needs to prove that they suffered loss as a consequence of the event. It is not enough simply to show that damage was caused by the event insured against.[18] However, German insurance law does not require the policyholder to show that their loss is a pecuniary one recognised by law.

A.36 Section 68 of the German Gesetz ueber den Versicherungsvertrag appears to suggest that insurance can be taken out if the policyholder has no insurable interest in the insured matter at the time of making the contract. In these circumstances, if the insured interest does not come into existence, the policyholder is freed from his obligation to pay premiums. Again, this is similar to the indemnity principle in that interest is assessed only if there is a loss. Where there is no loss, the policyholder is free to stop paying premiums.[19]

[16] Insurance Contract Act Law Number 50/1980, Article 25.

[17] M Seoane and R Juanes de Toledo*, International Insurance Law and Regulation* (2006) Spain at p 7.

[18] Hofmann, *Privatversicherungsrecht* (4th ed 1998), p 189.

[19] Section 68(1) of the Gesetz ueber den Versicherungsvertrag.

France

A.37 It is not clear to us whether there is a specific requirement for the policyholder to have an insurable interest in a contract of insurance in France. However, the Civil Code prohibits all contracts which would be contrary to public policy and to accepted morals.[20]

[20] A Soulier and V Spiquelaire, *International Insurance Law and Regulation* (November 1999), France.

APPENDIX B
THE LIFE ASSURANCE ACT 1774

An Act for regulating Insurances upon Lives, and for prohibiting all such Insurances except in cases where the Persons insuring shall have an Interest in the Life or Death of the Persons insured.

Whereas it hath been found by experience that the making insurances on lives or other events wherein the assured shall have no interest hath introduced a mischievous kind of gaming:

(1) No Insurance to be made on the lives of persons having no interest, &c.

From and after the passing of this Act no insurance shall be made by any person or persons, bodies politick or corporate, on the life or lives of any person, or persons, or on any other event or events whatsoever, wherein the person or persons for whose use, benefit, or on whose account such policy or policies shall be made, shall have no interest, or by way of gaming or wagering; and every assurance made contrary to the true intent and meaning hereof shall be null and void to all intents and purposes whatsoever.

(2) No policies on lives without inserting the persons names, &c.

And it shall not be lawful to make any policy or policies on the life or lives of any person or persons, or other event or events, without inserting in such policy or policies the person or persons name or names interested therein, or for whose use, benefit, or on whose account such policy is so made or underwrote.

(3) How much may be recovered where the insured hath interest in lives.

And in all cases where the insured hath interest in such life or lives, event or events, no greater sum shall be recovered or received from the insurer or insurers than the amount of value of the interest of the insured in such life or lives, or other event or events.

(4) Not to extend to insurances on ships, goods, &c.

Provided always, that nothing herein contained shall extend or be construed to extend to insurances bona fide made by any person or persons on ships, goods, or merchandises, but every such insurance shall be as valid and effectual in the law as if this Act had not been made.

APPENDIX C
OTHER STATUTES

MARINE INSURANCE ACT 1745 (REPEALED)

WHEREAS it hath been found by Experience, that the making Assurances, Interest or no Interest, or without further Proof of Interest than the Policy, hath been productive of many pernicious Practices, whereby great Numbers of Ships, with their Cargoes, have either been fraudulently lost and destroyed, or taken by the Enemy in Time of War; and such Assurances have encouraged the Exportation of Wooll, and the carrying on many other prohibited and clandestine Trades, which by Means of such Assurances have been concealed, and the Parties concerned secured from Loss, as well to the Diminution of the public Revenue, as to the great Detriment of fair Traders; and by introducing a mischievous kind of Gaming or Wagering, under the Pretence of assuring the Risque on Shipping, and fair Trade, the Institution and laudable Design of making Assurances, hath been perverted; and that which was intended for the Encouragement of Trade and Navigation, has, in many Instances, become hurtful of, and destructive to the same: For Remedy whereof, be it enacted by the King's most Excellent Majesty, by and with the Advice and Consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the Authority of the same, That from and after the first Day of *August* one thousand seven hundred and forty-six, no Assurance or Assurances shall be made by any Person or Persons, Bodies Corporate or Politick, on any Ship or Ships belonging to his Majesty, or any of his Subjects, or on any Goods, Merchandizes or Effects laden or to be laden on Board of any such Ship or Ships, Interest or no Interest, or without further Proof or Interest than the Policy, or by way of Gaming or Wagering, or without Benefit of Salvage to the Assurer; and that every such Assurance shall be null and void to all Intents and Purposes.

MARINE INSURANCE ACT 1788 (REPEALED FOR THE PURPOSES OF MARINE INSURANCE ONLY)

WHEREAS it hath been found, by Experience, that great Mischiefs and Inconveniencies have arisen to Persons interested in Ships or Vessels, and also to Persons using Trade or Commerce, from the Effect of an Act made in the twenty-fifth Year of the Reign of his present Majesty, intituled, An Act for regulating Insurances on Ships, and on Goods, Merchandizes, or Effects. And whereas it is highly expedient that other and more convenient Provisions should be made for the regulating Insurances hereafter to be made on Ships, and on Goods, Merchandizes, or Effects, than those which are contained and enacted in and by the said Act;' be it therefore enacted by the King's most Excellent Majesty, by and with the Advice and Consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the Authority of the same, That the said Act, made in the twenty-fifth Year of the Reign of his present Majesty, shall be, and the same is hereby repealed; and that, from and after the passing of this Act, it shall not be lawful for any Person or Persons to make or effect, or cause to be made or effected, any Policy or Policies of Assurance upon any Ship or Ships, Vessel or Vessels, or upon any Goods, Merchandizes, Effects, or other Property whatsoever, without first inserting, or causing to be inserted, in such Policy or Policies of Assurance, the Name or Names, or the usual Stile and

Firm of Dealing of one or more of the Persons interested in such Assurance; or without, instead thereof, first inserting, or causing to be inserted in such Policy or Policies of Assurance, the Name or Names of the usual Stile and Firm of Dealing of the Consignor or Consignors, Consignee or Consignees of the Goods, Merchandizes, Effects, or Property so to be insured; or the Name or Names, or the usual Stile and Firm of Dealing of the Person or Persons residing in *Great Britain* , who shall receive the Order for and effect such Policy or Policies of Assurance, or of the Person or Persons who shall give the Order or Direction to the Agent or Agents immediately employed to negociate or effect such Policy or Policies of Assurance.

Policies made contrary to this Act to be void.

And be it further enacted by the Authority aforesaid, That every Policy and Policies of Assurance, made or underwrote contrary to the true Intent and Meaning of this Act, shall be null and void to all Intents and Purposes whatsoever.

GAMING ACT 1845 (REPEALED)

Section 18 Wagers not recoverable at Law.

All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any court of law and equity for recovering any sum of money or valuable thing alleged to be won upon any wager, or which shall have been deposited in the hands of any person to abide the event on which any wager shall have been made: Provided always, that this enactment shall not be deemed to apply to any subscription or contribution, or agreement to subscribe or contribute, for or towards any plate, prize, or sum of money to be awarded to the winner or winners of any lawful game, sport, pastime, or exercise.

MARRIED WOMEN'S POLICIES OF ASSURANCE (SCOTLAND) ACT 1880

Section 1 Married woman may effect policy of assurance for her separate use.

A married woman may effect a policy of assurance, on her own life or on the life of her husband, for her separate use; and the same and all benefit thereof, if expressed to be for her separate use, shall, immediately on being so effected, vest in her, and shall be payable to her, and her heirs, executors, and assignees, excluding the jus mariti and right of administration of her husband, and shall be assignable by her either inter vivos or mortis causa without consent of her husband; and the contract in such policy shall be as valid and effectual as if made with an unmarried woman.

Section 2. Policy of assurance may be effected in trust for wife and children.

A policy of assurance effected by a man or woman on his or her own life, and expressed upon the face of it to be for the benefit of his or her spouse or children, or his or her spouse and children, or any of them, shall together with all benefit thereof, be deemed a trust for their benefit;[1];

[1] Words substituted by Married Women's Policies of Assurance (Scotland) (Amendment) Act 1980 (c. 56, SIF 49:6), s. 1(a)

and such policy, immediately on its being so effected, shall vest in him or her and his or her legal representatives in trust for the purpose or purposes so expressed, or in any trustee nominated in the policy, or appointed by separate writing duly intimated to the assurance office, but in trust always as aforesaid, and shall not otherwise be subject to his or her control, or form part of his or her estate, or be liable to the diligence of his or her creditors, or be revocable as a donation, or reducible on any ground of excess or insolvency: And the receipt of such trustee for the sums secured by the policy, or for the value thereof, in whole or in part, shall be a sufficient and effectual discharge to the assurance office: Provided always, that if it shall be proved that the policy was effected and premiums thereon paid with intent to defraud creditors, or if the person upon whose life the policy is effected shall be made bankrupt within two years from the date of such policy, it shall be competent to the creditors to claim repayment of the premiums so paid from the trustee of the policy out of the proceeds thereof.[2]

MARRIED WOMEN'S PROPERTY ACT 1882

Section 11 Moneys payable under policy of assurance not to form part of estate of the insured.

A married woman may effect a policy upon her own life or the life of her husband for her own benefit; and the same and all benefit thereof shall enure accordingly.

A policy of assurance effected by any man on his own life, and expressed to be for the benefit of his wife, or of his children, or of his wife and children, or any of them, or by any woman on her own life, and expressed to be for the benefit of her husband, or of her children, or of her husband and children, or any of them, shall create a trust in favour of the objects therein named, and the moneys payable under any such policy shall not, so long as any object of the trust remains unperformed, form part of the estate of the insured, or be subject to his or her debts:

Provided, that if it shall be proved that the policy was effected and the premiums paid with intent to defraud the creditors of the insured, they shall be entitled to receive, out of the moneys payable under the policy, a sum equal to the premiums so paid. The insured may by the policy, or by any memorandum under his or her hand, appoint a trustee or trustees of the moneys payable under the policy, and from time to time appoint a new trustee or new trustees thereof, and may make provision for the appointment of a new trustee or new trustees thereof, and for the investment of the moneys payable under any such policy. In default of any such appointment of a trustee, such policy, immediately on its being effected, shall vest in the insured and his or her legal personal representatives, in trust for the purposes aforesaid. The receipt of a trustee or trustees duly appointed, or in

[2] In this section where his appears the words [or her] were inserted by Married Women's Policies of Assurance (Scotland) (Amendment) Act 1980 (c. 56, SIF 49:6), s. 1(b) Amended by Civil Partnership Act 2004, section 132: Assurance policies. Section 2 of the Married Women's Policies of Assurance (Scotland) Act 1880 (c. 26) (which provides that a policy of assurance may be effected in trust for a person's spouse, children or spouse and children) applies in relation to a policy of assurance—(a) effected by a civil partner (in this section referred to as "A") on A's own life, and (b) expressed upon the face of it to be for the benefit of A's civil partner, or of A's children, or of A's civil partner and children, as it applies in relation to a policy of assurance effected as, and expressed upon the face of it to be for such benefit as, is mentioned in that section.

default of any such appointment, or in default of notice to the insurance office, the receipt of the legal personal representatives of the insured shall be a discharge to the office for the sum secured by the policy, or for the value thereof, in whole or in part.

MARINE INSURANCE ACT 1906

Section 4 Avoidance of wagering or gaming contracts

(1) Every contract of marine insurance by way of gaming or wagering is void.

(2) A contract of marine insurance is deemed to be a gaming or wagering contract—

(a) Where the assured has not an insurable interest as defined by this Act, and the contract is entered into with no expectation of acquiring such an interest; or

(b) Where the policy is made "interest or no interest," or "without further proof of interest than the policy itself," or "without benefit of salvage to the insurer," or subject to any other like term:

(3) Provided that, where there is no possibility of salvage, a policy may be effected without benefit of salvage to the insurer.

Section 5 Insurable interest defined

(1) Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.

(2) In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof.

Section 6 When interest must attach

(1) The assured must be interested in the subject-matter insured at the time of the loss though he need not be interested when the insurance is effected:

Provided that where the subject-matter is insured "lost or not lost," the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss, and the insurer was not.

(2) Where the assured has no interest at the time of the loss, he cannot acquire interest by any act or election after he is aware of the loss.

Section 23 What policy must specify

A marine policy must specify—

(1) The name of the assured, or of some person who effects the insurance on his behalf: …

MARINE INSURANCE (GAMBLING POLICIES) ACT 1909

Section1 Prohibition of gambling on loss by maritime perils

(1) If—

(a) any person effects a contract of marine insurance without having any bonâ fide interest, direct or indirect, either in the safe arrival of the ship in relation to which the contract is made or in the safety or preservation of the subject-matter insured, or a bonâ fide expectation of acquiring such an interest; or

(b) any person in the employment of the owner of a ship, not being a part owner of the ship, effects a contract of marine insurance in relation to the ship, and the contract is made "interest or no interest," or "without further proof of interest than the policy itself," or "without benefit of salvage to the insurer," or subject to any other like term,

the contract shall be deemed to be a contract by way of gambling on loss by maritime perils, and the person effecting it shall be guilty of an offence, and shall be liable, on summary conviction, to imprisonment, with or without hard labour, for a term not exceeding six months or to a fine not exceeding [level 3 on the standard scale], and in either case to forfeit to the Crown any money he may receive under the contract.

(2) Any broker or other person through whom, and any insurer with whom, any such contract is effected shall be guilty of an offence and liable on summary conviction to the like penalties if he acted knowing that the contract was by way of gambling on loss by maritime perils within the meaning of this Act.

LOCAL GOVERNMENT ACT 1972

Section 140 Insurance by local authorities against accidents to members.

(1) A local authority may enter into a contract of accident insurance against risks of any member of the authority meeting with a personal accident, whether fatal or not, while engaged on the business of the authority.

(2) Any sum received by the authority under any such contract shall, after deduction of any expenses incurred in the recovery thereof, be paid by them to, or the personal representatives of, the member of the authority in respect of an accident to whom that sum is received.

(3) The provisions of the Life Assurance Act 1774 shall not apply to any such contract.

LOCAL GOVERNMENT (SCOTLAND) ACT 1973

Section 86 Insurance by local authorities against accidents to members.

(1) A local authority may enter into a contract with any person whereby, in consideration of payments by the authority by way of premium or otherwise, that person undertakes to pay to the authority such sums as may be provided in the contract in the event of any member of the authority meeting with a personal accident, whether fatal or not, while he is engaged on the business of the authority.

(2) Any sum received by the authority under any such contract shall, after deduction of any expenses incurred in the recovery thereof, be paid by them to, or to the personal representatives of, the member concerned.

(3) The provisions of the Life Assurance Act 1774 shall not apply to any such contract, but any such contract shall be deemed for the purposes of the Financial Services and Markets Act 2000 to be a policy of insurance upon the happening of personal accidents.

INSURANCE COMPANIES AMENDMENT ACT 1973

Section 50 Validation of certain group policies.

Section 2 of the Life Assurance Act 1774 (policy on life or lives or other event or events not valid unless name or names of assured etc. inserted when policy is made) shall not invalidate a policy for the benefit of unnamed persons from time to time falling within a specified class or description if the class or description is stated in the policy with sufficient particularity to make it possible to establish the identity of all persons who at any given time are entitled to benefit under the policy.

ADOPTION ACT 1976

Section 37 Miscellaneous provisions relating to protected children.

(2) A person who maintains a protected child shall be deemed for the purposes of the Life Assurance Act 1774 to have no interest in the life of the child.

FOSTER CHILDREN (SCOTLAND) ACT 1984

A person who maintains a foster child for reward shall be deemed for the purposes of the Life Assurance Act 1774 to have no interest in the life of the child.

CHILDREN ACT 1989

Schedule 8, Para 11

A person who fosters a child privately and for reward shall be deemed for the purposes of the Life Assurance Act 1774 to have no interest in the life of the child.

LAND DRAINAGE ACT 1991

Schedule 2, paragraph 1

(1) Without prejudice to the other provisions of this Schedule:

(a) an internal drainage board may enter into a contract with any

person under which, in consideration of payments made by the board by way of premium or otherwise, that person undertakes to pay to the board such sums as may be provided in the contract in the event of any member of the board or of any of its committees meeting with a personal accident, whether fatal or not, while he is engaged on the business of the board;

(b) any sum received by an internal drainage board under any such contract shall, after deduction of any expenses incurred in the recovery of that sum, be paid by the board to, or to the personal representatives of, the person in respect of whose accident the sum is received;

(c) and the provisions of the Life Assurance Act 1774 shall not apply to any such contract.

FRIENDLY SOCIETIES ACT 1992

Section 99 Insurance of lives of children under 10.

(2) Subject to the following provisions of this section, if:

(a) after this section comes into force a friendly society or registered branch enters into a contract of insurance under which benefit in excess of £800 is payable on the death of any person; and

(b) that person dies under the age of 10,

the obligation of the society, branch or company as to payment of benefit is only to pay £800 (without prejudice to any person's right to recover part of the premiums paid).

(3) Subsection (1) above does not apply where the benefit is payable to a person who has an interest in the life of the person on whose death it is payable.

(4) The Treasury may by order substitute some other sum for the sum for the time being specified in subsection (1) above.

(5) For the purposes of this section

(a) "industrial assurance company" means a person, other than a friendly society, who immediately before the repeal of the Industrial Assurance Act 1923, carried on industrial assurance business, and after that repeal is subject to an existing liability or a liability which may accrue under any policy effected in the course of that business;

(b) "industrial assurance business" means business which, immediately before the repeal of the Industrial Assurance Act 1923, fell within section 1(2) of that Act

POLICE (NORTHERN IRELAND) ACT 2003.

Section 18 Council’s powers

Schedule 3 to the Police (Northern Ireland) Act 2000 (district policing partnerships) shall be deemed to have been enacted with the following paragraphs inserted after paragraph 10…

10B Insurance against accidents

(1) The council may insure against risks of a member of the DPP meeting with a personal accident, whether fatal or not, while he is engaged on the business of the DPP.

(2) Sub-paragraph (3) applies if the council receives a sum under any such insurance in respect of an accident to a member of the DPP.

(3) The council shall pay the sum to the member or his personal representatives, after deducting any expenses incurred in its recovery.

(4) The provisions of the Life Assurance Act 1774 as extended by the Life Insurance (Ireland) Act 1866 do not apply to any insurance under this paragraph.

THE CIVIL PARTNERSHIP ACT 2004

Section 253 Civil partners to have unlimited insurable interest in each other

(1) Where two people are civil partners, each of them is to be presumed for the purposes of section 1 of the Life Assurance Act 1774 (c. 48) to have an interest in the life of the other.

(2) For the purposes of section 3 of the 1774 Act, there is no limit on the amount of value of the interest.

GAMBLING ACT 2005

Section 335 Enforceability of gambling contracts

(1) The fact that a contract relates to gambling shall not prevent its enforcement.

(2) Subsection (1) is without prejudice to any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling).

APPENDIX D
FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES) ORDER 2001

3 INTERPRETATION

(1) In this Order—…

"contract of insurance" means any contract of insurance which is a contract of long-term insurance or a contract of general insurance, and includes—

(a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds or similar contracts of guarantee, where these are—

(i) effected or carried out by a person not carrying on a banking business;

(ii) not effected merely incidentally to some other business carried on by the person effecting them; and

(iii) effected in return for the payment of one or more premiums;

(b) tontines;

(c) capital redemption contracts or pension fund management contracts, where these are effected or carried out by a person who—

(i) does not carry on a banking business; and

(ii) otherwise carries on a regulated activity of the kind specified by article 10(1) or (2);

(d) contracts to pay annuities on human life;

(e) contracts of a kind referred to in article 1(2)(e) of the first life insurance directive (collective insurance etc); and

(f) contracts of a kind referred to in article 1(3) of the first life insurance directive (social insurance);

but does not include a funeral plan contract (or a contract which would be a funeral plan contract but for the exclusion in article 60);

"contract of general insurance" means any contract falling within Part I of Schedule 1;

"contract of long-term insurance," means any contract falling within Part II of Schedule 1;

PART I OF SCHEDULE 1 TO THE ORDER

Part I Contracts of General Insurance

1 Accident

Contracts of insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the person insured or, in the case of a contract made by virtue of section 140, 140A or 140B of the Local Government Act 1972 (or, in Scotland, section 86(1) of the Local Government (Scotland) Act 1973), a person for whose benefit the contract is made—

(a) sustaining injury as the result of an accident or of an accident of a specified class; or

(b) dying as a result of an accident or of an accident of a specified class; or

(c) becoming incapacitated in consequence of disease or of disease of a specified class,

including contracts relating to industrial injury and occupational disease but excluding contracts falling within paragraph 2 of Part I of, or paragraph IV of Part II of, this Schedule.

2 Sickness

Contracts of insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of loss to the persons insured attributable to sickness or infirmity but excluding contracts falling within paragraph IV of Part II of this Schedule.

3 Land vehicles

Contracts of insurance against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.

4 Railway rolling stock

Contract of insurance against loss of or damage to railway rolling stock.

5 Aircraft

Contracts of insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.

6 Ships

Contracts of insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.

7 Goods in transit

Contracts of insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.

8 Fire and natural forces

Contracts of insurance against loss of or damage to property (other than property to which paragraphs 3 to 7 relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.

9 Damage to property

Contracts of insurance against loss of or damage to property (other than property to which paragraphs 3 to 7 relate) due to hail or frost or any other event (such as theft) other than those mentioned in paragraph 8.

10 Motor vehicle liability

Contracts of insurance against damage arising out of or in connection with the use of motor vehicles on land, including third-party risks and carrier's liability.

11 Aircraft liability

Contracts of insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.

12 Liability of ships

Contracts of insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.

13 General liability

Contracts of insurance against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which paragraph 10, 11 or 12 relates.

14 Credit

Contracts of insurance against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

15 Suretyship

(1) Contracts of insurance against the risks of loss to the persons insured arising from their having to perform contracts of guarantee entered into by them.

(2) Fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee, where these are—

(a) effected or carried out by a person not carrying on a banking business;

(b) not effected merely incidentally to some other business carried on by the person effecting them; and

(c) effected in return for the payment of one or more premiums.

16 Miscellaneous financial loss

Contracts of insurance against any of the following risks, namely—

(a) risks of loss to the persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on;

(b) risks of loss to the persons insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts falling within paragraph 18);

(c) risks which do not fall within sub-paragraph (a) or (b) and which are not of a kind such that contracts of insurance against them fall within any other provision of this Schedule.

17 Legal expenses

Contracts of insurance against risks of loss to the persons insured attributable to their incurring legal expenses (including costs of litigation).

18 Assistance

Contracts of insurance providing either or both of the following benefits, namely—

(a) assistance (whether in cash or in kind) for persons who get into difficulties while travelling, while away from home or while away from their permanent residence; or

(b) assistance (whether in cash or in kind) for persons who get into difficulties otherwise than as mentioned in sub-paragraph (a).

PART II OF SCHEDULE 1 TO THE ORDER

CONTRACTS OF LONG-TERM INSURANCE

I Life and annuity

Contracts of insurance on human life or contracts to pay annuities on human life, but excluding (in each case) contracts within paragraph III.

II Marriage and birth

Contract of insurance to provide a sum on marriage [or the formation of a civil partnership] or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.

III Linked long term

Contracts of insurance on human life or contracts to pay annuities on human life where the benefits are wholly or party to be determined by references to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of

property of any description (whether or not so specified).

IV Permanent health

Contracts of insurance providing specified benefits against risks of persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that—

(a) are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the persons concerned, or without limit of time; and

(b) either are not expressed to be terminable by the insurer, or are expressed to be so terminable only in special circumstances mentioned in the contract.

V Tontines

Tontines.

VI Capital redemption contracts

Capital redemption contracts, where effected or carried out by a person who does not carry on a banking business, and otherwise carries on a regulated activity of the kind specified by article 10(1) or (2).

VII Pension fund management

(a) Pension fund management contracts, and

(b) pension fund management contracts which are combined with contracts of insurance covering either conservation of capital or payment of a minimum interest,

where effected or carried out by a person who does not carry on a banking business, and otherwise carries on a regulated activity of the kind specified by article 10(1) or (2).

VIII Collective insurance etc

Contracts of a kind referred to in article 1(2)(e) of the first life insurance directive.

IX Social insurance

Contracts of a kind referred to in article 1(3) of the first life insurance directive.