



**Law
Commission**
Reforming the law



Scottish Law Commission
promoting law reform

**Insurance Contract Law
SUMMARY OF RESPONSES TO SECOND CONSULTATION PAPER
Post Contract Duties and other Issues
Chapter 3: Insurable Interest**

This document summarises the responses to Chapter 3 of the Law Commissions' second consultation paper in the joint insurance law project

February 2013

THE LAW COMMISSION
THE SCOTTISH LAW COMMISSION

Joint Review of Insurance Contract Law

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

Chapter 3: Insurable Interest

Contents

	Page
Approach taken in this paper	ii
Part 1: Introduction	1
Part 2 : A statutory basis for insurable interest in indemnity insurance	3
Part 3 : Timing and consequences of insurable interest in indemnity insurance	5
Part 4: Retaining and repealing statutory provisions	9
Part 5: Defining insurable interest for indemnity insurance	11
Part 6: Life insurance: insurable interest based on economic interest	16
Part 7: Life insurance without evidence of economic loss: children and cohabitants	19
Part 8: Trustees of pension or group schemes	23
Part 9: Changes to the statutory basis	24
Appendix: List of respondents	27

Approach taken in this paper

Describing responses

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

Comments and Freedom of Information

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

Please contact us:

By email at commercialandcommon@lawcommission.gsi.gov.uk

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

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

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

PART 1

INTRODUCTION

- 1.1 The Law Commission and Scottish Law Commission are carrying out a major review of insurance contract law. As part of that review, in December 2011 we published a joint Consultation Paper on “Post Contract Duties and other Issues”.¹
- 1.2 The third chapter considered the requirement for insurable interest. At its simplest, this requirement means that, for a contract of insurance to be valid, the person taking out the insurance must stand to gain a benefit from the preservation of the subject matter of the insurance or to suffer a disadvantage should it be lost.
- 1.3 When we consulted on the issue in January 2008,² responses revealed strong support for retaining the principle of insurable interest. It was thought to guard against moral hazard, protect insurers from invalid claims and divide insurance from gambling. The law in this area, however, is not as clear as it ought to be. It is set out in a bewildering mix of case law and archaic statutes. This makes it difficult to state what amounts to an insurable interest or to specify the consequences of writing insurance without it.
- 1.4 We looked separately at indemnity insurance and life insurance. Indemnity insurance indemnifies the policyholder for losses suffered and examples include buildings insurance, liability insurance and business interruption insurance. The indemnity principle requires that the insured has suffered a loss in order to recover under the policy. By contrast, most life insurance is written on a contingency basis, paying a fixed sum on the death of the person insured.
- 1.5 For indemnity insurance, our proposals focused on restating current principles in a clearer way. For life insurance, however, we argued that the current rules are too restrictive. We proposed to widen the category to those permitted to insure the life of anyone who has a real probability of incurring an economic loss on another’s death. We also asked whether parents should be entitled to insure the lives of children under 18, perhaps for a limited amount, and whether a cohabitant should have an insurable interest in the life of another where they have lived in the same household as a spouse or civil partner.

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

² Insurance Contract Law: Insurable Interest, the Law Commission and the Scottish Law Commission, ICL Issues Paper 4 (January 2008).

RESPONSES

Insurable interest: indemnity insurance

- 1.6 We received 32 responses to the insurable interest section of our consultation across the indemnity and life insurance questions, as shown in the table below. One response was confidential.

Type of respondent	Number
Insurers and insurance trade associations	12
Lawyers, legal associations and the judiciary	10
Brokers and brokers' associations	2
Academics	2
Policyholders and policyholder/consumer groups	2
Other	4
Total	32

THANKS

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

PART 2

A STATUTORY BASIS FOR INSURABLE INTEREST IN INDEMNITY INSURANCE

- 2.1 In the Consultation Paper we proposed to retain the requirement of insurable interest but to restate it in clear terms. We asked whether consultees agreed that there should be a statutory requirement that an insured has an insurable interest in the subject matter of the insurance. Thirty consultees responded to this question, of whom 23 (77%) consultees agreed with the proposals for a statutory provision, four (13%) disagreed and three (10%) marked “other”.

Agreed

- 2.2 Many of those who argued for a statutory restatement pointed to the importance of the principle of insurable interest. The Lloyd’s Market Association (LMA) said that insurable interest is a “distinguishing feature of carrying on insurance business”. NFU Mutual said that the requirement of insurable interest “means that a policy of insurance is something more than a bet made by parties with no connection to the thing insured”.
- 2.3 The City of London Law Society thought statutory clarification could be “helpful” and said they did “not support the alternative option of legislation to abolish any need for insurable interest in the case of indemnity insurance”.
- 2.4 Keoghs LLP said it was a “difficult conundrum” but on balance they were inclined to “agree that there should be a statutory requirement that an insured has an insurable interest in the subject matter of the insurance but to leave the scope of the definition of insurable interest entirely with the Courts”.
- 2.5 The International Underwriting Association (IUA) did not have any “pressing concerns” with the principle as it currently operates under common law and did not feel it had caused significant problems or inequity at least in an indemnity insurance context. They pointed to the “notable absence of significant litigation and [Financial Ombudsman Service] activity on insurable interest in the non-life arena”. However, they said:

Whilst we do not think that the provisions of the Gambling Act 2005 ultimately apply to insurance or inadvertently abolish insurable interest, we do accept that there is now a degree of legal uncertainty in this area that would benefit from statutory clarification.

- 2.6 Direct Line Group expressed concern over the current mix of statutes governing the issue of insurable interest, suggesting that the current statutory framework “would benefit from a consolidation and consistent approach”.

Disagreed

- 2.7 The British Insurance Brokers’ Association (BIBA) did not agree that statutory provision was required, commenting that insurable interest would in that case:

... require a definition and would be difficult to change as commerce and procedures develop. Leave it to insurers to decide what they wish to insure and for them to word the contract accordingly.

2.8 The risk managers' association Airmic disagreed with the proposal and said that insurable interest was a matter for insurers to regulate, stating: "All that is required is for both parties to an insurance policy to be content that the insurance contract is valid and ethical." Legislative intervention as proposed could, in Airmic's view, "undermine the basis of many commercial insurance policies, such as key person insurance".

2.9 Both academic consultees thought that the requirement should be abolished. Professor John Birds was not sure that the concept of insurable interest in indemnity insurance "serves any useful purpose" and said:

Many other jurisdictions manage perfectly well without it ... the principle of indemnity ensures that an insured cannot recover more than what he/she has lost.

2.10 Similarly, Norton Rose LLP, who marked "other", said "it is difficult to see what the requirement of insurable interest adds to the common law principle of indemnity".

PART 3

TIMING AND CONSEQUENCES OF INSURABLE INTEREST IN INDEMNITY INSURANCE

An insurable interest at the time of loss

- 3.1 We asked whether consultees agreed that, to make a claim, an insured should be required to show insurable interest at the time of loss. Twenty five consultees responded to this question, of whom 20 (80%) agreed with our proposal and five (20%) disagreed.

Agreed

- 3.2 Browne Jacobson LLP described this proposal as “the most appropriate and commercially viable approach” and the British Insurance Law Association (BILA) thought this was arguably “the current legal position”. The LMA said this proposal would deal appropriately with situations “where property changes ownership and related insurance cover follows this, eg cargo covers”.
- 3.3 RSA said that, for indemnity insurance:

As the insured must normally show loss to succeed in his claim, the burden is merely one that he would have to discharge anyway.

- 3.4 The Law Society of Scotland agreed, but:

... could envisage situations where the insured, in seeking to mitigate his loss, sells the damaged property. We would not wish to see an insured in such a situation being prejudiced.

Disagreed/partially agreed

- 3.5 The main objection to this proposal was from those who said that the existence or otherwise of an insurable interest should be determined “at the outset of the policy”.
- 3.6 Naomi Talisman agreed that an insured should have to demonstrate an insurable interest at the time of loss, but also thought “that an insurable interest should be present at the time the contract is made”. She suggested that the issue of anticipatory insurance could be dealt with “by arranging for insurance cover to fall into place on the day of completion”.
- 3.7 Airmic and Professor Malcolm Clarke, consistent with their view that there should be no requirement for insurable interest at all, did not think it should be necessary for an insured to demonstrate an insurable interest at the time of loss.

Without a real probability of an insurable interest, the policy should be void

- 3.8 In the Issues Paper we argued that although the crucial issue for making a claim is whether an insurable interest exists at the date of the loss, the insurance would only be void if there was never a real probability that an insurable interest would be acquired.

- 3.9 We gave an example in which a business insures a garage it intends to buy from 1 February, but the purchase is delayed until 31 March. If the garage suffers storm damage on 20 February, the business may not claim, but we did not think that the policy should be void. The policy may operate perfectly satisfactorily from 31 March onwards. This contrasts with a situation in which a gambler “insures” the Eiffel Tower, without any intention of acquiring an interest in it. Here we thought that the insurance should be void for lack of insurable interest. The gambler should not be entitled to make a claim and the insurer should be required to return any premiums paid.
- 3.10 We asked whether an insurance contract should be void for lack of insurable interest unless there is a real probability that a party would acquire some form of insurable interest at some stage during the life of the contract. Eighteen consultees (69%) of the 26 who responded to this proposal agreed. Five (19%) disagreed and three (12%) marked “other”.

Agreed

- 3.11 RGA said that “insurable interest should be established at the outset, either on the basis there is a genuine insurable interest or it will be acquired during the lifetime of the policy.” The Investment and Life Assurance Group (ILAG), RSA and Geoffrey Lloyd gave similar responses. A number of other respondents ticked “agree” without further comment.
- 3.12 Direct Line Group agreed but said:
- ... if there has been a past insurable interest but it no longer exists then the policy should be cancelled back to the time when that interest ceased to exist and any premiums refunded – if allowed for in that product type, and subject to fees etc.
- 3.13 The Judges of the Court of Session agreed in principle that acquisition of an insurable interest should be anticipated at the “moment of entering into the contract”, but had concerns over what test should be applied, suggesting that the “real probability” test might be too onerous. Browne Jacobson LLP, marking “other”, thought that “a prospect of an interest arising should be sufficient to save the contract” and that the appropriate test should be that “the parties have a real expectation” of such an interest arising.

- 3.14 IUA agreed with the proposal, but thought:
- that there should be no 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 ... We believe that regulation, in particular the [Treating Customers Fairly] requirements, sufficiently protects consumers with regard to purchasing “worthless” policies ... The regulator is ultimately better equipped to address any issues arising in this area.

Disagreed

- 3.15 Consultees disagreed with the proposal for a variety of reasons. The City of London Law Society said that:

insurable interest should be tested at the time of loss, not at inception of the policy. At the point of loss it should be necessary for the insured to have an insurable interest – it should not be sufficient that at inception there had been a real probability of acquiring such an insurable interest.

3.16 The Bar Council commented:

Provided the insured has acquired an insurable interest at the time of the loss, we see no need for an additional requirement that there must be a “real probability” that a party would acquire some form of insurable interest during the life of the contract.

3.17 The Bar Council questioned why parties should not be free to negotiate contracts of insurance where both are aware of the possibility that an insurable interest might never arise. They argued that in some situations insurance contracts of this nature served a “useful commercial purpose” and thought that courts would “strain against” the insurable interest requirement in order to ensure the enforceability of such a policy, “with the result that the statutory meaning would be attenuated to simply meaning ‘something more than merely fanciful’”. The Bar Council said that, if the requirement of “real possibility” were intended to protect consumers (presumably against being sold worthless policies), “that should be addressed separately”.

Treatment of premium when contract void for lack of insurable interest

3.18 We asked whether, if the insured shows that a contract is void for lack of insurable interest, the insurer should not be entitled to sue for premium and the insured should be entitled to a refund of premiums already paid. Twenty five consultees responded to this question of whom seventeen (68%) agreed that the insurer should not be entitled to sue. Four (16%) disagreed and four (16%) marked “other”.

Agreed

3.19 The Faculty of Advocates said that this approach was “consistent with the meaning of ‘void’”. RSA took a marginally different approach, suggesting that “in the absence of any real probability, consideration fails on the part of the insurer, and the premium should be refunded to the customer”. In a similar vein, Direct Line Group said “The concept of premium acting as a risk transfer mechanism becomes de facto invalid if there is no risk to be transferred in the first place”.

3.20 Some respondents focused on the principle that the solution should “put the parties back in the position of the contract never having existed”. ACE and the LMA therefore thought that premiums should be returned subject only to a right of set off in respect of claims or other monies paid out. The Association of British Insurers (ABI) said that insurers ought to be permitted to reserve the right to set off both previously paid claims and administrative costs against any refunded premiums.

Disagreed

3.21 The IUA thought that this would be:

... better left to the contractual terms of the policy. Often there is a contractual provision in place for the return of premium and such a return is clearly fair where an honest mistake has been made. However where fraud is apparent we believe there remains an argument for the retention of the premium ...

3.22 The City of London Law Society marked “other”, saying:

We agree that if a contract is void for lack of insurable interest the insured should be entitled to a refund of premiums paid. However, this should be the case where the insurer has refused to pay a claim on the basis of lack of insurable interest. It should not be up to the insured to choose to take out a policy and subsequently demand a return of premiums on the basis that he does not have an insurable interest in the subject matter of the policy (in the absence of any misrepresentation by the insurer).

PART 4

RETAINING AND REPEALING STATUTORY PROVISIONS

Marine Insurance (Gambling Policies) Act 1909

- 4.1 We asked consultees whether they agreed that the Marine Insurance (Gambling Policies) Act 1909 should be repealed. All 23 consultees who responded to this question agreed.
- 4.2 Some consultees felt strongly about the issue; Browne Jacobson LLP said “it is neither necessary nor desirable to retain the criminal offence created by the Act”. The Bar Council noted that there was “no evidence of any prosecutions”. Geoffrey Lloyd summed up the situation succinctly, saying:

Effecting a contract of marine insurance without a bona fide interest is to be discouraged but it hardly qualifies as a criminal offence. Repeal it.

Marine Insurance Act 1788

- 4.3 We proposed that the Marine Insurance Act 1788 should be repealed. Again, 23 of 24 (96%) consultees who responded to this proposal agreed and Direct Line Group marked “other”.
- 4.4 Again Geoffrey Lloyd provided a useful summation of feeling on this issue. He said that “practice reveals that this legislation has been consistently honoured more in the breach than the observance”.

Marine Insurance Act 1906

- 4.5 We asked consultees whether they agreed that, for marine insurance, sections 4 to 15 of the Marine Insurance Act 1906 should be left as they are. The Consultation Paper suggested that these statutory provisions “operate well” and that they should not be part of proposed reform. Of 17 consultees who answered this question, 15 (88%) agreed with the proposal. One (6%) disagreed and one (6%) marked “other”.

Agreed

- 4.6 The vast majority of consultees were of the opinion that this was a well settled area of law, with which the marine insurance industry was happy. Any reform was regarded as having the potential to upset this situation while providing minimal benefit. Geoffrey Lloyd said, “If the Marine Insurance industry is satisfied these sections work well and there is no call from insureds to abandon them, why disturb them unnecessarily?” Norton Rose LLP said, “We agree that the partial definition of insurable interest in this Act operates well, and should therefore be left untouched”.

Disagreed/partially disagreed

- 4.7 Naomi Talisman said:

If the definition of insurable interest is improved upon by a new statute, it would be sensible for marine insurers to benefit from this by an amendment to section 5, particularly as the intention of the Law Commission's paper is to codify insurance law. It would be good to only have to look in one place for a definition of insurable interest that applies to all insurance.

- 4.8 The Law Society of Scotland was concerned that the section 5 definition is "unsatisfactory, since it defines "insurable interest" as an "interest"". There was also concern that the definition did not mesh well with Scots law, since "Scots law does not recognise equitable titles".

PART 5

DEFINING INSURABLE INTEREST FOR INDEMNITY INSURANCE

- 5.1 We asked consultees for their views on a statutory definition of insurable interest for indemnity insurance. We provided two alternatives. The first was to leave the definition entirely to the courts. The second was to provide a non-exhaustive statutory list of types of interest which would be sufficient to constitute an insurable interest. We proposed three specific categories to be included in the list.
- 5.2 A majority of respondents favoured a non-exhaustive list of interests, though many respondents stressed the need for flexibility. They did not wish the requirement of insurable interest to impede new forms of insurance.

Should the definition of insurable interest be left entirely to the courts?

- 5.3 Twenty two consultees responded to this question. Five (23%) agreed that the definition should be left to the courts. Thirteen (59%) disagreed and four (18%) marked "other".

Agreed

- 5.4 Several consultees, despite being in favour of a statutory requirement for insurable interest, were opposed to a statutory definition. The Faculty of Advocates was concerned that a statutory definition might operate "to exclude otherwise valid claims". The City of London Law Society shared the Faculty of Advocate's concern that finding a satisfactory formulation of a statutory definition was "likely to prove troublesome".
- 5.5 The ABI did not support a statutory definition, and thought that "it ought to be for the insurer to decide whether to accept the premium for a proposed risk and issue the policy accordingly, and not to be constrained by statute".

Disagreed

- 5.6 Several of those who disagreed with the proposal cited confusion and uncertainty as reasons for creating a non-exhaustive statutory list. The Judges of the Court of Session said:

In light of the difficult and inconsistent case-law ... which has developed in part around statutes which it is proposed to repeal, we consider that it would be unsatisfactory to leave further definition entirely to the courts, though ... the definition should leave sufficient flexibility to allow the courts to adapt it to new and varied circumstances.

- 5.7 Some consultees reiterated at this point in their responses that although they were in favour of a statutory definition, it was of high importance that the list be non-exhaustive. ACE said that if the list were to be "unduly restrictive, it would be preferable to have no definition and leave the matter to the courts".

STATUTORY DEFINITION OF INSURABLE INTEREST: NON-EXHAUSTIVE LIST

- 5.8 The alternative proposal was for the statute to set out a non-exhaustive list of forms of insurable interest. We asked consultees whether they agreed that any statutory list should be non-exhaustive. Twenty three respondents provided an answer to this question. Sixteen (69%) agreed with this proposal, two (9%) disagreed and five (22%) marked “other”.

Agreed

- 5.9 Many consultees who favoured a statutory definition stressed that it was important for the list to be non-exhaustive. ACE said “the list **must** be non-exhaustive” (ACE’s emphasis) because an exhaustive list “would risk severely restricting the development of new insurance products and impose an undue rigidity on the insurance market”.
- 5.10 Several other consultees similarly emphasised the need for flexibility to allow for the development of new products and “to keep pace with commercial realities” [Browne Jacobson LLP]. The ABI thought that if there was to be a statutory definition, any list should be non-exhaustive, leaving room for “judicial discretion on a case by case basis”.
- 5.11 Naomi Talisman proposed a specific “catch-all” provision at the end of her list, which would limit innovation to “something analogous to the above”.
- 5.12 Direct Line Group marked “other”, saying that it should be for the insurer to work within a broad definition to decide whether or not to accept a risk. This is broadly consistent with comments from other insurers throughout the consultation.

Disagreed

- 5.13 Professor John Birds thought that the list as set out was sufficiently broad in scope to be exhaustive.

ELEMENTS OF THE LIST

- 5.14 The issues paper set out three specific categories of interest to be included in a statutory definition. The three categories were generally supported. Several consultees who opposed the very idea of a statutory definition agreed that they were appropriate categories of insurable interest at common law.

Statutory definition of insurable interest: property rights

- 5.15 We asked whether any statutory definition should state that an insured has an insurable interest if the insured has a right in the property which is the subject matter of the insurance or a right arising out of a contract in respect of it. Twenty six consultees responded to this question, of whom 15 (57%) agreed. Three (12%) disagreed outright while eight (31%) marked “other”.

- 5.16 Amongst all consultees, it appears to be uncontroversial that an insured with a right in property which is the subject matter of the insurance, or a right arising out of a contract in respect of such property, should be regarded as having an insurable interest. The majority of those who agreed with the proposal did so without further comment. Those who disagreed did so because they thought that there should not be a statutory definition of insurable interest at all, rather than because they did not think that a property right should constitute an insurable interest.

Statutory definition of insurable interest: economic interest

- 5.17 We asked whether any statutory definition should provide that an insured has an insurable interest if the insured has a real probability either of:

- (1) economic benefit from the preservation of the insured subject matter; or
- (2) economic loss on its destruction,

which would arise in the ordinary course of things.

- 5.18 Twenty six consultees responded to this proposal. Fourteen (53%) agreed, three (12%) disagreed and nine (35%) marked “other”. Again, some consultees who disagreed with the concept of a statutory definition, agreed in part with the category proposed. In contrast to the previous question, however, there were also some substantive objections to this part of the definition.

Agreed

- 5.19 Both ACE and the Judges of Court of Session expressed general agreement with the proposal, but concern over the use of the “real probability” test. ACE thought that the test “could be construed as requiring an unduly high likelihood of economic benefit or loss. ‘Real possibility’ might be a preferable formulation.”

- 5.20 Similarly, the Judges of Court of Session said that:

... the insistence that there be a “real probability” of economic benefit or loss from the preservation or destruction of the subject-matter of the insurance might constrain the courts in developing the categories of insurable interest.

- 5.21 The Bar Council agreed with the proposal “subject to replacing ‘real probability’ with the phrase ‘factual expectation’”. It thought that “this more accurately codifies the existing case law, and ... we believe that ‘real probability’ is too ambiguous a phrase to operate satisfactorily”.

Disagreed

- 5.22 The Law Society of Scotland marked “other”, but made suggestions that represented fundamental disagreements with the policy of the proposal. They believed that:

Economic benefit could mean, for example, that a partner could insure the property owned by a Scottish partnership ... Or that a parent company could have an insurable interest in property owned by a subsidiary. “Patrimonial benefit” would limit the “insurable interest” to the company which actually owned the assets ... we would query whether the “economic benefit” test is a meaningful one; and, further, whether the courts are well equipped to make such a judgment. The “patrimonial” test, in contrast, is a legal one.

- 5.23 BIBA suggested that this should be “left for the parties to the contract to agree”.
- 5.24 Naomi Talisman submitted a proposed list of insurable interests which included a modified version of the economic interest test. She was concerned that:

the suggested definition refers only to the “destruction” of the insured subject matter. It needs to include “loss” and “damage” to be comprehensive.

Statutory definition of insurable interest: possession

- 5.25 We asked if the proposed statutory definition should state that an insured has an insurable interest if the insured has possession of the insured subject matter. Fourteen (56%) consultees of the 25 who responded to this proposal agreed with it. Three (12%) disagreed and eight (32%) marked “other”.
- 5.26 Two consultees who broadly agreed with the proposal expressed concern over the nature of the insured’s possession. BTO Solicitors thought that an insured should only have an insurable interest “where there is a contract by which the person who is possessing the item in question has a right to possess that item.” Mark Wibberley asked whether there should be “reference to the possession being legitimate.”

Statutory definition of insurable interest: other interests

- 5.27 We asked whether any other forms of insurable interest should be included in any non-exhaustive statutory list. Of 20 consultees who responded to this question, six (30%) agreed that other forms of interest should be included in any statutory list. Seven (35%) disagreed and seven (35%) marked other.

Agreed

- 5.28 Direct Line Group said that it “would welcome such list to be as exhaustive as possible. We generally welcome greater details as it ensures consistency and eliminates ambiguity and legal challenge”.
- 5.29 Other consultees focused on specific categories that they thought should be included. The Law Society of Scotland argued for “a formulation that covers financial assets specifically – rather than forcing them into the general coverage of ‘property’”. BTO Solicitors thought that “the subject of a [Contractors All Risks] policy and the position of sub-contractors or suppliers needs to be tackled given this is a product which is widely used”.

Disagreed

5.30 Browne Jacobson LLP said:

it is not desirable to attempt to create a definitive list, and we support a non-exhaustive list. In the circumstances, we see little benefit in attempting to codify residual categories. The matter is best left to the Courts.

5.31 ACE said “we do not have specific additions for the list, but would emphasise that the list must be non-exhaustive”.

PART 6

INSURABLE INTEREST BASED ON ECONOMIC INTEREST

- 6.1 We proposed a general category of insurable interest in life insurance based on an economic link between the life assured and the proposer. We asked whether consultees agreed that an insurable interest may be found where there is a real probability that the proposer will retain an economic benefit on the preservation of the life insured or incur an economic loss on the death. We also asked whether, if that were to be a basis for insurable interest, the law should require the value of the policy to be a reasonable valuation of the possible loss, made at the time of the contract.

INSURABLE INTEREST BASED ON ECONOMIC BENEFIT

- 6.2 Of the 21 consultees who answered this question, 18 (85%) agreed with this proposal. One (5%) disagreed and two (10%) marked “other”.

Agreed

- 6.3 This was a popular proposal, described as “sensible” (IUA) and “logical” (Geoffrey Lloyd). The ABI said “people should have an insurable interest in each other providing that they stand to lose financially if the relevant event occurs”. The Faculty of Advocates believed that this was already “modern practice” and supported the proposal to bring the law into line.
- 6.4 The Judges of the Court of Session agreed with the proposal but, as in the context of indemnity insurance, questioned whether “real probability” was the correct test. They said:

We consider that a “reasonable expectation” test is more consonant with the aim expressed throughout this section of the Consultation Paper of widening the test of insurable interest.

- 6.5 The Bar Council, marking “other”, also thought that “reasonable expectation” was “more apt”. There was concern that “‘real probability’ risks setting the bar too high, and ... in practice will end up simply being attenuated by the Courts”.

Disagreed

- 6.6 GRiD, an association for the group risk industry, was sceptical about the value of statutory changes in this area. It thought that “it should be the responsibility of the insurer to decide on what basis they are prepared to underwrite a risk”. Discussing cohabiting couples, GRiD thought that “it can also be difficult to demonstrate economic loss as mortgages, rental agreements, bank accounts and utility bills may not be in joint names”. In relation to group insurance, GRiD thought that so long as an insurer was able to quantify a risk, they should be free to offer insurance as they thought appropriate, and that market practice would ensure appropriate evidence and assurances were obtained from an insured.

Other

- 6.7 Norton Rose LLP gave an extensive response, citing investment contracts,³ where the amount payable on death of the subject of the insurance is the same or very close to the surrender value of the policy. Norton Rose suggested that, in many cases, such insurance contracts were often issued on the joint lives of children or grandchildren in order to preserve the investment value and minimise the chances of the contract being brought to a premature end by death. In such circumstances, said Norton Rose, “the owners of the policies rely upon the good faith of the insurer not to seek to rely upon the 1774 Act.” They suggested that, where benefits on death are largely the same as benefits on surrender, no insurable interest should be required, or a presumed interest, perhaps based on consent of the life insured, could be used.

VALUE OF THE POLICY PROPORTIONAL TO LOSS/BENEFIT

- 6.8 Fourteen consultees of the twenty who answered this question (70%) agreed with this proposal. Four (20%) disagreed and two (10%) marked “other”.

Agreed

- 6.9 The City of London Law Society said:

It is consistent with the requirement that there must be a probability of economic benefit/loss that the value of the policy should relate to the possible loss. Otherwise this raises significant moral hazard issues by creating a situation where the beneficiary would be economically better off if the life insured dies.

- 6.10 Others agreed with the proposal for similar reasons, or agreed but gave no comment.

Disagreed

- 6.11 Several consultees favoured freedom of contract and suggested the issue was better left to insurers to deal with. The IUA said that:

... insurers will consider each risk on its own merits and will price it and include contractual limits and provisions in accordance with this assessment. To take the extreme example in the consultation paper – of the office junior insured for £3m – this would be clearly be filtered out by requests for further information by the insurer. Even if it did not, it would ultimately remain up to the insurer to use their discretion and, even if they chose to write the risk, price and limit it accordingly.

³ These constitute insurance contracts by virtue of payment of the benefit being, in some circumstances at least, contingent on death (*Fuji Finance v Aetna Insurance Company* [1997] Ch 173).

- 6.12 The ABI thought that this matter might be “more satisfactorily addressed by FSA regulation, particularly the TCF requirements”.
- 6.13 Some consultees focused on the difficulty of applying such a test. The Faculty of Advocates said “it would be especially difficult for the layperson ... to put a value on loss of a life”.

PART 7

LIFE INSURANCE WITHOUT EVIDENCE OF ECONOMIC LOSS: CHILDREN AND COHABITANTS

7.1 We proposed that parents should have a limited insurable interest in the lives of their children. We asked:

- (1) Do consultees agree that parents should be entitled to take out insurance on the life of a child under 18?
- (2) Do consultees agree that the right would extend to the legal parent of a child and all those who treated the child as a child of the family?
- (3) Do consultees consider that there should be a cap on the amount for which children's lives may be insured?

PARENTS' INSURABLE INTEREST IN THEIR CHILDREN

7.2 Twelve consultees (67%) of 18 who responded to this proposal agreed. Two (11%) disagreed and four (22%) marked "other".

Agreed

7.3 The IUA said that "in principle we have no difficulty with extending the scope of natural affection to include children" but felt "there should be a clearly identifiable economic interest and dependency established". The Faculty of Advocates stated that its members had no objection to a policy being taken out on the life of a child, "at least to the extent of [the parent's] interest".

7.4 The Financial Services Consumer Panel thought that permitting bodies other than friendly societies to write such policies would increase "market competition for the benefit of consumers".

Disagreed

7.5 The City of London Law Society thought that there was "no justification for allowing life insurance to be taken out on the life of a child" unless the economic benefit test was satisfied. Naomi Talisman "strongly" disagreed, saying it was "morally wrong to encourage this type of insurance when it should be the child who is dependent on the parent, not the other way around". Again, she thought that if the child were over 18 and had taken on financial responsibilities towards his parents, the economic interest category of insurable interest would suffice.

RIGHT EXTENDED TO LEGAL PARENTS AND OTHERS WHO TREAT THE CHILD AS A CHILD OF THE FAMILY

7.6 Of 16 who responded to this question, 10 consultees (62%) agreed with our proposal. Two (13%) disagreed and four (25%) marked "other".

Agreed

- 7.7 GRiD noted that “a couple may have children from previous relationships where they both do not have legal responsibility for a child, but that child is still treated by both parents as part of their family”. Others agreed without further comment.

Disagreed

- 7.8 Most of those who disagreed or marked “other” referred to their responses to the previous question. Naomi Talisman added to her reasons for objecting to policies on the life of a child, saying that:

incentives should not be introduced for wrong doing by nefarious individuals who will take advantage of their positions as carers of children. We should not have to wait for an example of wrong doing before such a law can be repealed.

A CAP ON THE AMOUNT FOR WHICH A CHILD’S LIFE MAY BE INSURED

- 7.9 Seventeen consultees responded to this question, of whom 11 (65%) agreed with this proposal. Five (29%) disagreed and one (6%) marked “other”. We also invited suggestions as to what the cap should be.

Agreed

- 7.10 Most of those who agreed thought that a cap would help reduce moral hazard. A number divided the various types of benefits that might be received under a policy and considered the appropriateness of a cap on each.
- 7.11 ILAG was clear that “death benefits should have a cap”. RSA and ILAG referred to living benefits such as critical illness cover and suggested that they should not be subject to a cap, owing to the uncertain nature of the costs that might need to be met in relation to a seriously ill child. Hannover Life Re also felt that living benefits should not be subject to a cap.
- 7.12 Geoffrey Lloyd and the City of London Law Society, opposed to allowing these policies, thought a cap should be calculated only to cover funeral expenses.
- 7.13 Proposed caps given by consultees varied between £25,000 (Hannover Life Re) and “a flexible cap at or about £50k” (Richard Buttle). Four consultees (RGA, ILAG, ABI, IUA) agreed that £30,000 was an appropriate figure. ILAG suggested that limits for death benefits only were “typically less than 10,000 Euro” in other markets. Some suggested linking the figure to the statutory amount available for bereavement damages. ABI suggested that an alternative to a fixed cap would be “a flexible cap of or about £52,000 which is currently approximately twice average earnings”.

Disagreed

- 7.14 Several consultees thought that insurers “should decide what is reasonable and what risk they are prepared to cover” (GRiD). The ABI thought:

There are circumstances in which there could be very legitimate reasons for a very high sum assured. These might include living benefits for a critical illness such as childhood cancer. There is a real probability that a significantly ill child may not only require substantial modifications to be made to the home at short notice, but also expensive ongoing care, often from a high earning parent.

- 7.15 Two consultees pointed out that, “if a parent is determined to insure for more than the cap amount they may simply take out multiple policies which, as they are not policies of indemnity, would not be illegal” (Mark Wibberley).

SHOULD COHABITANTS HAVE AN INSURABLE INTEREST IN EACH OTHERS’ LIVES?

- 7.16 We proposed extending the categories of natural affection to include some cohabitants. We asked whether consultees agreed that (i) a person should have an insurable interest in the life of another, irrespective of whether they can show economic loss, (ii) where they have lived in the same household as spouses (husband, wife or civil partner) during the period of five years ending immediately before the contract of life insurance is taken out.
- 7.17 Of 19 who answered the first part of the question, 12 consultees (61%) agreed that, in principle, cohabitants should have an insurable interest regardless of proof of economic loss. Four (22%) disagreed, and three (17%) marked “other”.
- 7.18 Six consultees (40%) of 15 who answered the second part agreed that a five year period was appropriate. Seven (47%) disagreed. Two (13%) marked “other”.

Agreed (extension of natural affection category to cohabitants)

- 7.19 The IUA said that:

adding cohabitation to the list of ‘natural affection’ relationships recognises contemporary social patterns and occurs in practice anyway, at least to some extent. Further, the Ombudsman has already enforced this principle and legal assignment is also readily available to the parties to circumvent the existing rules.

- 7.20 The IUA noted though that as a matter of best practice underwriters would base coverage on economic dependency, “according to the economic and legal basis of the relationship”. Richard Buttle, marking “other”, suggested that this sort of cover “is already in effect nodded through”.
- 7.21 Geoffrey Lloyd thought that where cohabitants demonstrated a “long term commitment” there was no reason to discriminate between them and married couples in this regard. The Financial Services Consumer Panel thought it was “fair and reasonable for these couples to expect the same rights as spouses when taking out life insurance”.

Disagreed

- 7.22 Five of those who disagreed or marked “other” (including the ABI, Hannover Life Re and ILAG) thought that the economic loss test would suffice, and that there was no need to extend the category of natural affection. The ABI, Hannover Life Re, and ILAG all thought that where a couple had been cohabiting for five years, they would usually satisfy the economic dependency test.
- 7.23 Naomi Talisman (who disagreed) and the Bar Council (marking “other”) raised the possibility of moral hazard in these circumstances, and the possibility of encouraging wrongdoing “by nefarious tenants or carers”.

Agreed (five year time period)

- 7.24 The Judges of the Court of Session and the City of London Law Society appreciated the need for a “clear-cut benchmark”, though both noted that there was no particular reason why that period should be five years. The Judges of the Court of Session noted that “those who can show economic dependency within a shorter period can prove an insurable interest separately by that route without having to rely on this category”.

Disagreed

- 7.25 In addition to those who disagreed altogether with the extension of the natural affection category to cohabiting couples, three consultees who agreed with the extension thought that the five year period was undesirable. The Financial Services Consumer Panel thought that it was “an arbitrary and high threshold”, suggesting six months was appropriate. GRiD referred to the group insurance market where, they said, “it is common to consider periods of 3 months to 6 months”.
- 7.26 Two consultees thought that the definition of cohabitants for the purposes of this proposal should be commensurate with definitions in other parts of the law. The Law Society of Scotland thought that for Scots law at least the definition should mirror that given in section 25 of the Family Law (Scotland) Act 2006¹ while the IUA thought “it would seem logical to link the required duration to the existing statutes on inheritance and fatal accidents”.

¹ This defines cohabitants as persons living together as husband and wife, or civil partners. The section gives factors to take into consideration in answering that question: the length of time the couple have been living together; the nature of their relationship during that period; and the extent and nature of any financial arrangements during that period.

PART 8

TRUSTEES OF PENSION OR GROUP SCHEMES

- 8.1 We identified a problem in the law in regard to those who took out insurance on behalf of members of a pension scheme, or employers who provided group life insurance to their employees. We noted that it was not clear that, as the law currently stood, these trustees had a sufficient insurable interest in the lives they were insuring.

GROUP SCHEME TRUSTEES INSURABLE INTEREST

- 8.2 We asked whether statute should clarify that trustees of pension and other group schemes have an unlimited insurable interest in the lives of the members of the scheme. Nineteen consultees answered this question and 17 of them (89%) agreed with the proposal. Two (11%) marked “other”.

Agreed

- 8.3 A number of consultees had, as the Consultation Paper anticipated, assumed that the existence of an insurable interest in these circumstances was not in doubt. Norton Rose LLP said that:

The bare trust enables the employer to hold the amount payable for individual life assured on the trust for that life assured. As this does not enable anyone other than the life assured to benefit, we believe this is rightly considered to found a sufficient insurable interest.

- 8.4 This was broadly consistent with the interpretation offered by other consultees.

EMPLOYERS’ INSURABLE INTEREST IN THE LIVES OF EMPLOYEES

- 8.5 We also asked whether an employer should have an unlimited interest in the lives of its employees when entering into a group scheme whose purpose is to provide benefits for its employees or their families. Fifteen consultees (79%) of 19 who answered this question agreed with the proposal. Four (21%) marked “other”.
- 8.6 As with the previous question, this proposal was largely uncontroversial and consultees regarded the situation as analogous to trustees who take out a group policy and made similar comments.
- 8.7 Most of those who marked “other” did so as they believed that this was already the state of the law, and therefore that no reform was needed. The Bar Council was the exception, who saw this “as a matter primarily for the industry”.

PART 9

CHANGES TO THE STATUTORY BASIS

- 9.1 In our Consultation Paper we identified problems with the statutory underpinning of the requirement of insurable interest in contracts for life cover.

REPEALING SECTION 2 OF THE LIFE ASSURANCE ACT 1774

- 9.2 Section 2 of the Life Assurance Act 1774 imposes a formal requirement for those who would benefit from a policy to be named in the policy. We proposed the abolition of this requirement. 94% of consultees (17 of 18 who answered this question) agreed with our proposal. Only one disagreed, who had some concern about how the reforms might be shaped.
- 9.3 The Bar Council was “not aware that the requirement to name in the policy those interested in the insurance serves any useful commercial purpose: as opposed to providing insurers with a technical defence”.
- 9.4 The IUA and the ABI agreed with the proposal, but noted that for practical purposes insurers did often need to know who was interested in the policy. They thought though that this would be “best dealt with via regulation and market practice” (ABI).

A NEW STATUTORY REQUIREMENT FOR INSURABLE INTEREST

- 9.5 We also proposed an updated statutory requirement for insurable interest to replace that contained in the 1774 Act. Of nineteen who answered, 15 consultees (79%) agreed. Three (16%) disagreed and one (5%) marked “other”.

Agreed

- 9.6 Most consultees agreed with this proposal without further comment. The City of London Law Society thought that this would be “necessary” to implement the proposed changes to categories of natural affection and insurable interest based on economic interest.

Disagreed/marked “other”

- 9.7 Three consultees were worried that it would be difficult to produce a satisfactory statutory definition of insurable interest. There was concern that the concept was “not well understood outside of the insurance industry” and that as a result there would be “no proportionate benefit” from reforming the concept. There was also concern that inadequacies in a new statutory definition might lead to uncertainty and unintended consequences.
- 9.8 Airmic was not convinced that there ought to be any requirement for insurable interest in this area.

LACK OF INSURABLE INTEREST: VOID BUT NOT ILLEGAL

- 9.9 We proposed some changes to the consequences of a failure to meet the statutory requirement for insurable interest. We asked if consultees agreed that, where an insurable interest is not present, the contract should be void but not illegal. Nineteen consultees responded to this question, of whom 17 (89%) agreed with our proposal. Two (11%) disagreed.

Agreed

- 9.10 Several consultees agreed in principle but thought the situation was unlikely to ever occur “since insurable interest is established at the outset and not policed thereafter” (Hannover Life Re). BILA noted that an insurer could be subject to regulatory penalties for writing a contract without insurable interest.
- 9.11 The ABI thought that it should be at the option of the insurer to declare the contract void.

Disagreed/marked “other”

- 9.12 GRiD remarked that “the only way of enforcing this requirement is to make it illegal” but did not elaborate on why they thought it would be insufficient to make such contracts void.
- 9.13 Airmic said it is “not necessary for the insured to show an insurable interest”, and that “all that is required is for both parties ... to be content that the insurance contract is valid and ethical”.

SEPARABILITY OF COMPOSITE POLICIES WHERE INSURABLE INTEREST LACKED FOR PART OF THE POLICY

- 9.14 We proposed that, for composite policies, where insurable interest was present for part of the insurance but not others then the policy should be treated as separable. Seventeen of 18 consultees (94%) who responded agreed with this proposal. One (6%) disagreed.
- 9.15 There was very little further comment made in response to this question. The ABI noted that “policies are often written in this way and the proposal would not greatly change the way the industry operates”.
- 9.16 GRiD’s objection to the proposal was based on its objection overall to a statutory requirement of insurable interest.

A STATUTORY REQUIREMENT FOR INSURABLE INTEREST IN CONTINGENCY INSURANCE

- 9.17 Finally, we proposed some changes to the way insurable interest works in relation to contingency insurance. We asked whether consultees agreed that, for contingency insurance, insurable interest must be present at the time of the contract.
- 9.18 Nineteen consultees answered this question. Sixteen (84%) agreed with our proposal, two (11%) disagreed and one (5%) marked “other”.

Agreed

9.19 The Bar Council agreed:

... provided that the insurable interest is defined as “a reasonable expectation” of an economic dependency, then that concept is sufficiently flexible to allow insurance to be effected prior to the economic dependence having arisen.

9.20 BILA thought that this was “re-stating the current common law position”.

Disagreed/other

9.21 The ABI drew a distinction between the time of contract and the time inception. They said “it should be sufficient for [the insurable interest] to exist at inception”.

A NON-EXHAUSTIVE DEFINITION OF INSURABLE INTEREST FOR CONTINGENCY INSURANCE

9.22 We asked consultees whether statute should provide a non-exhaustive definition of insurable interest in contingency insurance. Of 19 consultees who answered, 14 (74%) agreed with this proposal. Five (26%) disagreed.

Agreed

9.23 The City of London Law Society thought that a new statutory definition would be necessary in order to accommodate the new categories of insurable interest that the Consultation Paper proposed.

9.24 Several consultees (including one who marked “disagree”) were supportive of the “non-exhaustive” aspect. The Bar Council suggested that this “allows the insurance industry flexibility if it wishes to come up with new products, which are seen to serve a commercial purpose”. The ABI (who disagreed with the need for a definition) said that “if the definition was to be widened and put into statutory form, it should be a non-exhaustive list”. Geoffrey Lloyd thought it would be useful to have a statutory definition which could “take new situations into account without the need for further legislation”.

Disagreed

9.25 Some who disagreed were those who opposed a requirement for insurable interest. Mark Wibberley, who agreed with the proposal for a statutory requirement of insurable interest, nonetheless said of a statutory definition:

I do not believe the Act is the place for this to appear, it should be agreed upon within the insurance industry between insurers, brokers and risk manager representatives (eg Airmic).

APPENDIX

LIST OF RESPONDENTS

Association of British Insurers (ABI)
ACE
Airmic
Professor John Birds
British Insurance Brokers' Association (BIBA)
British Insurance Law Association (BILA)
Browne Jacobson LLP
BTO Solicitors
Richard Buttle
City of London Law Society Insurance Law Committee
Professor Malcolm Clarke
Direct Line Group (formerly RBS)
Faculty of Advocates
Financial Services Consumer Panel
GRiD
Hannover Life Reassurance (UK) Limited (Hannover Life Re)
Investment and Life Assurance Group (ILAG)
International Underwriting Association (IUA)
Judges of the Court of Session
Keoghs LLP
The Law Reform Committee of the Bar Council of England and Wales (the Bar Council)
The Law Society of Scotland
Geoffrey Lloyd
Lloyd's Market Association (LMA)
NFU Mutual Insurance Society Ltd (NFU Mutual)
Norton Rose LLP
RGA UK
RSA
Dr Caroline Sijbrandij
Naomi Talisman
Mark Wibberley
One confidential response