



**Law  
Commission**  
Reforming the law

  
**Scottish Law Commission**  
*promoting law reform*

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**Reforming Insurance Contract Law  
Issues Paper 10  
Insurable interest: updated proposals**

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**27 March 2015**

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# THE LAW COMMISSIONS – HOW WE CONSULT

**About the Commissions:** The Law Commission and the Scottish Law Commission were set up by the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

- The Law Commissioners are: The Rt Hon Lord Justice Lloyd Jones (Chairman), Professor Elizabeth Cooke, Stephen Lewis, Professor David Ormerod QC and Nicholas Paines QC. The Chief Executive is Elaine Lorimer.
- The Scottish Law Commissioners are: The Honourable Lord Pentland (Chairman), Caroline Drummond, David Johnston QC, Professor Hector L MacQueen and Dr Andrew J M Steven. The Chief Executive is Malcolm McMillan.

**Topic of this Issues Paper:** This paper contains our updated proposals for reform of the requirement for insurable interest. We have previously discussed this matter and made proposals for reform in our 2011 Consultation Paper, *Insurance Contract Law: Post Contract Duties and other Issues*, and in our 2008 Issues Paper 4. We have now reviewed our proposals in light of the consultation responses and other representations made to us.

**Geographical scope:** England and Wales, Scotland.

## How to respond

We invite responses by **29 June 2015**.

Please send your responses either:

**By email to:** [commercialandcommon@lawcommission.gsi.gov.uk](mailto:commercialandcommon@lawcommission.gsi.gov.uk); or

**By post to:** Laura Burgoyne, Law Commission, 1st Floor, Tower, Post Point 1.53, 52 Queen Anne's Gate, London SW1H 9AG. Tel: 0203 334 5327

If you send your comments by post, it would be helpful if, where possible, you also send them to us electronically (in any commonly used format).

A suggested response form is available on our website.

**Information provided to the Commissions:** We may publish or disclose information you provide us in response to this consultation, including personal information. For example, we may publish an extract of your response in Commission publications, or publish the response in its entirety. We may also be required to disclose the information, such as in accordance with the Freedom of Information Act 2000 and the Freedom of Information (Scotland) Act 2002. If you want information that you provide to be treated as confidential please contact us first, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic disclaimer generated by your IT system will not be regarded as binding on the Commissions.

The Commissions will process your personal data in accordance with the Data Protection Act 1998.

THE LAW COMMISSION  
THE SCOTTISH LAW COMMISSION

**Joint Review of Insurance Contract Law**

**Issues Paper 10**  
**Insurable interest: updated proposals**

**Contents**

	Page
<b>Part 1:</b> Introduction	1
<b>Part 2:</b> Indemnity insurance	5
<b>Part 3:</b> Life and other non-indemnity insurance	15

# PART 1: INTRODUCTION

- 1.1 The Law Commission of England and Wales and the Scottish Law Commission are undertaking a joint review of insurance contract law. To date, we have published two reports,<sup>1</sup> which have resulted in legislation introduced through the special parliamentary procedure for uncontroversial Law Commission Bills.<sup>2</sup> The nature of the procedure makes it essential for us to work with insurers, brokers, policyholders and other stakeholders, to obtain broad agreement to the reforms which we recommend.
- 1.2 This paper revisits the topic of insurable interest. We have consulted on this twice before: in an Issues Paper in 2008,<sup>3</sup> and as part of our 2011 Consultation Paper.<sup>4</sup> In 2012 we published an analysis of responses to the Consultation Paper.<sup>5</sup>
- 1.3 In 2012 we took the view that reforming the law of insurable interest was not a priority. We were told that many of the problems with the current law were theoretical rather than practical. Furthermore, consultees' views on the issue varied. Although most agreed with the overall direction of our proposals, concerns were expressed over some of the details.

<sup>1</sup> See our Reports: *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (December 2009), Law Com No 319; Scot Law Com No 219, available at <http://lawcommission.justice.gov.uk/areas/consumer-insurance.htm> and [http://www.scotlawcom.gov.uk/index.php/download\\_file/view/268/107/](http://www.scotlawcom.gov.uk/index.php/download_file/view/268/107/) and *Insurance Contract Law: Business Disclosure; Warranties; Insurers' Remedies for Fraudulent Claims; and Late Payment* (July 2014), Law Com No 353; Scot Law Com No 238, available at [http://lawcommission.justice.gov.uk/docs/lc353\\_insurance-contract-law.pdf](http://lawcommission.justice.gov.uk/docs/lc353_insurance-contract-law.pdf) and [http://www.scotlawcom.gov.uk/index.php/download\\_file/view/1291/107/](http://www.scotlawcom.gov.uk/index.php/download_file/view/1291/107/).

<sup>2</sup> In the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015.

<sup>3</sup> Issues Paper 4 - *Insurable Interest* (January 2008). Available at: [http://lawcommission.justice.gov.uk/docs/ICL3\\_Intermediaries\\_and\\_Pre-contract\\_Information.pdf](http://lawcommission.justice.gov.uk/docs/ICL3_Intermediaries_and_Pre-contract_Information.pdf) and [http://www.scotlawcom.gov.uk/index.php/download\\_file/view/203/107/](http://www.scotlawcom.gov.uk/index.php/download_file/view/203/107/).

<sup>4</sup> Chapter 3, *Insurance Contract Law: Post Contract Duties and other Issues* (December 2011) Law Commission Consultation Paper No 201; Scottish Law Commission Discussion Paper No 152 ((2011) LCCP 201/SLCDP 152). Available at: [http://lawcommission.justice.gov.uk/docs/cp201\\_ICL\\_post\\_contract\\_duties.pdf](http://lawcommission.justice.gov.uk/docs/cp201_ICL_post_contract_duties.pdf) and [http://www.scotlawcom.gov.uk/index.php/download\\_file/view/947/107/](http://www.scotlawcom.gov.uk/index.php/download_file/view/947/107/).

<sup>5</sup> Available at: [http://lawcommission.justice.gov.uk/docs/post-contract-duties\\_responses\\_insurable-interest.pdf](http://lawcommission.justice.gov.uk/docs/post-contract-duties_responses_insurable-interest.pdf) and [http://www.scotlawcom.gov.uk/index.php/download\\_file/view/1121/107/](http://www.scotlawcom.gov.uk/index.php/download_file/view/1121/107/).

- 1.4 However, in 2014 we were approached by the Investment and Life Assurance Group (ILAG) on behalf of life insurers, asking us to return to this issue. ILAG told us that their members are under pressure to write policies which include cover for children and cohabitants, and to insure “key employees” for substantial amounts.<sup>6</sup> Although these policies perform a useful social function, they may be considered void under the current law, strictly applied. Some court cases in England have even labelled them as “illegal”.<sup>7</sup> This may put insurers and policyholders in a difficult position.
- 1.5 In practice, it is unlikely that anyone would take issues like these to court, and we think that the courts would make every effort to find an insurable interest where both parties have willingly entered into the agreement. However, we also think that it is unsatisfactory to have law which is so old and out-dated that the only way in which the market can function is by ignoring it. It may even bring the law itself into disrepute. We have therefore returned to this subject to see if a package of reform measures could be introduced in a third Bill, again as an uncontroversial measure.
- 1.6 We are extremely grateful to all those who have responded to us on this issue previously. We are aware of the work this imposes on consultees, and we are not asking people to carry out a further detailed examination of this issue. Instead, we are interested in finding out whether consultees think that legislative reform on insurable interest would be desirable, and if so, whether the proposals we now put forward would have their broad support. Of course, if consultees do have detailed comments, we would be keen to receive them.

### **How to respond**

- 1.7 Our proposals, and the consultation questions, are set out at the end of Parts 2 (Indemnity insurance) and 3 (Life and other non-indemnity insurance) of this document. We seek responses by **29 June 2015**, by email or by post as indicated on page i. A suggested response form is provided on our websites.

### **WHAT IS INSURABLE INTEREST?**

- 1.8 At its simplest, the requirement for insurable interest 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 or damaged. The responses to the Issues Paper revealed strong support for retaining the principle of insurable interest. It was thought to guard against moral hazard,<sup>8</sup> protect insurers from invalid claims and distinguish insurance from gambling. However, we identified various problems with the current law:

<sup>6</sup> We discussed these issues with ILAG members in detail at a meeting on 19 September 2014.

<sup>7</sup> For example, *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558. The Scottish courts have entertained actions over policies where there was no insurable interest but the insurer had chosen to honour the policy: see (2011) LCCP 201/SLCDP 152 para 10.4, footnote 7.

<sup>8</sup> In this context, moral hazard is the incentive for a policyholder to intentionally bring about the insured event in order to gain from the payment.

- (1) The law is a bewildering mix of common law and statute, including various eighteenth century statutes. For example, in life insurance, the main Act – the Life Assurance Act – dates from 1774. Furthermore, there is uncertainty over the effect of the Gambling Act 2005, which may or may not affect insurance contracts.
- (2) The definition of insurable interest, largely contained in case law, is uncertain. In the context of life insurance particularly, it has been interpreted extremely narrowly. Some binding cases no longer accord with modern perceptions, suggesting for example that a son could not take out burial insurance on the life of his mother because there is no legal obligation on an adult child to bury a parent.<sup>9</sup>
- (3) The doctrine differs depending on the type of insurance. Discussions of insurable interest typically divide insurance between indemnity insurance (such as buildings or liability insurance) and contingency insurance (mainly life and personal accident insurance). However, these distinctions are not clear cut and there are some unnecessary variations. Further, minor variations between English and Scots law on the matter are not helpful and generally not based on any coherent view of policy or fundamental doctrine.

## **OUR PREVIOUS PROPOSALS**

### **Generally**

- 1.9 The current state of the law in this area makes it difficult to state with certainty what amounts to an insurable interest, or to specify the consequences of writing insurance without it. Our 2011 Consultation Paper made proposals to clarify the law.
- 1.10 We looked separately at indemnity insurance and contingency insurance. Indemnity insurance indemnifies the policyholder for losses suffered; examples include buildings insurance, liability insurance and business interruption insurance. The indemnity principle requires that the insured should have suffered a loss in order to recover under the policy. By contrast, contingency insurance pays a fixed sum on a given event. Most life insurance is written on a contingency basis, as are many accident and critical illness policies.
- 1.11 For indemnity insurance, our proposals focused on restating current principles in a clearer way. These proposals were well supported, with limited additional comments offered on the detail.

<sup>9</sup> *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558.

## **Life insurance**

- 1.12 For life insurance, however, we argued that the current rules are too restrictive. We proposed to widen the category of those entitled to insure another person's life to allow cohabitants to insure each other's lives, and parents to insure the lives of their children under 18. However, we took a cautious approach to these extensions. We suggested, for example, that life insurance on children should be subject to a financial cap, and that cohabitants should have lived together for a minimum period before being entitled to insure each other's lives.
- 1.13 Some consultees thought that we had been too cautious. It was put to us that whether a particular form of insurance might result in moral hazard was an issue which should be left to the good sense of the industry – or, failing that, to regulatory rather than statutory intervention. It was suggested that enshrining a cap or detailed definition in statute may make it difficult to respond to a rapidly developing market and changing family structures.
- 1.14 Our current proposals would allow a parent to insure the life of any child (irrespective of their age), without any cap on the amount. It would also be permissible for cohabitants to insure each other's lives, without a minimum period of cohabitation. We say this on the basis that insurers will exercise restraint in not insuring these lives for inappropriately large payments, and that if this were to become an issue the Financial Conduct Authority may seek to intervene.

## **THE STRUCTURE OF THIS PAPER**

- 1.15 In this paper we set out our current proposals, first on indemnity insurance and then on life insurance. We start with a short explanation of the issues, list our proposals and then ask questions.
- 1.16 To keep this paper brief, we do not give a full account of the current law. Consultees who wish to know more about the law as it is now are referred to Part 11 of our 2011 Consultation Paper. For ease of reference, we have placed a copy of this Part separately online.<sup>10</sup>

<sup>10</sup> [http://lawcommission.justice.gov.uk/consultations/insurable\\_interest.htm](http://lawcommission.justice.gov.uk/consultations/insurable_interest.htm) and <http://www.scotlawcom.gov.uk/law-reform-projects/joint-projects/insurance-law>. There have been no significant developments since 2011.

## PART 2: INDEMNITY INSURANCE

### INTRODUCTION

- 2.1 We start by looking at insurable interest in indemnity insurance, where (unlike life insurance) the policyholder is indemnified against a loss. In the 2011 Consultation Paper, we set out several provisional proposals for reform of insurable interest in the indemnity insurance context. These proposals were well supported and in this paper we propose only small amendments to them.
- 2.2 For a more detailed discussion of insurable interest in indemnity insurance, see Part 12 of the Consultation Paper.<sup>1</sup>

### RETAINING INSURABLE INTEREST

- 2.3 In response to our 2008 Issues Paper,<sup>2</sup> most consultees argued that the insurable interest requirement in indemnity insurance should be retained.<sup>3</sup> As we explained in our Consultation Paper, they gave four reasons.
- (1) **It is the hallmark of insurance.** Several respondents, including the Association of British Insurers (ABI), argued that insurable interest is part of the definition of insurance and delineates the boundaries within which the insurance industry operates. This is important for legal, regulatory and tax purposes.<sup>4</sup> Furthermore, the concept is used in various jurisdictions and there was concern that its abolition would make English and Scots law based contracts less competitive.
  - (2) **It reinforces market discipline.** It was said to be one of the factors restraining the insurance industry from trading which is more speculative.<sup>5</sup>
  - (3) **It acts as a barrier against invalid claims.** This was particularly true for marine insurance policies on goods, where the benefit may be assigned but claims may only be brought by those to whom risk has passed under a contract of sale. Requiring an insurable interest ensures that only one interested party can claim.
  - (4) **It may have other specific uses.** Respondents mentioned a variety of other specific uses. For example, the requirement for insurable interest may help define where insurance is located, which is increasingly important for regulatory and tax purposes.

<sup>1</sup> *Insurance Contract Law: Post Contract Duties and Other Issues* (2011) LCCP 201/SLCDP 152.

<sup>2</sup> Issues Paper 4 - *Insurable Interest* (2008).

<sup>3</sup> 13 out of the 15 consultees who addressed the issue said that insurable interest should be retained. See (2011) LCCP 201/SLCDP 152, paras 12.2 to 12.25.

<sup>4</sup> Different regulatory and tax regimes apply to insurance compared to other commercial risk transfer products or to gambling. It is therefore often necessary to distinguish insurance from (for example) credit derivatives or betting.

<sup>5</sup> Insurance might in this context be contrasted with the practice of derivative trading, which has come under considerable scrutiny since the 2008 financial crisis.



## **A STATUTORY BASIS FOR INSURABLE INTEREST**

- 2.4 While the requirement of an insurable interest arises at common law in Scotland, the precise legal basis for the requirement of insurable interest in English law is uncertain. Questions about the effect of the Gambling Act 2005 on insurance have added to that uncertainty.<sup>6</sup>
- 2.5 In the Consultation Paper we proposed that there should be a statutory requirement that the insured has an insurable interest in the subject matter of the insurance.<sup>7</sup> The majority of consultees (23 of 30 who responded to this question, or 77%) were in favour of this statutory clarification. For example, Direct Line Group expressed concern over the current mix of statutes governing the issue of insurable interest, and suggested that the current statutory framework “would benefit from a consolidation and consistent approach”. The International Underwriting Association (IUA) 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 We agree that it is desirable to provide a clear statutory basis for the requirement of insurable interest.

## **TIMING AND CONSEQUENCES**

### **Consequences of lack of insurable interest**

- 2.7 In English law, an insurance contract made without insurable interest is said to be not only void but also illegal.<sup>8</sup> This means that not only are claims not paid, but premiums may not be repayable.<sup>9</sup> A Court of Appeal judge commented that he was baffled by this rule and asked Parliament to look at it again.<sup>10</sup> The Scots law of unjustified enrichment may by contrast allow recovery of premiums paid under an illegal contract which is void but involves no “moral turpitude”.<sup>11</sup>

<sup>6</sup> The Gambling Act 2005 legalised certain gambling contracts and there is some debate about whether it could have indirectly removed the requirement for insurable interest in indemnity insurance. See paras 11.26 to 11.35 of (2011) LCCP 201/SLCDP 152. The 2005 Act extends to both England & Wales and Scotland.

<sup>7</sup> (2011) LCCP 201/SLCDP 152, paras 12.41 to 12.42.

<sup>8</sup> *Harse v Pearl Life Assurance Co* [1904] 1 KB 558.

<sup>9</sup> In the 1989 Insurance Ombudsman Bureau Annual Report, the ombudsman said he would not treat these policies as illegal.

<sup>10</sup> *Feasey v Sun Life Assurance Co* [2003] EWCA Civ 885, [2003] 2 All ER (Comm) 587, per Lord Justice Waller at [192].

<sup>11</sup> *Cuthbertson v Lowes* (1870) 8 M 1073; cf *Jamieson v Watt's Trs* 1950 SC 265.

2.8 Under the current law, it is not always clear when an interest has to exist. For marine insurance, the insured must have an insurable interest at the time of the loss, but need not necessarily have one when the contract is entered into. For non-marine insurance, the position is less clear in England and Wales, though it has been argued that it is probably the same as for marine insurance. This contrasts with the Scots law position, where the common law requires an interest to be demonstrated at the time the policy is taken out.<sup>12</sup>

2.9 In 2010 we pointed out that in some cases the policyholder may have an insurable interest at some time during the insurance period, but not at other times. We gave the following example:

In January a second-hand car dealer enters into a year's contract to insure a garage which it intends to buy in February. The purchase is delayed until 31 March. From 1 April to 31 October, the policyholder owns the garage, but sells it again on 1 November.

2.10 Under Scots law, it is arguable that the car dealer would not have an insurable interest because the dealer had no right in the property when the contract was entered into. In England and Wales the position is unclear, although it appears that it would depend on the situation at the time of the loss. We propose clarifying these issues.

2.11 Below, we consider the following questions:

- (1) What interest must be shown for an insurance contract to be valid?
- (2) What are the consequences of an insurance contract being considered void for lack of insurable interest?
- (3) When may the policyholder claim for a loss?

### **What interest must be shown for an insurance contract to be valid?**

#### ***Possibility of acquiring an insurable interest***

2.12 In the Consultation Paper, we suggested that an insurance contract should be void for lack of insurable interest unless there is a "real probability" that a party will acquire some form of insurable interest at some stage during the life of the contract. In the example above, the second hand car dealer had, in January at the time of the contract, a real probability of acquiring an insurable interest in the garage. We think that this on its own should be sufficient to make the contract a valid one for which premiums are due. Whilst it is true that the insured only obtains seven months benefit out of a twelve month contract, this was the risk that the insured took in organising insurance in advance.

2.13 This proposal was well supported (with 18 of 26 consultees, or 69%, agreeing). However, some consultees (including those who agreed with the policy) made particular comments or raised queries about how this would work in particular circumstances. We have therefore revisited the detail of this proposal.

<sup>12</sup> *The Laws of Scotland (Stair Memorial Encyclopaedia)*, Vol 12, para 856.

### ***“Real probability”?***

- 2.14 Some consultees raised concerns that the threshold of “real probability” was too high a bar, and could threaten to undermine useful commercial insurance products which cover future ventures.<sup>13</sup> Consultees suggested alternative formulations such as “reasonable expectation” and “reasonable prospect”.
- 2.15 We think that the differences are more presentational than substantive. In most circumstances the courts would try to find an insurable interest where the parties have willingly entered into a contract. However, we agree that the language used should not suggest an overly high threshold and we agree that this could be implied by “real probability”.
- 2.16 The wording of any statutory test which we ultimately recommend will be determined based on consultees’ views, a review of formulations used in other areas of law, and discussions with parliamentary draftsmen as to the best way to capture the flexible, objective nature of the assessment. In the meantime, we propose that at the time of the contract, there must be a “reasonable prospect” (or similar) of acquiring an insurable interest. If there is not, the policy should be void. In such circumstances the policy is effectively worthless.

### ***Never actually acquiring an interest***

- 2.17 In our Consultation Paper we considered the appropriate outcome where the insured might have obtained an insurable interest but did not do so. Suppose, in this example, that the dealer went into liquidation in February, and never bought the garage. Again, the contract would be considered valid because at the outset there was a reasonable prospect that an insurable interest might have been acquired. On the other hand, a gambler who enters into a contract of insurance against the collapse of the Eiffel Tower, having no reasonable expectation of acquiring an interest in it, will have entered into an invalid contract of insurance.

### ***Actually acquiring an insurable interest***

- 2.18 In their consultation responses, some parties envisaged a scenario in which, despite having no “real probability” or “reasonable expectation” of acquiring an interest at the time of the contract, somehow the policyholder does in fact acquire an interest during the period of the insurance.
- 2.19 In discussing the example above, the Judges of the Court of Session put the problem in the following terms:

<sup>13</sup> The Bar Council gave the example of the policy in *BP plc v GE Frankona Reins Ltd* [2003] 1 Lloyd’s Rep 537, which covered BP’s interest in any offshore projects that it might undertake within a fixed period, though at the time when the insurance was placed it was unclear what, if any, offshore projects might proceed.

At the time of entering into the policy in January, the car dealer may genuinely intend to buy the garage in February, but he might find it difficult to prove that as at the date of the policy... He might, for example, find it difficult to prove there was “real probability” of his offer being accepted... The fact that he might ultimately be successful in buying the garage would then count for nothing – he would have the garage, but his policy would be void and he would be uninsured....

2.20 The concern was also put forward by the Bar Council who asked:

If the “gambler” did in fact acquire an interest in the Eiffel Tower before the date of the loss, even though that was a remote possibility at the time when the insurance was effected, why then should he not be able to recover if the Eiffel Tower did then collapse?

2.21 We think it is relatively unlikely that an insured would have no reasonable expectation of acquiring an insurable interest but then end up doing so. In the former case, we anticipate that replacing the “real probability” test with “reasonable prospect”, or similar, would assist. The latter case is more theoretical but even so we do appreciate that it could occur.<sup>14</sup> In either case, two unfortunate outcomes are possible:

- (1) The policyholder could potentially be left without a valid insurance contract in the event of a claim; or
- (2) The insurer could be left vulnerable to a claim by the policyholder for return of the premium despite the policyholder acquiring an interest (assuming that the Eiffel Tower was not damaged during the policy term and therefore the policyholder did not seek to claim).

2.22 We have therefore modified our proposal as follows:

- (1) An insurance contract should be valid (in terms of insurable interest) if the insured has at the outset of the policy a reasonable prospect (or similar)<sup>15</sup> of acquiring an insurable interest during the life of the policy.
- (2) If the insured actually acquires an insurable interest at any time during the duration of the policy, this should be conclusive proof of a reasonable prospect having existed at the outset of the policy.

<sup>14</sup> Another example might be a company acting optimistically by insuring a property it wished to acquire even though it did not have the resources to do so. If it received an unexpected windfall, the sale might go ahead.

<sup>15</sup> See paras 2.14 to 2.16 for a discussion of the language here.

**What are the consequences of an insurance contract being considered void for lack of insurable interest?**

***Premiums must be paid unless the contract is void***

2.23 We proposed that if the insured shows that an insurance contract is void for lack of (actual or anticipated) insurable interest, the insurer should not be entitled to sue for the premium and the insured should be entitled to a refund of premiums already paid. Of twenty five consultees who responded to this question, seventeen (68%) agreed.

2.24 RSA said that, “in the absence of any real probability, consideration fails on the part of the insurer, and the premiums should be refunded to the customer”. 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.

2.25 We believe that a refund of premiums paid should always be available where the contract is void. This ensures that both parties will seek to enter into insurance contracts where there is a reasonable prospect of acquiring an insurable interest, rather than overly speculative agreements. If the contract is valid, the insurer is entitled to sue for any unpaid premium.

**When may the policyholder claim for a loss?**

2.26 In deciding whether the policyholder should be entitled to make a claim, the crucial issue is whether there is an insurable interest at the time of the loss. We said that, if the insured does not have an insurable interest at the time when the loss occurs, they may not make a claim. This is the position under the current law, and we think it should be confirmed in statute.

2.27 In the car garage example above, suppose that the garage suffers minor storm damage on 1 February, but the dealer decides to go ahead with the purchase regardless. The dealer may not claim for this damage, as it did not have an insurable interest at the relevant time. However, if the property sustained damage in June (during the period of the insured’s ownership) the insured would be entitled to claim.

2.28 In our Consultation Paper, we asked whether in order to make a claim the insured must have an insurable interest at the time of the loss. Of the consultees that responded to this question, 20 out of 25 (80%) agreed.

## **EFFECT ON EXISTING STATUTES**

### **Repealing the Marine Insurance (Gambling Policies) Act 1909**

- 2.29 This Act makes it a criminal offence to effect a contract of marine insurance without having a bona fide interest. We have not found any evidence of prosecutions under the Act. We do not think it is necessary to impose criminal liability, as any problems in the market are subject to financial services regulation. All 23 consultees who responded to this question supported the repeal of this Act.<sup>16</sup>

### **Repealing the Marine Insurance Act 1788**

- 2.30 This Act requires the names of those interested in the insurance to be inserted into the policy. The Act was repealed by the Marine Insurance Act 1906, but only insofar as it applies to marine insurance. It appears to continue to apply to non-marine insurance but is routinely ignored. Of 24 consultees who responded to this proposal, 23 (96%) agreed that the 1788 Act should be repealed.<sup>17</sup>

### **Retaining the provisions on insurable interest in the Marine Insurance Act 1906**

- 2.31 Sections 4 to 15 of the 1906 Act govern the requirement for insurable interest for insurance contracts that fall within the ambit of the Act. We have been told they operate well and do not intend these provisions to be affected by our proposed reforms.<sup>18</sup> Of 17 consultees who answered this question, 15 (88%) agreed that this was the correct approach.

## **DEFINING INSURABLE INTEREST**

- 2.32 In the Consultation Paper, we discussed two options for encapsulating an insurable interest requirement in statute.<sup>19</sup> One option would be to impose a requirement for insurable interest by statute but leave the meaning of insurable interest entirely to the courts. Alternatively, statute could set out a definition of sorts, in the form of a non-exhaustive list for non-marine indemnity insurance.
- 2.33 The majority of our consultees (16 of 23, or 69%) favoured a non-exhaustive list which defines insurable interest for the purpose of indemnity insurance.<sup>20</sup>

### **Examples of interests amounting to insurable interest**

- 2.34 We analysed the main cases on insurable interest and identified three examples of interests which we proposed would form part of any non-exhaustive list. We asked consultees whether they agreed with each of them.

<sup>16</sup> For more information on the Marine Insurance (Gambling Policies) Act 1909 see (2011) LCCP 201/SLCDP 152, paras 12.51 to 12.52.

<sup>17</sup> For more information on the Marine Insurance Act 1788 see (2011) LCCP 201/SLCDP 152, paras 12.54 to 12.55.

<sup>18</sup> (2011) LCCP 201/SLCDP 152, paras 12.57 to 12.58.

<sup>19</sup> (2011) LCCP 201/SLCDP 152, paras 12.60 to 12.65.

<sup>20</sup> 5 of 22 consultees (23%) thought that the definition should be left entirely to the courts.

### ***Right in property***

- 2.35 We suggested that an insured has an insurable interest if the insured has a right or interest in the property which is the subject matter of the insurance contract or a right arising out of a contract in respect of it. This is the classic test, as set out in *Lucena v Craufurd*.<sup>21</sup> Twenty six consultees responded to this question, of whom 15 (57%) agreed. Those who disagreed did so because they did not think there should 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. The substance of the rule was not controversial.

### ***Possession***

- 2.36 We also said that an insured should have an insurable interest where they have possession of the insured subject matter. This would provide for cases concerning bailees, such as carriers of goods.<sup>22</sup> It would also cover situations in which the insured has custody of money or other property.<sup>23</sup> In England and Wales, the courts have held that bailees may insure not just their liability to the property owner but the whole extent of the property for its full value.<sup>24</sup> Any sum recovered in excess of the bailee's immediate loss or liability is held on trust for the owner.
- 2.37 Fourteen consultees of the 25 who responded to this proposal (56%) agreed with it. Only three consultees disagreed, and eight marked "other". Again, those who disagreed or marked "other" generally did so because they did not think there should be a statutory definition of insurable interest at all. It therefore remains our policy that an insured should have an insurable interest where they have possession or custody of the insured subject matter.

### ***Reasonable prospect of economic benefit or loss***

- 2.38 Finally, we said that an insured should have an insurable interest where the insured has a factual expectation, either of an economic benefit from the preservation of the insured subject matter, or of an economic loss on its destruction, which would arise in the ordinary course of things. This is the wider test proposed by Mr Justice Lawrence in *Lucena v Craufurd*, which has since been approved by the Court of Appeal in *Feasey*.<sup>25</sup>
- 2.39 14 of 26 consultees (53%) agreed with this proposal. Only three (12%) disagreed, but nine (35%) marked "other", making comments about how this would work.

<sup>21</sup> (1806) 2 Bos & PNR 269. For Scotland see Gloag & Henderson *The Law of Scotland* (13th ed 2012) para 20.04 (insurable interest generally proprietary, including right in security, or one giving a right to enjoyment of the property in some way).

<sup>22</sup> In Scots law, there is no direct equivalent of bailment but a party who has a liability for the loss or destruction of property (usually under a contract such as one of carriage) has thereby an insurable interest: Gloag & Henderson *The Law of Scotland* (13th ed 2012) para 20.04.

<sup>23</sup> Under a contract of deposit in Scots law the depositary is obliged to provide a secure place of custody and to exercise due care to prevent loss or damage to the property (Gloag & Henderson *The Law of Scotland* (13th ed 2012) para 13.22). This probably suffices for an insurable interest to arise.

<sup>24</sup> For example, *A Tomlinson (Hauliers) Ltd v Hepburn* [1966] AC 451.

<sup>25</sup> *Feasey v Sun Life Assurance Co* [2003] EWCA Civ 885 [2003], 2 All ER (Comm) 587.

- 2.40 We originally proposed that there should be a “real probability” of economic loss or gain. Again, some consultees, including the Judges of the Court of Session and the insurer ACE, queried whether this was the appropriate test. ACE suggested that this test required “an unduly high likelihood of economic benefit or loss”. They suggested alternatives such as “reasonable expectation”, “reasonable prospect” and “real possibility”. We agree that these broader formulations better represent the flexible nature of the test and are in line with our general approach in this area.<sup>26</sup>
- 2.41 We propose that insureds should have an insurable interest where they have a reasonable prospect (or similar) of economic benefit from the preservation of the insured subject matter, or of an economic loss on its being damaged or destroyed, which would arise in the ordinary course of things. Further discussion and analysis will be required before we recommend any particular form of words.

#### **Statutory definition of insurable interest: other interests**

- 2.42 We asked whether any other forms of insurable interest should be included in any non-exhaustive statutory list. Consultees generally emphasised that the list should be non-exhaustive. For example, ACE said:

In our view, the list **must** be non-exhaustive. To do otherwise would risk severely restricting the development of new insurance products.

- 2.43 Only a small number suggested other specific interests to be included – such as interests in financial assets specifically rather than general “property”, or the arrangements for construction policies including sub-contractors’ interests. However, given that the list will be non-exhaustive, we do not propose to include other very specific forms of insurable interest in case that would narrow the interpretation of the provision unduly. The statute would need to be drafted in a way which retained the current ability of the courts to develop the definition of insurable interest flexibly to meet new circumstances.

### **LIST OF UPDATED PROPOSALS: INDEMNITY INSURANCE**

#### **Timing and consequences**

##### ***Concluding a valid insurance contract***

**Proposal 1:** An insurance contract is void for lack of insurable interest unless the policyholder has an insurable interest at the time the contract is made or there is a reasonable prospect (or similar) at that time that the policyholder will acquire some form of insurable interest during the life of the contract.

**Proposal 2:** If the insured actually acquires an insurable interest at any time during the duration of the contract, this should be conclusive proof that they had such a reasonable prospect (or similar) at the time of the contract.

##### ***When the insured can make a claim***

**Proposal 3:** To make a claim, the insured must have an insurable interest at the time of the loss.

<sup>26</sup> See also paras 2.14 to 2.16 above.



### ***Consequences for lack of insurable interest***

**Proposal 4:** If an insurance contract is void for lack of insurable interest, the insurer should not be entitled to sue for premium, and the insured is entitled to a refund of premiums already paid.

### **Repealing obsolete statutes**

**Proposal 5:** The Marine Insurance (Gambling Policies) Act 1909 should be repealed.

**Proposal 6:** The Marine Insurance Act 1788 should be repealed.

### **Retaining the provisions on insurable interest in the Marine Insurance Act 1906**

**Proposal 7:** For marine insurance, sections 4 to 15 of the Marine Insurance Act 1906 should be left as they are.

### **Defining insurable interest**

**Proposal 8:** Statute should define insurable interest for the purpose of indemnity insurance using a non-exhaustive list of examples of insurable interest.

**Proposal 9:** The statute should state that an insured has an insurable interest if the insured has:

- (1) 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;
- (2) possession or custody of the insured subject matter; or
- (3) a reasonable prospect (or similar) either of an economic benefit from the preservation of the insured subject matter, or of an economic loss on its damage or destruction, which would arise in the ordinary course of things.

### **CONSULTATION QUESTIONS**

**Question A:** Do you agree that the law of insurable interest in indemnity insurance should be clarified in statute?

**Question B:** Do you agree in broad terms with these proposals?

**Question C:** Do you have any detailed comments on these proposals?

A suggested response form is provided on our website.

# PART 3: LIFE AND OTHER NON-INDEMNITY INSURANCE

## INTRODUCTION

- 3.1 Non-indemnity or “contingency” insurance pays a set sum on the occurrence of a defined event. It includes life insurance, personal accident insurance and critical illness cover. It would also include valued policies on land, goods and marine insurance.<sup>1</sup>
- 3.2 The focus of this Part is on life, accident and critical illness insurance. These types of policy are governed by the Life Assurance Act 1774, and we use the term “life insurance” as shorthand for them.
- 3.3 We think that the current law is unduly restrictive, and have identified the following particular issues:<sup>2</sup>
  - (1) The law allows people to insure their own life and that of their spouse for an unlimited amount, based on “natural affection”. However, this rule is extremely limited, excluding cohabitants and children. We propose expanding the category of natural affection to recognise other relationships.
  - (2) Many policies are based on the fact that the insured will suffer financial loss on the death or injury of another. This category is restricted in two ways.
    - (a) It only covers “pecuniary loss recognised by law”. This is very narrow, requiring the insured to have a legal right to payment and not a reasonable expectation based on a less formal arrangement. We propose that this test should be relaxed.
    - (b) Under section 3 of the Life Assurance Act 1774, any recovery is limited to the value of the insurable interest at the time of the contract, even though the extent of loss may vary over time. We propose that this test should be relaxed.
  - (3) The basis of insurable interest in group insurance policies is uncertain. We propose that there should be statutory rules to deal with this type of policy.

<sup>1</sup> Broadly speaking, a valued policy is one which requires the insurer to pay to the policyholder a fixed sum in the event of loss, rather than an amount based on the extent of the actual loss suffered.

<sup>2</sup> See *Insurance Contract Law: Post Contract Duties and other Issues* (2011) LCCP 201/SLCDP 152, Part 13, and Issues Paper 4 - *Insurable Interest* (2008), Part 4 for further discussion.

- 3.4 In response to our Consultation Paper there was considerable agreement that the concept of insurable interest should be retained and expanded to allow people more readily to insure cohabitants and children. There was also significant agreement that the law should make it easier to insure the life of another where there was a real probability<sup>3</sup> of economic loss on their death.
- 3.5 However, many insurers thought that in some respects the proposals were too detailed and prescriptive. They thought our reforms should be confined to broad principles and, for example, should not include specific caps or limits.
- 3.6 In this Part we set out updated proposals. These proposals build on the tentative proposals included in our Consultation Paper, and in some instances modify those proposals based on the responses received to the consultation or views communicated to us since then.

### **BRIEF OVERVIEW OF THE CURRENT LAW**

- 3.7 The Life Assurance Act 1774 renders null and void any insurance policy to which the Act applies if it is made in the absence of insurable interest. Although the statute does not indicate what type of interest is required, subsequent case law and statutes have established four categories:
- (1) Interest arising out of a potential financial loss which is recognised by law and which can be shown to have existed at the time the contract was made. Currently, this test is applied very narrowly.
  - (2) Interest arising out of natural affection, which does not require financial loss to be evidenced. Under the current law, natural affection extends only to give the insured an interest in their own life,<sup>4</sup> and that of their spouse or civil partner.<sup>5</sup>
  - (3) Interest arising out of statutory provisions.
  - (4) Interest recognised by the courts that does not fit into any of the above categories.
- 3.8 The Act limits the amount of any recovery to the value of the interest. This must necessarily be assessed at the time the contract is made. In terms of formalities, it requires the names of those interested to be noted in the policy document.
- 3.9 The Act applies not just to life but also "other events", though not to "ships, goods, or merchandises",<sup>6</sup> nor to indemnity insurance of any kind.<sup>7</sup>

<sup>3</sup> See paras 2.14 to 2.16 for a note on this terminology.

<sup>4</sup> *Wainwright v Bland* (1835) 1 Moo & R 481.

<sup>5</sup> *Griffiths v Fleming* [1909] 1 KB 805; *Reed v Royal Exchange Assurance Co* (1795) Peake Ad Cas 70; Civil Partnership Act 2004, section 253. This now also extends to same sex married couples: Marriage (Same Sex Couples) Act 2013, s 11 and Marriage and Civil Partnership (Scotland) Act 2014, s 4. It has been suggested that, in Scots law, a child is entitled to insure the life of a parent in some circumstances following from the obligation of parents to maintain their children; see LCCP 201/SLCDP 152, para 11.76.

<sup>6</sup> Section 4.

- 3.10 In English law (probably contrasting with Scots law in this), life insurance made without interest is not only void but also illegal.<sup>8</sup>
- 3.11 A full discussion of the current law, as set out in the 2011 Consultation Paper, is published separately and available on our websites.<sup>9</sup>

## **PROPOSALS FOR REFORM: INSURABLE INTEREST BASED ON ECONOMIC LOSS**

### **The test for insurable interest**

#### ***Current law***

- 3.12 Under the current law, a policyholder may insure the life of another person on the grounds that they would suffer a financial loss on the other's death. The current test is very narrow: the insured must show an interest which is pecuniary and recognised by law. A "pecuniary interest"<sup>10</sup> is one that is capable of valuation. It must represent an underlying legal obligation, not a voluntary undertaking.
- 3.13 As discussed in the Consultation Paper, the cases interpret this strictly, suggesting (for example) that there is no legal obligation on a son to bury his mother.<sup>11</sup> This means it is difficult for people to insure the life of a family member other than a spouse, even if they are economically dependent on them and would suffer a loss if they died. For employers insuring the lives of employees, the extent of the loss has been limited to the value of the employee's services during their notice period.<sup>12</sup> The notice period was the only legally recognised right the employer had.
- 3.14 The rigidity of this rule is often ignored in practice since it is out of step with modern expectations. Several forms of life insurance products are bought and sold on the basis of a financial interest in the life insured which may not technically amount to a "pecuniary interest recognised by law" - key person policies in particular. It is important that the rules are updated and brought in line with modern practice. This would also allow children to insure the life of a parent when they are economically dependent on them, without having to demonstrate a clear legal obligation on the parent to maintain the child.

<sup>7</sup> *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199.

<sup>8</sup> *Harse v Pearl Life Assurance Co* [1904] 1 KB 558; above para 2.7.

<sup>9</sup> [http://lawcommission.justice.gov.uk/consultations/insurable\\_interest.htm](http://lawcommission.justice.gov.uk/consultations/insurable_interest.htm) and <http://www.scotlawcom.gov.uk/law-reform-projects/joint-projects/insurance-law>.

<sup>10</sup> In Scotland, "pecuniary interests" are often referred to as "patrimonial interests".

<sup>11</sup> *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558.

<sup>12</sup> *Simcock v Scottish Imperial Insurance Co* (1902) 10 SLT 286.

### ***Our 2011 proposal***

- 3.15 In our Consultation Paper, we proposed that an insurable interest should exist where there was a “real probability” of economic loss on death.<sup>13</sup> The underlying policy was well supported; 18 of 21 of respondents to this question (85%) agreed. However, several who supported the policy felt that the bar of “real probability” was too high. The Judges of the Court of Session 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.

- 3.16 The Bar Council also believed that there was a concern that “‘real probability’ risks setting the bar too high, and ... in practice will end up simply being attenuated by the Courts”.

### ***Updated proposal***

- 3.17 Although the differences are likely to be largely semantic, we agree that a test based on “reasonable expectation” or “reasonable prospect” of economic loss may be more appropriate from a presentational perspective than a test based on “real probability”.<sup>14</sup> These formulations better capture the flexible nature of the test. They are also more in line with our general approach towards reforms in this area which aims to widen and modernise the concept of insurable interest so that it works in a wide variety of contexts.
- 3.18 We propose that an insurable interest should be found where a person has a reasonable prospect (or similar) of economic benefit from the preservation of the life insured, or economic loss on the death. A similar rule would apply in other contingency insurances, such as accident and critical illness cover: a person should have insurable interest where they have a reasonable prospect (or similar) of economic loss on the occurrence of the contingent event (that is, illness of, or injury to, the person insured).<sup>15</sup>

### **The value of the policy**

- 3.19 A related but more difficult issue is whether the insured amount should be confined to a reasonable expectation of the value of the likely benefit or loss, as is currently the case under section 3 of the Life Assurance Act 1774.
- 3.20 This can lead to practical difficulties for those who are insuring themselves or others against future uncertainties. For example, nobody can know exactly how valuable an employee will be to a firm at the point of their death.

<sup>13</sup> (2011) LCCP 201/SLCDP 152, paras 13.69 to 13.75.

<sup>14</sup> See also paras 2.14 to 2.16 above.

<sup>15</sup> The exact wording of any statutory test which we ultimately recommend – reasonable expectation, reasonable prospect, or similar – will be determined based on consultees’ views and also discussions with parliamentary draftsmen as to the best way to capture the flexible, objective nature of the assessment.

### ***Our 2011 proposal***

- 3.21 In the Consultation Paper we suggested that the value of the policy should be limited to a reasonable valuation of the interest. Acknowledging the potential difficulties, we said:

It would be possible to maintain a very loose, general test that the amount of the insurance must be reasonable, given the likely loss that the proposer will suffer. This would be assessed at the time of the contract and would need to allow the parties some element of discretion in reaching inherently subjective valuations.<sup>16</sup>

- 3.22 We noted that insurable interest based on economic interest must be broad enough to cover a wide variety of policies, from creditor-debtor insurance (where the valuation may be more precise, if the loan is made over a fixed term) to children taking out insurance over their parents (where the policy may be over a number of years and the value very difficult to quantify). Any statutory requirement for the valuation to be reasonable would have to cater for policies at both ends of the spectrum. In some cases, we envisaged that the test would rely completely on the estimations of the parties.

- 3.23 In response to that proposal, some consultees argued that the value of the policy should be left to the discretion of the specific insurers and policyholders. For instance, the International Underwriting Association (IUA) stated:

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 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.

### ***Updated proposal***

- 3.24 We now agree with the IUA. There is no clear rationale for limiting the value of policies. For most policies of this sort the threat of moral hazard is hard to find. Furthermore, a statutory test limiting the value of insurance policies would add unnecessary complexity to the law. Valuations are often uncertain and can change over the length of a policy.
- 3.25 Rather than a statutory requirement of “reasonableness”, it should be for the parties to determine the value of the policy. A policyholder must decide whether they are willing to pay higher premiums for more generous valuations and cheaper premiums if the valuations are more conservative. Ultimately, the value of the particular policy and the cost of the premium will vary depending on the risk appetite of the respective parties. This may however be a matter on which regulators or industry bodies such as the ABI consider it appropriate to issue guidance or codes of practice if this was thought to be necessary.

<sup>16</sup> (2011) LCCP 201/SLCDP 152, para 13.73.

## **INSURANCE WITHOUT EVIDENCE OF ECONOMIC LOSS: NATURAL AFFECTION**

- 3.26 Under the current law, a person may insure their own life, and that of a spouse or civil partner, without evidence of financial dependency or expectation of financial loss. This is said to be on the basis of “natural affection”.
- 3.27 Despite the somewhat incongruous label given to this category we agree that it has a purpose. The nature of certain relationships means that loss on death is presumed and need not be evidenced. We think that those relationships extend beyond the self and spouse/civil partner categories, and in the Consultation Paper we proposed certain limited extensions to the category of “natural affection”, to cover parents insuring the lives of their children, and cohabitants insuring each other, subject to certain caveats.
- 3.28 As we explain below, we now propose the same extensions, but without some of the caveats we previously included.

### **Children**

- 3.29 Several insurance products, such as family and travel insurance, provide small payments to parents on the death or injury of children under 18. Although parents are rarely economically dependent on such children, there is clearly a demand for such products.
- 3.30 In our Consultation Paper we suggested that parents should have an insurable interest in the life of their child. We suggested that this should be the case for the legal parents of the child and all those who treat the child as a child of the family.<sup>17</sup> However, we proposed two restrictions on this extension which we have since reconsidered.

### ***Value of the policy***

- 3.31 In the Consultation Paper we proposed that there should be a cap on the amount for which children’s lives may be insured. We tentatively suggested a limit of twice the bereavement damages available under the Fatal Accidents Act 1976.<sup>18</sup>

<sup>17</sup> Various statutory provisions provide that foster parents have no insurable interest in the life of a foster child, and (in England and Wales) that a prospective adopter has no interest in the child concerned until an adoption or similar order is made. The Adoption and Children (Scotland) Act 2007 does not contain any provision relating to an insurable interest in the life of an adopted child. See Issues Paper 4, para 3.20. We do not propose any changes to these provisions.

<sup>18</sup> The current level of bereavement damages under the Fatal Accidents Act 1976 is £12,980: Damages for Bereavement (Variation of Sum) (England and Wales) Order 2013/510. The 1976 Act only applies to England & Wales. In Scotland, the Damages (Scotland) Act 2011 regulates awards of damages in, *inter alia*, cases of wrongful death. There is no formal tariff although since *Hamilton v Ferguson Transport (Spean Bridge) Ltd (sub nom Thomson v Dennis Thomson Builders Ltd)* 2012 SC 486 the Scottish courts have been seeking to make the level of judicial damages awards more consistent with jury awards. For a summary of relevant case law and useful table setting out the awards made in each case, see A Hajducki QC, “The view after *Hamilton*- a discussion of recent damages awards for bereaved relatives in wrongful death claims” 2014 SLT 133. (Note that since the article was written, in *Currie v Esure Services Ltd* [2014] CSIH 112, the Inner House rejected the reclaiming motion on the level of the awards.)

- 3.32 These proposals were generally supported. However, we also received representations from stakeholders, particularly insurers, who have suggested that a statutory cap is unnecessary and could cause problems. These concerns were discussed in detail at a meeting of the Investment & Life Assurance Group (ILAG) attended by the Law Commission on 19 September 2014.
- 3.33 Life insurance products are bought and sold in a variety of different contexts. Setting a cap on life insurance would have a knock on effect on the use of insurance bonds and employee group insurance schemes. A cap appropriate for one type of policy may not be appropriate for another.
- 3.34 Most life insurance policies have a value linked to genuine economic interests, driven by market concerns. For example, life insurance policies which have add-ons covering the lives of children tend only to cover funeral and bereavement costs.<sup>19</sup> We think it is unlikely that a market would develop for large pay-outs in the absence of economic loss. However, as was pointed out at the ILAG meeting, there may well be a need for more valuable policies to be written in respect of critical illness or personal injury cover for children. A court applying the current law might not be able to find a legally recognised pecuniary loss suffered by the parents of a child with long term care needs. However, it is clear that in practical terms this could represent a significant (and unpredictable) financial commitment which insurance should, in our view, legitimately cover.
- 3.35 Furthermore, the cap would not necessarily address the issue of moral hazard. The cap would only apply per policy, and parents would always be able to obtain insurance above the value of the cap by taking out several policies with multiple insurers on the life of the same child. Indeed, this might occur without any suggestion or suspicion of foul play, where a child was insured under both parents' employee schemes and under a travel policy.
- 3.36 Finally, a cap would only work if it was kept up to date. This does not always happen, and is particularly difficult if the value of the cap is contained in primary legislation.
- 3.37 We are not persuaded that it is necessary to have a statutory limit on the amount for which a child's life can be insured. As a financial product, the value of a policy will be assessed and limited by the market. A brief overview of policies available in the Irish market, where such cover is permissible, indicates that insurers offer policies covering children up to around 6000 euros.<sup>20</sup> If thought necessary, regulators and the industry could issue guidance on this point.

<sup>19</sup> This is based on anecdotal evidence received from insurers, particularly through ILAG.

<sup>20</sup> Key features: term life insurance, [http://www.blinc.ie/uploadedFiles/blinc/Revamp\\_2012/Protection/Term\\_life\\_insurance\\_key\\_features.pdf?ts=1424768333065](http://www.blinc.ie/uploadedFiles/blinc/Revamp_2012/Protection/Term_life_insurance_key_features.pdf?ts=1424768333065) (last visited 26 February 2015) and

Guaranteed term protection: Zurich life, [http://www.zurichlife.ie/static/documents/PR\\_LSIGTP\\_CG/Custom\\_Guide.PDF?docTag=&docVer=12](http://www.zurichlife.ie/static/documents/PR_LSIGTP_CG/Custom_Guide.PDF?docTag=&docVer=12) (last visited 26 February 2015).



### **Children of any age**

- 3.38 The Consultation Paper proposed that parents should be entitled to insure the lives of children under 18. We now propose that parents should be taken to have an insurable interest in the lives of their children, whatever their age. There is no reason to limit “natural affection” to younger children.
- 3.39 Whereas it is unlikely that there will be a market for high value insurance cover for children under 18, with adult children there is more likely to be an element of financial dependency and a reasonable expectation of economic loss. It may be therefore that insurance policies covering more than funeral and bereavement costs are more common in respect of adult children. This is a matter for the market to decide.
- 3.40 We also heard arguments in favour of allowing insurance to be taken out over the lives of grandchildren, particularly in the context of life insurance wrappers.<sup>21</sup> This was not a point we considered in our Consultation Paper, and we ask consultees for their views.

### **Cohabitants**

- 3.41 In our Consultation Paper we proposed that the category of natural affection should be extended to cover cohabitants, by which we mean couples who live together as spouses in an intimate relationship but who are not married or in a civil partnership. We noted that cohabitation is increasingly common and several indicators point to the fact that this trend will continue.<sup>22</sup>
- 3.42 We received general support for this policy, with 12 of 19 of respondents to this question (61%) agreeing. 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 rules.
- 3.43 Those who disagreed generally did so on the basis that extending natural affection to cohabitants was unnecessary, because cohabitants will often be able to prove economic dependence on the life of one another and could therefore obtain insurance under the “economic loss” test. We accept this, but nevertheless believe that cohabitants should be taken to have an insurable interest without having to prove economic dependence, in the same way as spouses and civil partners.

<sup>21</sup> Life insurance wrappers are investment products which are presented as life insurance for tax and regulatory reasons. Usually, the premium is paid either as a lump sum or a portfolio of assets. The insurance company will invest the premium either until the expiry of a fixed number of years or until the insurance event occurs. Some of these policies are written on the life of grandchildren to give the bond a long investment period.

<sup>22</sup> (2011) LCCP 201/SLCDP 152, paras 13.87 to 13.89 and in particular footnote 29.

### **Definition of “cohabitant”**

- 3.44 The definition we proposed in the Consultation Paper had two parts.
- 3.45 The first concerned the nature of the relationship between the individuals. In our Consultation Paper we proposed that cohabitants must be in an “intimate relationship” and live together as if they were spouses.<sup>23</sup> This ensures that those who are not able to get married or enter into civil partnerships will not qualify, and should go towards preventing moral hazard or wrongdoing “by nefarious tenants or carers” as envisaged by Naomi Talisman in her consultation response. We are still content with this part of the definition.
- 3.46 As we said in the Consultation Paper, the existing statutory definitions of cohabitation focus on relationships with qualities that are associated with marriage or civil partnership, and refer to a couple who have lived in the same household as spouses, or as if they were spouses. Most also require that this has been the case for a prescribed period of a minimum duration, and we suggested that a minimum time period should form the second part of a statutory definition.
- 3.47 In England and Wales, both the Inheritance (Provision for Family and Dependents) Act 1975 (the 1975 Act) and the Fatal Accidents Act (the 1976 Act) define cohabitants in the context of the death of one cohabitant.<sup>24</sup> For these purposes, a cohabitant is an individual who has been living as the spouse of the deceased for a period of 2 continuous years prior to the death of the deceased.
- 3.48 By contrast, in Scots law there is no minimum period in section 25 of the Family Law (Scotland) Act 2006.<sup>25</sup> So long as the two individuals are either living as spouses or civil partners they are in a cohabitant relationship. In determining whether or not they are in fact living as spouses the courts have adopted a multifaceted approach relying on several factors, of which length of cohabitation is only one.<sup>26</sup>
- 3.49 In 2011, we proposed that there should be a minimum duration requirement, in order to provide a “clear-cut benchmark” for the insurer. We suggested a relatively long period of five years. This was because, while the 1975, 1976 and 2006 Acts only provide a cohabitant with an entitlement to apply to a court for financial provision (to be determined at the court’s discretion), inclusion in the natural affection category would mean the ability to insure a life without proof of economic interest. Many cohabitants will also satisfy the economic loss test so people who have a genuine economic interest would not be excluded even if they did not meet the minimum duration.

<sup>23</sup> (2011) LCCP 201/SLCDP 152, paras 13.87 to 13.102.

<sup>24</sup> See section 1(1A) of the 1975 Act or section 1(3)(b) of the 1976 Act.

<sup>25</sup> 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.

<sup>26</sup> Compare, for example, the sheriff court decisions in *Harley v Thompson* 2014 GWD 36-373 (13 months’ cohabitation enough where parties pooled resources during that time) and *Gutcher v Butcher* 2014 GWD 31-610 (relationship lasting ten years not cohabitation where parties kept separate significant parts of their lives, especially property and finances).

- 3.50 Responding to our Consultation Paper, 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. Of course, this is not possible when different statutes provide different things. The Law Society of Scotland thought that for Scots law at least the definition should mirror that given in the Family Law (Scotland) Act 2006 – with no time limit - while the IUA thought “it would seem logical to link the required duration to the existing statutes on inheritance and fatal accidents”. Providing different rules for Scotland and England on the same matter in the law of insurance is very undesirable.
- 3.51 The Financial Services Consumer Panel thought that the five years we proposed was “an arbitrary and high threshold”.<sup>27</sup> Although the City of London Law Society saw the practical benefits of a clear benchmark, they noted that any fixed period would be “in some ways arbitrary”.
- 3.52 The combination of arguments has persuaded us that including a minimum duration is unnecessary and unhelpful.
- 3.53 We now propose that a person should have an insurable interest in the life of another, irrespective of whether they can show economic loss, where they live in the same household as if they were spouses (including same-sex spouses) when the insurance is taken out, without the need to show a minimum period of cohabitation. The duration of a couple’s cohabitation might still be taken into account as a factor in determining whether they are living together “as spouses”.

**OTHER CATEGORIES OF INTEREST WHERE IT IS NOT NECESSARY TO SHOW FINANCIAL LOSS**

- 3.54 This possibility was first described in 2003 by Lord Justice Waller in the Court of Appeal case of *Feasey v Sun Life Assurance Co of Canada*.<sup>28</sup> That case concerned the right of a P&I club to insure employees and other persons against injury suffered aboard members’ vessels.<sup>29</sup>
- 3.55 The result of his judgment was that in some policies on lives (in particular those where the policy is on many lives over a substantial period) it may not be necessary to show strict pecuniary loss recognised by law. Giving a dissenting judgment in that case, Lord Justice Ward did not accept that the Court of Appeal could ignore two House of Lords decisions which said that there must be a legal or equitable relationship between the insured and the subject matter of the insurance.<sup>30</sup>

<sup>27</sup> A five year threshold in the insurable interest context is considerably more onerous than the two year period in the 1975 and 1976 Acts. Not only is it a longer period, but the five years would have to have passed before an insurance policy could be taken out – whereas with the 1975 and 1976 Acts, the (two year) period has to have passed before the date of death.

<sup>28</sup> *Feasey v Sun Life Assurance Co* [2003] EWCA Civ 885 [2003]; 2 All ER (Comm) 587.

<sup>29</sup> A P&I or “Protection & Indemnity” club is a form of mutual insurance covering third party risks.

<sup>30</sup> *Lucena v Craufurd* (1806) 2 Bos & PNR 269 and *Macaura v Northern Assurance Company Ltd* [1925] AC 619.

### **Trustees of pension or group schemes**

- 3.56 *Feasey* was an unexpected decision and has been treated with caution by many commentators.<sup>31</sup> It may provide a basis for insurable interest to be found in the group insurance context, but this is by no means settled. Group insurance is a common and useful insurance product, and it is undesirable for its legal status to be uncertain.
- 3.57 In our Consultation Paper 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. This was very well supported, with 17 of 19 consultees who answered this question (89%) in favour.
- 3.58 We also considered whether an employer should have an unlimited interest in the lives of its employees when entering into a group scheme whose purpose it is to provide benefits for its employees or their families. This proposal also received strong support, with 15 of 19 consultees (79%) agreeing.
- 3.59 In the light of this support, we put forward the same proposals in this paper.

### **REPEALING SECTION 2 OF THE LIFE ASSURANCE ACT 1774**

- 3.60 Section 2 of the 1774 Act requires that the name of the person who benefits from life insurance must be inserted into the policy or otherwise the policy is unlawful. In the Consultation Paper we said that this sanction is clearly inappropriate: the insurer's own failure to insert the name allows the insurer to refuse the claim, which cannot be right. Although it is good practice for insurance contracts to be in writing, such stringent statutory requirements are unnecessary. We suggested that section 2 should be repealed. This was strongly supported, with 17 out of 18 consultees who answered this question (94%) agreeing.

### **A NEW STATUTORY REQUIREMENT FOR INSURABLE INTEREST**

- 3.61 As discussed in the Consultation Paper,<sup>32</sup> the legal basis of the requirement for insurable interest is unclear, particularly in indemnity insurance. We noted that the distinction between indemnity and contingency insurance is far from exact. We therefore proposed that, as far as possible, any new or restated insurable interest requirement should apply to all forms of insurance except marine insurance. We proposed that it should replace the requirement set out in the Life Assurance Act 1774. Of the 19 consultees who answered this question, 15 (79%) agreed.

<sup>31</sup> See, for example, M Templeman QC, "Insurable interest: a suitable case for treatment?" in B Soyer (ed) *Reforming Marine and Commercial Insurance Law* (2008), pp 199 and 200 and J Birds, *Bird's Modern Insurance Law* (9th ed 2013) at para 4.2.2.

<sup>32</sup> (2011) LCCP 201/SLCDP 152, Part 11.

- 3.62 We accordingly proposed that, as with indemnity insurance, if an insurable interest is not present, the contract should be void but not illegal. This would mean that there would be no valid insurance cover, but that the policyholder would be entitled to recover premiums paid. Of 19 consultees who answered this question in the Consultation Paper, 15 (79%) agreed. In composite policies where insurable interest is present for some parts of the insurance but not others, we suggested that the policy should be treated as separable. In other words, if there was insufficient interest for the life element, but sufficient interest for the indemnity element, only the life element would be void. Of 18 consultees who answered this question, 17 (94%) agreed.
- 3.63 We also proposed setting out for contingency as for indemnity insurance a non-exhaustive list of ways in which an insurable interest may be demonstrated. For contingency insurance, this list would include the extended category of natural affection and those who may insure on the basis of a reasonable prospect of economic loss. Of 19 consultees who answered, 14 (74%) agreed.
- 3.64 Finally, we proposed to clarify that, for contingency insurance, insurable interest must be present at the time of the contract in order for the contract to be valid. 16 of 19 consultees (84%) agreed. It is not necessary for there to be an insurable interest at the time of the loss in order to make a claim. This differs from our proposals on indemnity insurance, where we propose that, for the contract to be valid, a reasonable prospect of acquiring an insurable interest must exist at the time of the contract. To make a claim in indemnity insurance, there must be an insurable interest at the time of the loss.
- 3.65 All of the above proposals received widespread stakeholder support and we have not changed our position on them.

## **LIST OF UPDATED PROPOSALS: LIFE INSURANCE**

### **An insurable interest based on economic loss**

**Proposal 10:** An insured has an insurable interest where there is a reasonable prospect (or similar) that the insured will retain an economic benefit on the preservation of the life insured or incur an economic loss on death.

**Proposal 11:** There should be no statutory limit on the amount for which the insured may obtain insurance over the life insured.

### **Natural affection**

#### ***Cohabitants***

**Proposal 12:** A person should have an insurable interest in the life of another, irrespective of whether they can show economic loss, where they live together as spouses when the insurance is taken out.

#### ***Children***

#### **Proposal 13:**

- (1) Parents should be entitled to take out insurance on the lives of their children of any age, without evidence of economic loss.

(2) There need not be a statutory cap on the amount which can be insured.

### **Trustees of pension or group schemes**

**Proposal 14:** Trustees of pension and other group schemes should have an unlimited insurable interest in the lives of the members of the scheme.

**Proposal 15:** An employer should also 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.

### **Repealing section 2 of the Life Assurance Act 1774**

**Proposal 16:** Section 2 of the Life Assurance Act 1774 should be repealed.

### **A new statutory requirement for insurable interest**

**Proposal 17:** There should be a statutory restatement of the requirement of insurable interest for the purpose of life insurance which replaces the requirement set out in the Life Assurance Act 1774. This should also include a non-exhaustive list of insurable interest in contingency insurance.

**Proposal 18:** If an insurable interest is not present, the policy should be void but not illegal.

**Proposal 19:** For composite policies, where an insurable interest is present for some part of the insurance but not others, the policy should be treated as separable.

**Proposal 20:** For contingency insurance, insurable interest must be present at the time of the contract. It need not be present at the time of the loss in order to make a claim.

#### **CONSULTATION QUESTIONS**

**Question D:** Do you agree that there is a need for statutory reform in this area?

**Question E:** Do you agree that the concept of insurable interest should be expanded for life and other non-indemnity insurance along the lines proposed?

**Question F:** Do you have any detailed comments on these proposals?

**Question G:** In particular, do you think that people should be entitled to take out insurance on the lives of their grandchildren without evidence of financial interest?

A suggested response form is provided on our website.