

THE LAW COMMISSION
AND
SCOTTISH LAW COMMISSION

Reforming insurance contract law

**SHORT CONSULTATION ON DRAFT BILL:
INSURABLE INTEREST**

April 2016

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PREFACE

The Law Commission and Scottish Law Commission are reviewing the law of insurance contracts. This project has already resulted in the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA) and the Insurance Act 2015.

In March 2015, we published an Issues Paper¹ on insurable interest. We sought views on updated proposals, having consulted on this twice before: in an Issues Paper in 2008,² and as part of our 2011 Consultation Paper.³

We have been told that the current law, which is unclear in some respects, and antiquated and restrictive in others, has had the effect of inhibiting the insurance market's ability to write particular types of product for which there is demand. This message has been particularly strong from life and protection insurers.

Our updated and simplified proposals were very well supported.⁴ They are intended to be relatively permissive to ensure that, broadly speaking, insurance products which insurers want to sell, and policyholders want to buy, could be made available without technical concerns about insurable interest due to the current narrow definitions.

We hope that the resulting draft Bill will be suitable for the special parliamentary procedure for uncontroversial Law Commission bills.

THIS CONSULTATION

We welcome comments on this draft Bill by **Friday 20 May 2016**, by email to:

commercialandcommon@lawcommission.gsi.gov.uk

The draft Bill is intended to reflect the proposals set out in our issues paper, and this limited consultation is designed to test the success of the drafting in implementing these proposals, rather than to test the underlying policy. In some instances, we have refined our thinking in response to consultation responses.

We have included questions to direct consultees to key matters, but are also happy to take more general comments if consultees feel they are important.

We hope to publish a final draft Bill and report in autumn 2016.

¹ Issues Paper 10 – *Insurable interest: updated proposals* (March 2015).

² Issues Paper 4 - *Insurable Interest* (January 2008).

³ 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).

⁴ We are publishing a summary of responses received to that issues paper, at the same time as this consultation. Available from <http://www.lawcom.gov.uk/project/insurance-contract-law/> and <http://www.scotlawcom.gov.uk/law-reform/law-reform-projects/joint-projects/insurance-law/>.

CLAUSE 1: DEFINITIONS

- 1.1 As with the Insurance Act 2015 and Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA), the draft Bill does not define “contract of insurance” itself. This definition will be taken from common law principles.
- 1.2 Clause 1 defines “insurer” and “insured”, based on the definitions in the Insurance Act 2015.
- 1.3 Contracts of reinsurance and retrocession are treated as contracts of insurance at common law.⁵ In such contracts, the party purchasing the insurance (the insurer or the reinsurer) is the “insured” for the purposes of the Bill, and the party providing the insurance (the reinsurer or the retrocessionaire) is the “insurer”.

Definition of “life-related insurance”

- 1.4 Analyses of insurable interest traditionally divide insurance between indemnity insurance and contingency insurance. We have also made this distinction in our consultation and issues papers. Generally speaking, property and liability insurance, and other “non-life” insurances, are contracts of indemnity. In contrast, life, accident and critical illness insurance policies are not: they generally provide that the insurer will pay a fixed sum of money on the occurrence of the event insured against. This is contingent, rather than indemnity, insurance.
- 1.5 However, some consultees pointed out that these distinctions are not clear cut and are sometimes unnecessary. Some forms of life insurance, such as key employee cover, have an indemnity element. Valued policies over property provide for a pre-agreed amount to be payable on the property’s loss or destruction, meaning that they are not pure indemnity contracts. For the purposes of the draft Bill, we thought the distinction between indemnity and contingency was less helpful and relevant than the distinction between life and non-life insurances.
- 1.6 Our substantive proposals about life insurance, and in particular the people in respect of whom a policyholder should be entitled to take out cover, apply equally to other types of protection insurance. It was clear from the responses to our last issues paper that stakeholders did not regard the term “life insurance” as covering insurances such as critical illness, but many said that the same principles should apply to them.
- 1.7 The draft Bill therefore introduces the concept of “life-related” insurance. A contract of life-related insurance includes any contract of insurance under which the insured event is the “death, injury, ill-health or incapacity of an individual”.

⁵ *Delver, Assignee of Bunn v Barnes* (1807) 1 Taunt 48; *Forsikringsaktieselskabet National (of Copenhagen) v Attorney General* [1925] AC 639; *Toomey v Eagle Star Insurance Co Ltd* [1994] 1 Lloyd’s Rep 516.

1.8 The term is intended to cover traditional life insurance contracts which pay out on the death of the life insured (or in some cases the earlier surrender or expiry of the policy). It is also intended to capture insurances which otherwise depend on human life or health such as personal accident, critical illness and disability insurances.

1.9 We think that this category will encompass both indemnity and contingency policies as long as they relate to a human life.

Q1. Do consultees agree that personal accident, critical illness, disability and other insurances dependent on human life be subject to the same insurable interest rules as life insurance?

1.10 This category would also cover insurance-linked investment products which have a life insurance element.⁶

1.11 The definition of life-related insurance also refers to contracts under which the insured event is the continuation of an individual's life. This is intended to capture annuities, which we think must be treated as a type of life-related insurance.

Q2. Do consultees consider that the definition of "life-related insurance" works for insurance-linked investment products and annuities?

Insurance other than life-related insurance

1.12 The "non-life" category, by default, includes all contracts which do not fall within the definition of life-related insurance. There is no need for further definition. It will include, for example, property and liability insurances. Most insurances in this category will be indemnity insurance, but not necessarily all.

⁶ These are discussed further from para 2.28 below.

CLAUSE 2: LIFE-RELATED INSURANCE

CLAUSE 2(1): INSURABLE INTEREST REQUIREMENT AND EFFECT OF NO INTEREST

- 2.1 Clause 2(1) means that an insured under a contract of life-related insurance must have an insurable interest in the individual who is the object of the insurance. In legislation, the singular includes the plural so, where a contract pertains to the life or health of more than one individual, then the insured must have an insurable interest in each of them.
- 2.2 The insured must have the insurable interest at the time the insurance contract is entered into (but, for life-related insurance, not at the time of the loss).
- 2.3 If the insured does not have an insurable interest then the contract will be void (but not illegal).⁷

CLAUSE 2(2) DEFINITION OF INSURABLE INTEREST FOR LIFE-RELATED INSURANCE

- 2.4 Clause 2(2) sets out a non-exhaustive “definition” of insurable interest in a life-related context. This takes the form of a list of situations in which an insured has an insurable interest.
- 2.5 The list encompasses three broad categories of interest for life insurance purposes. The first is based on specific relationships: if the relationship exists, there is no need for the insured to demonstrate financial dependency or expectation of financial loss. Insurable interest is taken on the basis of the nature of the relationship. We have previously referred to these relationships as being those of “natural affection”.
- 2.6 The second category is based on the prospect of economic loss: a policyholder may insure the life of another person on the grounds that they would suffer a financial loss on the other’s death (or the occurrence of another insured event such as injury or incapacity of the life insured).
- 2.7 The third category encompasses policies which are designed to cover multiple different lives.
- 2.8 Clause 2(2) is based on the current law but extends the categories to broaden the scope of the policies which could be written.

“Natural affection”

Self and partner, including cohabitant

- 2.9 As under the current common law, an insured has an insurable interest in themselves, and in their spouse or civil partner. Clauses 2(2)(a) and (c) of the draft Bill confirm this position in statute.

⁷ We discuss the effect of a void contract below from para 4.1 and the removal of the illegality rule from 5.1.

- 2.10 Clause 2(2)(c) also extends this category to include the insured's cohabitant – that is, an individual who lives with the insured as their spouse or civil partner.
- 2.11 As set out in our 2015 issues paper, we do not consider it necessary for primary legislation to further define the concept of living together as spouses or civil partners. This was widely supported by life insurers. The existing statutory definitions of cohabitation⁸ focus on relationships having 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. Some also require that this has been the case for a prescribed period of a minimum duration. We think that the courts will have regard to definitions of cohabitation in other areas of the law. We also think that insurers or the Financial Conduct Authority might usefully provide guidance on this.

Children and grandchildren

- 2.12 Several insurance products, such as family and travel insurance, provide relatively small payments to parents on the death or injury of children under 18. Although parents are rarely economically dependent on younger children, there is clearly a demand for such products. Parents may sometimes be economically dependent on adult children, but this does not amount to “a pecuniary interest recognised by law”.⁹
- 2.13 Clause 2(2)(b) provides that an insured has an insurable interest in the lives of their children and grandchildren. It also provides an insurable interest for those who treat a child as their child or grandchild.¹⁰
- 2.14 We have not been 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. Whereas it is unlikely that there will be a market for high value insurance cover for children under 18 in the event of death, with adult children there is more likely to be an element of financial dependency and a reasonable expectation of economic loss should they die. It may therefore be that insurance policies covering more than funeral and bereavement costs are more common in respect of adult children. That is a matter for the market to decide.

⁸ For example, s 62 of the Family Law Act 1996 as amended by Civil Partnership Act 2004, Schedule 9, Part 1, para 13, and Rule 5 of the Family Proceedings Courts (Miscellaneous Amendments) Rules 2005/1977. For Scots law, see s 25 of the Family Law (Scotland) Act 2006.

⁹ *Halford v Kymer* (1830) 10 B&C 724.

¹⁰ The concept of “treated as” is adopted from the Children Act 1989, see section 105(1). As it is used without definition in that Act, we do not think that it is necessary to define it in this Bill. Various statutory provisions state 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.

- 2.15 A brief overview of policies available in the Irish market, where such cover is permissible, indicates that insurers offer policies covering children up to 18 for values of around 6000 euros.¹¹ If thought necessary, regulators and the industry could issue guidance on this point.
- 2.16 Below, we explain why we do not recommend that an insured should have an automatic insurable interest in their parents and grandparents.¹²

Group insurance policies

Trustees of pension schemes

- 2.17 The case of *Feasey v Sun Life Assurance Co of Canada*¹³ raised the possibility of other categories of insurable interest where it was not necessary to show financial loss, particularly where the insurance covered a number of people. 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, particularly for long-term insurance. A significant amount of life insurance and critical illness insurance is written through employer sponsored group schemes. It is undesirable for its legal status to be uncertain.
- 2.18 Clause 2(2)(d) therefore provides that trustees of pension and other group schemes have an insurable interest in the lives of the members of the scheme.

Other cases where insurance is taken out for the benefit of others

- 2.19 Clause 2(2)(e) goes further and provides that, where an insured takes out a policy which is for the benefit of others, the insured will have an insurable interest in those other individuals. This will mean, for example, that an employer will have an unlimited interest in the lives of its employees when entering into a group scheme the purpose of which is to provide benefits for its employees or their families.¹⁴ However, the clause is drafted in wide terms, designed to be inclusive of all group policies. In any case, it will also be open to the employer to demonstrate an economic interest as discussed below.

Economic loss

- 2.20 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. Typical examples include:

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

¹¹ Key features: term life insurance, 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/Customr_Guide.PDF?docTag=&docVer=12 (last visited 26 February 2015).

¹² From para 2.23.

¹³ *Feasey v Sun Life Assurance Co* [2003] EWCA Civ 885 [2003]; 2 All ER (Comm) 587.

¹⁴ This will not cover situations where the policy is for the employer's benefit, as in key person insurance.

- (2) A joint debtor in the life of another joint debtor (to the amount of the debt). For example, cohabiting friends buying a house together who are declared to be jointly and severally liable for the mortgage will be able to insure each other's lives to the amount of the whole of the mortgage debt.
 - (3) An employer in the life of an employee, to the value of the period of notice. If the employee is a "key person" it may also be possible to insure the costs of recruiting and training a replacement, and any loss of profits in the meantime, though this is by no means certain.
- 2.21 Under the current law, this category is extremely limited. The insured must show an interest which is "pecuniary and recognised by law".¹⁵ The cases interpret this strictly, suggesting (for example) that there is no legal obligation on a son to bury his mother.¹⁶ 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.
- 2.22 Clause 2(2)(f) sets out a broader economic interest test. Rather than requiring a pecuniary interest recognised by law, an insured would have an insurable interest where they have a reasonable prospect of suffering economic loss on the occurrence of the insured event (such as the death or illness of, or injury to, the person insured).

Q3. Do consultees consider that this non-exhaustive list is appropriately drawn to cover all the key situations in which an insured should be able take out insurance over another person?

INSURING THE LIVES OF PARENTS AND GRANDPARENTS

- 2.23 A few consultees suggested that insureds should be able to insure the lives of their parents or grandparents without having to show any reasonable prospect of economic loss on their death or on another insured event (such as illness or need for long term care). They suggested more flexibility was needed to allow for the development of policies providing cover for long-term care needs, and we agree that insurance covering later life care costs could be socially useful. We have therefore given this question careful consideration, but have not been persuaded that an automatic insurable interest, without any need to demonstrate an economic interest, is necessary or appropriate.

¹⁵ In Scotland, "pecuniary interests" are often referred to as "patrimonial interests".

¹⁶ *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558.

- 2.24 The Dilnot Report¹⁷ proposes placing on individuals an obligation to pay for a proportion of their own long term care costs (up to £35,000). The Report notes that, at present, the market does not offer insurance products which would enable an individual to insure themselves against such costs. Under the current law, an individual would be permitted to take out such cover, so the lack of product availability does not seem to be attributable to the rules of insurable interest.
- 2.25 We appreciate that (adult) children might wish to take out insurance to provide for parents' care needs if, for example, the parents are not in a financial position to do this themselves. We think that the expanded economic interest test in clause 2(2)(f), discussed above, would assist families who have a genuine concern about economic loss. The economic interest test would be satisfied in cases where an insured could show that there was a reasonable prospect that they would end up covering any (or a proportion of) care costs incurred by their parents, or where grandparents are relied upon for childcare so that their loss or incapacity would have a financial impact on a family. In such cases, an insurable interest could therefore be shown.
- 2.26 We are concerned that there are strong moral hazard arguments against allowing children to take out straightforward life insurance over (particularly elderly) parents, whose vulnerability is often raised as a matter of concern in debates about assisted dying, for example. It is already open¹⁸ to an individual to take out insurance on their own life and assign the benefit of the policy to their child or grandchild if the desired effect is to provide a cash benefit immediately upon death and the relevant person consents.
- 2.27 We therefore do not think that the case has been made for providing an automatic insurable interest in respect of the lives of parents and grandparents.

Q4. Do consultees agree that the economic loss test is sufficient to ensure that families can ensure parents or grandparents in appropriate situations?

INVESTMENT LINKED INSURANCE CONTRACTS

- 2.28 Life-related insurance within the meaning of the draft Bill is intended to include investment linked insurance contracts and investment bonds with an insurance element. We have been told that these are marketed and used as investment products, and that the life assurance element of them is generally nominal (generally around 1.0% or 0.1% of the value of the underlying investments).

¹⁷ The Dilnot Commission was tasked with reviewing the funding system for care and support in England. The final report containing the advice and recommendations of the Commission to Government was published in July 2011 and is available here: <http://webarchive.nationalarchives.gov.uk/20130221130239/http://dilnotcommission.dh.gov.uk/files/2011/07/Fairer-Care-Funding-Report.pdf>.

¹⁸ Married Women's Property Act 1882, s 11 and Married Women's Policies of Assurance (Scotland) Act 1880, ss1 and 2; Civil Partnership Act 2004, s 132.

- 2.29 Such policies are long term investment vehicles used by individuals, trusts (including pension schemes) and bodies corporate. They typically continue until the death of the last surviving life assured, unless they are surrendered by the policyholder before this. To maximise flexibility and the life of the investment, the practice is generally to have a number of lives assured and to include lives that are likely to outlive the policyholder – this was a key reason for the argument that grandchildren should be included in the category of natural affection.
- 2.30 We do not make any special provision for such contracts. However, the draft Bill is more permissive in scope than the current law and we do not therefore think that it will inhibit insurers' activities here.
- 2.31 Investment products with an insurance element clearly fulfil an important economic role. However, we do not think that treating them separately from other insurance contracts in the context of insurable interest is practical or desirable. There are regulatory reasons why such products involve an insurance element and removing the requirement for insurable interest – which is otherwise required in order to have a valid insurance contract – may appear to subvert this. There is a strong market for such products under the existing legal regime and insurers have not been calling actively for reform of the legal rules on investment linked insurance products.

Q5. Are there any negative consequences which this Bill could have on investment linked insurance products compared to the current law?

CLAUSE 3: INSURANCE OTHER THAN LIFE-RELATED INSURANCE

- 3.1 Clause 3 sets out the requirement for insurable interest in insurance other than life-related insurance. For ease, in this paper we refer to such insurances as “non-life” policies. Clause 3 also addresses questions of timing of the requirement, consequences of lack of interest, and the definition of insurable interest in this context.

Clause 3(1): requirements for an insurable interest at the outset of the contract

- 3.2 Clause 3(1) provides that, at the time of the entering the contract, the insured must have either:
- (1) an insurable interest; or
 - (2) a reasonable prospect of acquiring an insurable interest during the policy term.
- 3.3 If the insured has no insurable interest or reasonable prospect of acquiring one, the policy is void. In such circumstances the policy is effectively worthless.
- 3.4 If an insured has an insurable interest at the outset and then loses or disposes of it, the contract is still valid as the insurer has been on risk. The position is the same where the policyholder had a reasonable prospect of obtaining an interest which does not in fact materialise.

Clause 3(2): insurable interest at the time of a claim

- 3.5 Clause 3(2) provides that, to make a claim on a non-life policy, the insured must also have an insurable interest at the time of the insured event. If there is no interest at that time any claim would not be payable. However, the insurance contract would not be void.
- 3.6 This is not the same as requiring that the insured actually suffers a loss. The draft Bill does not require this, nor does it require that a payment under an insurance contract bears resemblance to the loss suffered. These are matters for the indemnity principle which is an implied term of contracts of indemnity insurance and which is distinct from considerations of insurable interest.

3.7 We think that most, if not all, non-life contracts will be contracts of indemnity. We have previously considered whether there is such a thing as a non-life contingency policy. In our previous published papers, we suggested that valued policies on land or other property were contingency policies, based on the fact that they pay out a fixed sum on the occurrence of an insured event regardless of the actual value of the loss at the time it is suffered. Such policies might be used, for example, to protect works of art, so that a set value is determined at the outset. However, in response to our latest issues paper, some consultees suggested that these were better regarded as indemnity contracts (albeit not pure indemnity). We have returned to the case law on this matter and agree that this is the better view.¹⁹

3.8 If we assume that the indemnity principle will always apply to non-life contracts, then the fact that the draft Bill requires the insurer to have an insurable interest at the time of the insured event should not cause any additional complications because the fact that the insured will have to have suffered loss (in order to satisfy the indemnity principle) necessarily means they have some form of interest.

Q6. Do consultees consider that there are any non-life insurance policies in which the requirement to have an insurable interest at the time of the insured event would be problematic? That is, are there any circumstances in which a non-life policy would, apart from this requirement, pay out in the absence of an insurable interest at the time of the insured event?

3.9 We thought this could potentially affect parametric policies, although have provisionally concluded not. We have prepared a separate paper, available on our website, setting out our understanding of parametric policies and their interaction with our proposed recommendations. Interested stakeholders are directed to that paper, on which we would welcome views.

Definition of insurable interest for non-life insurance

3.10 Clause 3(3) sets out a non-exhaustive “definition” of insurable interest in a non-life context. Again, this takes the form of a list of situations in which an insured has an insurable interest. Consultees stressed the need for this to be non-exhaustive so as not to inhibit the future development of innovative products.

3.11 It provides that an insured has an insurable if the insured:

- (1) has a right in the subject matter of the insurance;
- (2) has a right arising out of a contract in respect of the subject matter;
- (3) has possession or custody of the subject matter; or
- (4) will suffer an economic loss if the insured event relating to the subject matter occurs.

¹⁹ See, for example, MacKinnon J in *Goole Steam Towing Co v Ocean Marine* [1928] 1 KB 589 at 594.

- 3.12 The first three limbs are largely focussed on property insurance and reflect the current law.²⁰ We considered referring to “lawful” possession, as suggested by some consultees. However, in some circumstances this may deprive the lawful owner of some form of compensation where the party in possession was liable to compensate the owner. In other cases, the indemnity principle would operate to mean that a party in unlawful possession could not recover under the contract (and would not be entitled to reclaim premiums, having had an insurable interest).
- 3.13 The final limb is intended to be broad and moves away from the property focus of our previous proposals, which had made some consultees concerned. We think this comfortably covers the types of insurance which consultees were keen to see included, such as liability insurance, D&O and business interruption cover.
- 3.14 We are aware that it is very wide and could arguably lead to relatively speculative insurance being written. However, there are many situations in which a policyholder may legitimately wish to protect an economic interest. The courts have already moved in this direction and may be seen to have approved a wider version of the test first discussed by Mr Justice Lawrence in a dissenting judgment in 1806:²¹

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

- 3.15 We do not seek to limit the concept of insurable interest or to prevent insurers from writing policies which are currently accepted as valid by the courts. Nor do we agree that it is for insurable interest to ensure that insurers retain the desired rights of subrogation or to protect them from multiple insurance situations. There will be many issues which insurers take into account when agreeing to underwrite a risk and it is open to them to investigate these issues through the disclosure process. From a consumer protection perspective, the FCA or FOS do not rely on insurable interest provisions to target mis-selling of insurance products to consumers or other policyholders.

Q7. Do consultees consider that this non-exhaustive list is appropriately drawn to cover all the key situations in which an insured should be able take out non-life insurance?

²⁰ In Scots law, “possession” may be “civil”, where a person holds through the acts of another (such as where an agent holds the property), as well as physical (or “natural”). In the great majority of cases, however, the civil possessor will enjoy some other right in the subject-matter (eg ownership) or by way of a contract, and may therefore derive its insurable interest through clause 3(3)(a) or (b) rather than (c) (which may accordingly be taken as limited to physical possession along with custody).

²¹ *Lucena v Craufurd* (1806) 2 Bos & PNR 269. Lord Justice Waller’s broad definition in *Feasey v Sun Life Assurance Co* [2003] EWCA Civ 885, [2003] 2 All ER (Comm) 587 is remarkably similar to Mr Justice Lawrence’s dissenting view.

CLAUSE 4: CONSEQUENCES OF THE CONTRACT BEING VOID

- 4.1 When a contract is void, it is as if the contract had never existed. Generally the position at law is that money paid under a void contract can be recovered. There are numerous reasons why a contract may be held to be void and the ability to recover money paid may vary dependent on the reason.
- 4.2 The draft Bill does not make specific provision for return of the premium in other cases, where there has been no deliberate or reckless untrue statement. This is a matter for the general law.
- 4.3 In insurance contracts, the basis for the insured's payment of the premium is that the insurer runs the risk of having to indemnify against the insured event. If the insurer has never been on risk the contract is void as the basis for payment of the premium has failed. This was held to be the case in *Re London County Commercial Reinsurance Office Ltd*²² where insurance premiums were recoverable in relation to reinsurance contracts which were void because they had been entered into subject to a policy proof of interest (PPI) condition.
- 4.4 The general rule is therefore that premiums would be reclaimable by the insured if the contract is void for lack of insurable interest.

Untrue statements: deliberate or reckless behaviour

- 4.5 Section 84(1) of the Marine Insurance Act 1906 provides for return of premium where a contract has failed, but includes a specific exception where there has been fraud or illegality on the part of the assured. However, whether section 84 applies to insurance contracts other than marine insurance contracts is unclear.²³
- 4.6 It appears that, without a specific provision to the contrary, an insured may be able to recover its premiums even if it had procured the policy through fraud or by deliberately misleading the insurer as to its insurable interest.²⁴

Clause 4 of the draft Bill

- 4.7 Return of premium to a fraudulent insured is inconsistent with the provisions of CIDRA 2012 and the Insurance Act 2015, which provide that the insurer can retain premiums paid where an insured has acted deliberately or recklessly in the course of its pre-contractual disclosure. These provisions do not apply to a contract which is void for lack of insurable interest because the contract is already void.

²² [1922] 2 Ch 67.

²³ See *Colinvaux's Law of Insurance* (10th ed 2014), para 8-029, and *MacGillivray on Insurance Law* (13th ed 2015), para 8-030.

²⁴ See, for example, *Spence v Crawford* [1939] 3 All ER 271 per Lord Wright at 288-289. For Scots law, see R Evans-Jones, *Unjustified Enrichment*, Vol 1, Enrichment by Deliberate Conferral: *Condictio* (2003), paras 9.103-104 and 9.116-118.

- 4.8 Clause 4 of the draft Bill therefore provides that, if an insured makes an untrue statement about the nature of its insurable interest and either knows it is untrue or does not care whether or not the statement is true, then the insurer may retain the premiums paid in pursuance of the void contract.
- 4.9 This reflects the “deliberate or reckless” formulations used in the CIDRA and the 2015 Act.
- 4.10 However, this has the potential to produce harsh results, particularly in relation to life insurance policies which include an investment element and joint policies where one policyholder makes a deliberate misrepresentation and the other acts honestly and reasonably. For example, if a consumer takes out a life insurance policy with a significant investment element and is subsequently found to have lied about health issues, we think that the court should be able to order the return of the premium with interest. This would deprive the estate of any increase in value of the investment as opposed to paying the investment element only and retaining the premiums in relation to the life insurance element. This reflects our approach in CIDRA.²⁵ As in CIDRA 2012, clause 4 provides that, in the case of a consumer contract, an insurer need not return any of the premiums paid except to the extent that it would be unfair to the insured to retain them.

Q8. Should an exception to the retention of premiums be limited to consumer contracts only, or extended to all cases where it appears that it would be unfair to the insured for the insurer to retain them?

²⁵ See Law Commission and Scottish Law Commission, *Consumer Insurance Law: Pre-contract disclosure and misrepresentation*, from para 6.44. http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc319_Consumer_Insurance_Law.pdf

CLAUSE 5 TO 8: REMAINING CLAUSES

RELATIONSHIP WITH EXISTING LAW

- 5.1 Clause 5 provides that the provisions made by the draft Bill would, if enacted, replace any other rule of law relating to the requirement for an insurable interest.
- 5.2 This means that common law rules concerning insurable interest are superseded. Importantly, it means that contracts which are void for lack of insurable interest can no longer be treated as illegal. Therefore, as discussed above, there is scope for premiums to be recovered by the insured.

MARINE INSURANCE

- 5.3 Sections 4 to 15 of the Marine Insurance Act 1906 govern the requirement for insurable interest for insurance contracts that fall within the ambit of that Act.²⁶
- 5.4 The industry has told us that the provisions of the 1906 Act work well and should not be disturbed. Without a strong case for reform, we agree they should be left as they are, even if that creates a separate regime for marine insurance.
- 5.5 Clause 6 of the draft Bill therefore provides that its terms do not apply to marine insurance contracts which are covered by the 1906 Act.

REPEALS

- 5.6 Clause 7(1) repeals three pieces of legislation relating to insurable interest.

Life Assurance Act 1774

- 5.7 The draft Bill repeals the 1774 Act in its entirety. The Act comprises four sections:
 - (1) Section 1 bans the making of insurances where there is no interest, and renders any policy issued in such circumstances null and void. This is superseded by the draft Bill.
 - (2) Section 2 requires the names of those interested to be noted in the policy document. If not, the policy is unlawful. We have argued 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.

²⁶ See (2011) LCCP 201/SLCDP 152, paras 12.57 to 12.58.

- (3) Section 3 limits the amount of any recovery to the value of the interest. We do not think there is any reason to place statutory requirements on the value of policies in this context. This effectively introduces an element of indemnity into insurable interest, which is particularly out of place in the provisions on life policies which are generally contingency insurance. There is no clear rationale for limiting the value of life-related policies in this way (or at all) and it can lead to practical difficulties for those who are insuring themselves or others against future uncertainties.
- (4) Section 4 provides that the 1774 Act does not apply to "ships, goods, or merchandises". Again, this is superseded.

Marine Insurance (Gambling Policies) Act 1909

- 5.8 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, and we do not think it is necessary to impose criminal liability as any problems in the market are subject to financial services regulation.

Marine Insurance Act 1788

- 5.9 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.²⁷
- 5.10 If the insurer wishes clarity about the interested parties, the insurer is free to include the names of those interested in its contracts. We are not convinced that there should be a statutory requirement. It would be unfortunate for an insurer to be able to escape liability under a contract because the interested party was not named.

CONSEQUENTIAL AMENDMENTS

- 5.11 Clause 7(2) cross refers to a Schedule which sets out various consequential amendments. These either substitute a reference to the draft Bill instead of the current provisions, or repeal the provisions in full where they are superseded by the terms of the draft Bill.
- 5.12 For example, section 99 of the Friendly Societies Act 1992 (insurance of lives of children under 10) is repealed, because the small exception allowing limited insurance to be taken out over children's lives would be superseded by our proposed reforms, which allow an insured to insure their children without any statutory limit. This is also the case for section 253 of the Civil Partnership Act 2004.

²⁷ For more information on the Marine Insurance Act 1788 see (2011) LCCP 201/SLCDP 152, paras 12.54 to 12.55.

- 5.13 However, the position in the Children Act 1989, which excludes the possibility of a foster parent having an insurable interest in the life of a foster child, is retained. The exception is based on policy considerations so a reference to the draft Bill is substituted.²⁸

APPLICATION

- 5.14 Clause 8(3) means that the draft Bill applies to contracts entered into after it comes into force. However, clause 8(4) provides that contracts entered into before that date will not be void for lack of insurable interest if the insured would have an insurable interest under the provisions of the draft Bill.
- 5.15 This possibility was raised with us by consultees. We have included it because we think it is undesirable for the current rules, which are unclear and rather arbitrary, to operate to allow insurers or insureds to try to escape an arrangement which they entered into and which would be valid under the modernised provisions.

Q9. Do consultees foresee any significant difficulties with such an approach?

SEVERABILITY

- 5.16 In our consultations, we suggested that where an insured has an insurable interest in some parts of the insured subject matter but not others, the policy should be severable so that where the interest exists the insured can still recover under the policy.
- 5.17 For example, a travel insurance policy is likely to include life and life related provisions as well as non-life indemnity elements. The Life Assurance Act 1774, enacted before such policies existed, provides that "every assurance" is void if made without insurable interest. The question therefore arises as to whether the whole policy would be held to be void due to a lack of insurable interest for the purposes of the Life Assurance Act 1774 or whether the policy is severable and the risk divisible. For example, if there was no insurable interest for the life insurance part because it insured a life which was too remote from the insured, could a claim for lost luggage under the non-life part still be paid? Or if the policyholder suffered an injury and incurred a medical bill, could that be paid even if the policyholder had tried also to insure the life of an unrelated travel companion in respect of whom they had no insurable interest?

²⁸ This also applies to the Foster Children (Scotland) Act 1984, section 18.

5.18 Professor Clarke suggests²⁹ that implicit in Lord Mansfield's judgment in *Tyrie v Fletcher*³⁰ is the notion that risk in insurance policies may be divisible, not entire, where a single contract of insurance covers separately identifiable risks. It follows that, if a policy was comprised of life insurance as well as other forms of indemnity insurance, then merely the life insurance part of it would be held void due to the absence of insurable interest. The remaining parts of the insurance which do not require such an interest could still be upheld.

5.19 Section 84(2) of the Marine Insurance Act 1906 provides:

Where the consideration for the payment of the premium is apportionable and there is a total failure of any apportionable part of the consideration, a proportionate part of the premium is, under the like conditions, thereupon returnable to the assured.

5.20 More recent authority suggests that the premium of a "single risk" policy is not divisible. In *Swiss Reinsurance Company and Others v United India Insurance Company Limited*³¹ it was held that the particular policy could not be divided even where different elements of the policy had been rated separately because a global discount had been applied on top.

5.21 The court went on to say, however, that ascertaining whether the risks under a policy can be apportioned to parts of the premium is a question of the construction of the policy.³² It therefore appears that a premium can be divided but that it depends on the policy and facts of the individual situation. In any case, *Swiss Reinsurance Company* is not directly on point, and was in fact an attempt by a policyholder to get some premium back because the property was destroyed (in a non-insured way) so the insurer was no longer on risk.

5.22 According to Clarke, divisible risks are identified in the same ways as divisible obligations under other kinds of contract.³³ After some consideration, we have concluded that the draft Bill need not make specific provision about this and that it should be left to interpretation of the contract. We think that the courts will be able to reach the right decision on existing principles.

Q10. Do consultees agree that the question of severability is best left to the construction of the contract?

²⁹ MA Clarke, *The Law of Insurance Contracts* (5th ed 2006), para 13-12A.

³⁰ (1777) 2 Cowp 666.

³¹ [2005] EWHC 237 Comm. See para 49.

³² Para 67.

³³ Clarke, para 13-12A, referencing Glanville Williams (1941) 57 LQR 373 and 490.

LIST OF QUESTIONS

The questions set out throughout this paper are listed below. In addition to these questions, we welcome general comments on whether the Bill correctly implements our policy and if there are any unintended consequences which we have not foreseen.

CLAUSE 1: DEFINITIONS

Q1. Do consultees agree that personal accident, critical illness, disability and other insurances dependent on human life be subject to the same insurable interest rules as life insurance?

Q2. Do consultees consider that the definition of “life-related insurance” works for insurance-linked investment products, and annuities?

CLAUSE 2: LIFE-RELATED INSURANCE

Q3. Do consultees consider that this non-exhaustive list is appropriately drawn to cover all the key situations in which an insured should be able take out insurance over another person?

Q4. Do consultees agree that the economic loss test is sufficient to ensure that families can ensure parents or grandparents in appropriate situations?

Q5. Are there any negative consequences which this Bill could have on investment linked insurance products compared to the current law?

CLAUSE 3: NON-LIFE INSURANCE

Q6. Do consultees consider that there are any non-life insurance policies in which the requirement to have an insurable interest at the time of the insured event would be problematic? That is, are there any circumstances in which a non-life policy would, apart from this requirement, pay out in the absence of an insurable interest at the time of the insured event?

Q7. Do consultees consider that this non-exhaustive list is appropriately drawn to cover all the key situations in which an insured should be able take out non-life insurance?

CLAUSE 4: CONSEQUENCES OF THE CONTRACT BEING VOID

Q8. Should an exception to the retention of premiums be limited to consumer contracts only, or extended to all cases where it appears that it would be unfair to the insured for the insurer to retain them?

GENERAL

Q9. Do consultees foresee any significant difficulties in providing that contracts entered into under the old law are not void for lack of insurable interest if the insured would have an insurable interest under the provisions of the draft Bill?

Q10. Do consultees agree that the question of severability is best left to the construction of the contract?