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Scottish Law Commission
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**Insurance Contract Law
SUMMARY OF RESPONSES TO ISSUES PAPER 10:
Insurable Interest**

This document summarises the responses received to the Law Commissions' tenth issues paper in the joint insurance law project

April 2016

THE LAW COMMISSION
THE SCOTTISH LAW COMMISSION

Joint Review of Insurance Contract Law

**SUMMARY OF RESPONSES TO
ISSUES PAPER 10:
INSURABLE INTEREST**

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Approach taken in this paper

Describing responses

This paper describes the responses we have received to the proposals on insurable interest set out in Issues Paper 10: Insurable Interest, published in March 2015. It aims to report the points made by the consultees. It does not give the views of the Law Commission or the Scottish Law Commission.

Comments and Freedom of Information

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

Please contact us:

- By email at commercialandcommon@lawcommission.gsi.gov.uk
- By post, addressed to Laura Burgoyne, Law Commission, 52 Queen Anne's Gate, First Floor Tower, London SW1H 9AG.

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

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

PART 1: INTRODUCTION

- 1.1 The Law Commission 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,¹ which have resulted in legislation introduced through the special parliamentary procedure for uncontroversial Law Commission Bills.² 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 In March 2015 we published an Issues Paper³ on insurable interest as part of our joint review. We sought views on updated proposals, having consulted on this twice before: in an Issues Paper in 2008,⁴ and as part of our 2011 Consultation Paper.⁵
- 1.3 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 2008 Issues Paper revealed strong support for retaining the principle of insurable interest. It was thought to guard against moral hazard,⁶ protect insurers from invalid claims and distinguish insurance from gambling.
- 1.4 In the issues paper, we looked separately at indemnity insurance and life insurance. Indemnity insurance indemnifies the policyholder for losses suffered and examples include buildings insurance, liability insurance and business interruption insurance. The indemnity principle requires that the insured has suffered a loss in order to recover under the policy. By contrast, most life insurance is written on a contingency basis, paying a fixed sum on the death of the person injured.

¹ 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/ 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 and http://www.scotlawcom.gov.uk/index.php/download_file/view/1291/107/.

² In the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015.

³ Issues Paper 10 – *Insurable interest: updated proposals* (March 2015).

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

⁵ 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).

⁶ 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 of the claim.

- 1.5 The current state of the law in this area makes it difficult to say with certainty what amounts to an insurable interest, or to specify the consequences of writing insurance without it. We made proposals to clarify the law, and in some places to make substantive changes to it.
- 1.6 In response to our previous consultations on this matter, there has been general agreement that the law requires reform, but some inconsistency over the ways in which it should be reformed.
- 1.7 The feeling that the requirement for insurable interest is ripe for reform was reflected in the responses to our most recent issues paper. We received 31 responses, which can be broken down as follows:

Insurers	9
Insurance industry associations	5
Brokers and brokers' associations	2
Law firms and lawyers' organisations	7
Individuals including insurance academics	8

- 1.8 The Appendix contains a list of respondents.

APPROACH IN THIS DOCUMENT

- 1.9 In March 2015, when we published Issues Paper 10, we published a set of simplified proposals. Because of the time and effort consultees had already invested responding to previous consultations on this issue, we did not ask consultees for detailed comments on each proposal. Instead, we asked general questions about whether statutory reform was needed, and whether consultees generally agreed with our latest proposals.
- 1.10 It is therefore more difficult to give definite statistics of which consultees agreed or disagreed with any particular proposal. However, we have sought to indicate how many people commented on each individual proposal, and summarise the substantive comments which we did receive.

THANKS

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

PART 2: INDEMNITY INSURANCE

INTRODUCTION

- 2.1 In most types of non-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 our March 2015 Issues Paper we proposed only small amendments to them.
- 2.2 The responses we received show that these proposals remain well supported.

STATUTORY CLARIFICATION OF THE LAW

- 2.3 We asked whether consultees agreed that the law of insurable interest in indemnity insurance should be clarified in statute.
- 2.4 21 of 24 consultees who addressed the point agreed or broadly agreed.
- 2.5 The law firm Weightmans commented:

The law of insurable interest is fragmented and there is a need for further clarification. Further, the current law of insurable interest has had the unintended consequence of restraining the market to the extent that it is unable to write insurance products for which there is sizeable demand.

- 2.6 Confirming its view that the requirement for insurable interest should be retained, the Association of British Insurers (ABI) said:

The requirement of an insurable interest for indemnity contracts maintains the distinction between insurance and gambling, and avoids undesirable social risks such as the potential for an increase in invalid or even fraudulent insurance claims. Current market practice generally works well for both the insured and the insurer... However, we do accept and agree with the Law Commission that some consolidation would be beneficial for both consumers and insurers, in order to achieve a greater level of consistency and transparency in the law.

- 2.7 Direct Line did not agree that there was necessarily a need to clarify the law in statute:

[W]e are not aware of any issue with the operation of insurable interest in indemnity insurance, and do not feel strongly that this should be clarified in statute.

- 2.8 Three consultees, all insurance academics, thought that the requirement for insurable interest in indemnity insurance should be removed. Professor John Birds argued that:

a requirement of interest at any time is actually unnecessary, as the principle of indemnity suffices to ensure that no one can recover more than he or she is entitled to, provided that “indemnity” is defined widely enough to include cases of real economic loss.

- 2.9 Gary Meggitt has also argued for its abolition:

The doctrine of insurable interest grew out of eighteenth-century anxieties over fraudulent seafarers and habitual gamblers. It was created by the courts, entrenched by statute and remains in place to this day despite the fact that it serves no practical or legal purpose.⁷

- 2.10 In their responses to our consultation, both accepted that our proposals were an improvement if removal was not an option:

Failing its abolition, I agree that the law of insurable interest should be clarified in statute. This should, however, be done in the broadest possible terms to provide the courts with sufficient scope to interpret the requirement for an insurable interest on the part of policyholders in light of changing legal, social and commercial circumstances.
[Meggitt]

DETAILED PROPOSALS

- 2.11 We then set out nine more detailed proposals concerning insurable interest in indemnity insurance, covering the point at which the interest must exist, the consequences of lack of interest, and a non-exhaustive definition of insurable interest in this context.
- 2.12 We asked if consultees agreed in broad terms with these proposals, and invited further comment.
- 2.13 Most consultees agreed or broadly agreed with the proposals. For example, Aon said:

We believe that the Law Commission’s current proposals are a sensible way forward. Save for cases of fraud, parties should be able to enter into a contract without fear that a legal loophole will result in such a contract being void. The current law is also unfair as the insured is taking all the risk.

⁷ G Meggitt, ‘Insurable interest – the doctrine that would not die’, *Legal Studies*, Vol 35 No 2, 2015, pp 280-301.

2.14 The Bar Council commented:

Although in practice we have found it to be rare for insurers to take points about lack of insurable interest in indemnity insurance, we are persuaded that it would be desirable to have clarification of insurable interest in a statute. We support the repeal of the Marine Insurance (Gambling Policies) Act 1909 and the Marine Insurance Act 1788.

2.15 Heather Thomas argued that insurable interest is in fact a live issue:

The premise behind insurable interest is that insurers need to be protected from prospective policyholders seeking to abuse or misuse an insurance product. It is this premise which is obsolete. Insurers are perfectly well able to delineate the interest insured and to determine whether and to what extent they wish to be committed. As it stands, insurable interest offers them an argument which at least muddies the waters if it does not determine the outcome. At the BILA conference on 26 June 2012, Colin Edelman QC in the Chair took an extremely unscientific straw poll of how many practitioners in the room had encountered insurable interest as an issue being raised as a defence. When the majority of those practitioners present raised their hand, there was an audible gasp. There may not be many, or any, cases decided since *Feasey* (in which I was involved), but it would be a mistake to suppose that this is a dormant issue.

2.16 Many made further comments on individual proposals, and we summarise these below.

TIMING AND CONSEQUENCES

Concluding a valid insurance contract

2.17 **Proposal 1:** We proposed that an insurance contract should be void for lack of insurable interest unless:

- (1) the policyholder has an insurable interest at the time the contract is made; or
- (2) there is a reasonable prospect at that time that the policyholder will acquire some form of insurable interest during the life of the contract.

2.18 Of 24 consultees who commented on this proposal, 21 agreed or broadly agreed.

2.19 The Insurance Law Committee of the City of London Law Society (CLLS) considered that it is “currently unclear when an insurable interest must exist”. The Committee was in favour of the proposal, believing that it would “help to clarify the law”.

- 2.20 The International Underwriting Association (IUA) also agreed, and further commented:

On a related point, we would reiterate ... that there should be no legal requirement on insurers to check that policyholders have an expectation or a chance of loss at the outset of an indemnity contract of insurance. Regulation, in particular the TCF requirements, sufficiently protects consumers with regard to purchasing 'worthless' policies and poor underwriter practice therein.

- 2.21 The ABI suggested that, as well as the existence of insurable interest,

consideration should also be given to the willingness of the parties to enter into the contract of insurance. Insurers should be free to write policies that are required by customers.

- 2.22 Some consultees commented on the meaning of "reasonable prospect". For example, the British Insurance Brokers' Association (BIBA) said:

We would appreciate it if the Law Commission would expand upon the term 'reasonable prospect' – who applies the test? Is it objective or subjective? Is the 'reasonable prospect' in the opinion of the client or the insurer? [W]e would not want it to be an avenue for a claim to be rejected by an insurer.

- 2.23 Financial and Legal Insurance Company argued that:

'reasonable prospect' should be defined as having more than a 50% chance of acquiring an insurable interest - the use of this phrase linked to a 50% chance is currently used for legal protection insurance policies when deciding if a claim has prospects of succeeding. It is also well understood and accepted by the legal profession and FOS.

- 2.24 The Insurance Division of Lloyds Banking Group suggested that the contract should not necessarily be void and said that they would prefer for

the remedy for lack of insurable interest to be that the contract is voidable at the option of the insurer, rather than void. The insured will know whether or not they have an interest in the subject-matter of the insurance. Allowing the insured to assert that the policy is void for want of such an interest gives them an option to seek return of the premium once they realise that an insured event will not occur.

- 2.25 We also considered the – almost hypothetical – situation in which, at the outset of the contract, the insured has neither an insurable interest nor a reasonable prospect of acquiring one, yet during the course of the policy term does in fact acquire an interest.

2.26 **Proposal 2:** We tentatively proposed that, 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 a reasonable prospect at the time of the contract.

2.27 Only four consultees commented on this proposal. They did not agree that it was required.

2.28 The Bar Council did “not see the need for the legal fiction envisaged” by this proposal. Similarly, the British Insurance Law Association (BILA) said:

We do not see why it is necessary to ... provide that acquiring an insurable interest during the policy period should be conclusive proof of a reasonable prospect having existed at the start of the policy. Insurers will indemnify on the basis that the insured had an insurable interest at the time of the loss in respect of which indemnity is given.

2.29 In contrast to BILA’s point, Direct Line Group argued that:

if there was no reasonable prospect of obtaining an insurable interest when incepting the policy, even if by chance someone was to obtain an interest through the life of the policy, then it would not have been the intention of the insurer to have offered insurance accepting the customer’s premium.

When the insured can make a claim

2.30 **Proposal 3:** We proposed that, to make a claim, the insured must have an insurable interest at the time of the loss. Of the eight consultees who specifically commented on this proposal, all agreed.

2.31 CLLS agreed and said:

The Committee notes that this [requirement] is a hallmark of insurance and distinguishes it from other contracts, such as credit derivatives contracts (which do not typically require the buyer to have an insurable interest at the time of loss).

2.32 RSA argued that the indemnity principle should also be mentioned here:

The intended statute will say that possession is sufficient to establish insurable interest, but it must be made clear that there is a two tier test - insurable interest and loss (the indemnity principle). Where one of these is missing, a policy of indemnity does not respond (unless the insurance is expressly intended to provide additional cover).

Consequences of lack of insurable interest

2.33 **Proposal 4:** We proposed that, if an insurance contract is void for lack of insurable interest, the insurer should not be entitled to sue for premium, and should return premiums already paid. Of the 11 consultees who directly commented on this proposal, eight broadly agreed although many made additional comments.

2.34 Franziska Arnold-Dwyer asked for clarification that premiums would not be refundable if the insured had an insurable interest (or a reasonable prospect of acquiring one) at the time of the contract but subsequently loses the interest:

In this situation, the insurer has been on risk and no refund should be available, even if the insured is no longer entitled to claim under the contract.

2.35 Two other consultees echoed this point.

2.36 Four consultees argued that insurers should be entitled to deduct reasonable administrative costs from the payments refunded to the policyholder. Andrew Carrick suggested:

It would seem equitable that ... whilst an insurer cannot charge a premium, it should be entitled to make a reasonable charge for administrative costs, and any legislation should not prevent this (as opposed to enforcing it).

2.37 Disagreeing with the proposal, CLLS argued that the insured should not be entitled to a refund if the policy was found to be void for lack of insurable interest. They argued that this would “act as a disincentive to the purchase of insurance on a speculative basis”. The IUA argued that refund of premiums should be left to the contractual terms of the policy.

Fraudulent misrepresentation by the insured

2.38 Several consultees argued that there should be an exception to the insured’s right to a refund of premiums where the insured had fraudulently misrepresented to the insurer the existence of an insurable interest.

2.39 Three consultees mentioned the potential for money laundering. For example, Direct Line Group said:

[I]f a policy is incepted (with no reasonable chance of insurable interest) and a return of premium is permitted regardless of a fraudulent claim, then there is concern that this could be used as a vehicle for obtaining clean money via a refund for purposes of money laundering.

- 2.40 Weightmans referred to provisions in the Insurance Act 2015 and Consumer Insurance (Disclosure and Misrepresentations) Act 2012 preventing return of premium in cases of fraud:

The acts provide for a return of premium to policyholders in the event that an “innocent” misrepresentation has been made to the insurer. However, in the event that any misrepresentation was deliberate and/or reckless, the acts expressly provide that the insurer can cancel the policy and retain any premium paid. We propose a similar wording within this section of the proposed amendments so that those insureds who deliberately or recklessly mislead the insurer as to the nature of their interest in the proposed risk forfeit their premiums. This will act as a powerful and important deterrent to those minded to mislead their insurers and perpetrate fraud.

EXISTING STATUTES

Obsolete statutes

- 2.41 **Proposals 5 and 6:** We proposed the repeal of:

- (1) The Marine Insurance (Gambling Policies) Act 1909, which makes it a criminal offence to effect a contract of marine insurance without having a bona fide interest.
- (2) The Marine Insurance Act 1788, which requires the names of those interested in the insurance to be inserted into the policy. This Act was repealed by the Marine Insurance Act 1906, but only insofar as it applies to marine insurance.

- 2.42 All consultees who commented supported the repeal of these Acts, although on the 1788 Act the ABI noted that:

there may be a need for insurers to know who is interested in the policy for underwriting purposes and to reduce the potential for fraud.

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

- 2.43 **Proposal 7:** 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 proposed that they should not be affected by our proposed reforms.

- 2.44 The consultees who addressed this point agreed, although Franziska Arnold-Dwyer said:

this somewhat detracts from the idea of uniform rules for all types of indemnity insurance.

DEFINING INSURABLE INTEREST

2.45 **Proposal 8:** We proposed that statute should define insurable interest for the purpose of indemnity insurance using a non-exhaustive list of examples of insurable interest.

2.46 **Proposal 9:** We suggested that the insured should be said to have 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.

2.47 Of 10 consultees who commented on the proposal to define insurable interest using a non-exhaustive list, five agreed. Five raised concerns which generally focussed on the risk of impeding future development of new insurance products. Nearly all consultees emphasised that any list should be non-exhaustive.

2.48 The ABI had some concerns about any statutory definition of insurable interest, saying:

[I]nsurers should be free to decide whether to accept a premium for a proposed risk and issue a policy. Allowing for flexibility and freedom in the market ultimately benefits consumers, due to the availability of products which suit their needs.

2.49 They thought there was

a risk that in defining insurable interest too narrowly, the development of new insurance products, or even products to cover new or emerging risks, could be restricted to the detriment of consumers. If there is a non-exhaustive list of examples, which we tentatively support, then the statute should make clear that the list is for illustrative purposes.

2.50 Franziska Arnold-Dwyer said:

My preference would be to define insurable interest with an open-textured test, similar to s.5(2) of the Marine Insurance Act 1906. If a list of examples is included, I would suggest that this list is preceded by a general definition or test and that it is made clear that the list of examples contains examples that would tend to show that the insured has an insurable interest (i.e. the examples are in the nature of a rebuttable presumption).

2.51 Consultees generally agreed with the three elements we proposed. However, it was noted that the examples were focussed on property insurance and consultees suggested that economic interest such as professional indemnity insurance and other types of non-property interests (such as a landlord's interest in the tenant's payment of rent) should be more directly addressed.

2.52 Emphasising that any list must be non-exhaustive, Direct Line Group gave an example of a common insurance arrangement which should not be excluded:

In Motor Insurance a father may wish to make sure his son has valid insurance in place for his new vehicle. Whilst the father has no insurable interest in this vehicle he may wish to add the vehicle to his own multi vehicle insurance policy to reduce the administrative burden. It is also often convenient for both parties to have the premium taken in one payment – for both the father's and son's cars - albeit the son's premium is calculated as if he is the policyholder. Any exhaustive list defining insurable interest may not pick up scenarios such as this, removing the opportunity to provide a product which is useful to society in general.

2.53 Linklaters stressed the need to retain a distinction between insurance and derivatives:

The proposals should not apply to contracts where the terms of the contract and the rights and obligations thereby created are such that the payee's entitlement to receive a payment is not conditional on the payee suffering a loss or detriment or otherwise having an insurable interest in the subject matter of the contract at any time. The fact that the payee as a matter of fact has or acquires an insurable interest ... during the life of the contract should not cause a contract to be characterised as a contract of insurance if the terms of the contract are such that the payee's right to receive the payment or other benefit are not conditional on the payee suffering a loss or detriment or otherwise having an insurable interest in the subject matter of the contract.

2.54 Franziska Arnold-Dwyer felt that category (3) might give insurable interest too wide a meaning.

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.⁸
- 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 used the term “life insurance” as shorthand for them.
- 3.3 In general, our updated proposals were well supported. As in our 2011 paper, we proposed widening the definition of insurable interest for life insurance purposes. The proposals we set out in our March 2015 paper were less prescriptive than those in the 2011 consultation paper, and this was welcomed. Consultees generally agreed that reforms should be confined to broad principles and should not include specific caps or limits.

STATUTORY CLARIFICATION OF THE LAW

- 3.4 We asked whether consultees agreed that there was a need for statutory reform in this area. All 24 consultees who answered this question agreed that there was a need for reform.
- 3.5 The Investment and Life Assurance Group (ILAG) said:

The Law Commission is absolutely right to recommend reform of the current legal framework. Public perception of insurable interest is not in line with the current legal definition and this has caused the insurance industry to move beyond the letter of the law in order to serve policyholders’ best interests. There is therefore a real danger that the current law is so out-dated and impractical that it is increasingly ignored to the point of irrelevance. The concept of insurable interest should be retained and reform is vital to preserve its value.

⁸ 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.

3.6 Aon agreed that clarification was needed for the efficiency of the industry:

Given the uncertainty in this area of law, a lot of time and money can be wasted by having to ask lawyers to confirm that technically an insurable interest exists. For example, we come across the concept of insurable interest frequently, in relation to longevity and mortality hedging transactions. Questions on this topic most usually arise either when:

- (a) longevity risks are transformed between derivative and insurance for structural reasons, or
- (b) confirmation is needed that pension scheme trustees are not over-insuring.

3.7 The ABI said:

We think there is a case for statutory reform of the law relating to insurable interest in the context of life and other non-indemnity insurance, to consolidate the current position, to help remove areas of uncertainty and to update to better reflect current market practice.

3.8 Law firm BLM agreed but cautioned:

A number of controls will be removed and there is a requirement for responsible underwriting. The FCA will need to be aware of the implications.

3.9 Two consultees argued in favour of abolishing the insurable interest requirement for life insurance. Lloyds Banking Group said:

We note the historical concern around moral hazard which shaped the current insurable interest position but do not consider this poses a risk today. Instead, insurers consider the regulatory guidance on product development alongside developing customer needs. As such, we would favour abolition of the requirement for insurable interest for life and other non-indemnity insurance, leaving insurers to set their own eligibility constraints to avoid any moral hazard risk.

Investment linked insurance contracts

3.10 Three stakeholders – all of whom were insurers or insurance bodies – suggested that an insurable interest requirement was not necessary or appropriate for investment linked insurance contracts and investment bonds.

3.11 Standard Life explained:

By 'investment-linked insurance contracts' we mean a non-qualifying investment linked life assurance contract which is a long term contract written on an own life or life of another basis, and where the benefits payable on death are calculated by reference to the underlying assets or where those benefits do not exceed 110% of the amount that is calculated in relation to the underlying investments.

3.12 Canada Life said:

The risk of moral hazard is greatly reduced for such products and therefore it is questionable whether it is required for this type of business as it creates additional complication and administration, for little value.

3.13 The ABI said:

It would be very helpful if thought could be given to the situation regarding policies with multiple owners and lives assured. This is an important consideration for investment bonds – and if in this context the requirement for an insurable interest were retained, it would be helpful if it were put beyond doubt that the policyholder is not required to have an insurable interest in *every* life assured.

3.14 They continued:

Should trustees be prevented from investing in life insurance bonds, then this could impact upon life insurance business – possibly resulting in business being lost to the UK. This is because trustees will not legally be able to invest in UK life insurance bonds but will be able to invest in, for example, Isle of Man life insurance bonds, since there is no such requirement in the Isle of Man (and some other jurisdictions).

DETAILED PROPOSALS

An insurable interest based on economic loss

3.15 **Proposal 10:** We proposed that an insured should be taken to have an insurable interest where there is a reasonable prospect that the insured will retain an economic benefit on the preservation of the life insured or incur an economic loss on death.

3.16 All 10 consultees who directly addressed this proposal agreed.

3.17 Aegon said:

We believe this proposal will facilitate the continued provision of insurance contracts offering genuine benefits to the public and employers/employees. It will remove uncertainty surrounding the legality of such contracts.

3.18 The IUA said the proposal was “sensible” and that it would:

offer a greater degree of flexibility for both insureds and insurers and would provide certainty in the areas of interest recovery and key employee coverage that currently are not totally clear.

3.19 Most consultees felt that “reasonable prospect” was an appropriate standard, but a small number preferred “reasonable belief” or “reasonable expectation”.

Value of interest

3.20 **Proposal 11:** We suggested that there should be no statutory limit on the amount for which the insured may obtain insurance over the life insured. This would mean the repeal of section 3 of the Life Assurance Act 1774, which caps the policy limit at the value of the interest at the time of the contract.

3.21 Of 11 consultees who addressed this proposal, 10 agreed with it.

3.22 Group Risk Development (GRiD) said:

Insurers will have their own appetite to risk and appropriate controls and processes in place to manage those risks. Each insurer should be free to assess the risks as presented to them. The practical implications of introducing a financial limit are unworkable. The individual could simply take out multiple policies with different insurers to overcome any limit.

3.23 Aegon noted that other non-statutory controls were available:

Should there be a need for a limit (which we do not anticipate) there are other methods that are more flexible and able to react to market changes e.g. regulation by the FCA or introduction of best practice or guidance notes by the ABI.

3.24 By contrast, Ian Howgate argued very strongly that the amount for which the insured may obtain insurance should in all cases be capped by his economic interest on the preservation of the life insured or his economic loss on death. He argued that the law of insurable interest should be revised:

so that the cover at the point of claim should only pay out up to the level of the insurable interest at the time of claim. That would prevent people being ripped off by over-insurance whether immediate at the point of contract or a number of years down the line.

Insurance without evidence of economic loss

3.25 Under the current law, a person may insure their own life, and that of a spouse or civil partner, without evidence of financial dependence or expectation of financial loss. We proposed that the categories of person over whom individual insureds have this automatic insurable interest should be expanded to include cohabitants and the insured's children. In the issues paper and previous consultation papers, we referred to these relationships as those of "natural affection".

Cohabitants

3.26 **Proposal 12:** We proposed that 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. Unlike in our 2011 consultation paper, we did not propose that statute should set out a minimum period of cohabitation.

3.27 Of 13 consultees who addressed this point directly, 12 agreed with the extension to cohabitants.

- 3.28 Agreeing that there need not be a statutory minimum period of cohabitation, BILA added:

We foresee that there may well be litigation about whether people were in fact cohabitants, but we do not consider it likely that such disputes would exhibit novel characteristics or over-burden the judicial system.

- 3.29 The IUA thought:

In principle we think it would be preferable to have an established dependency or financial interest but it is perhaps a moot point in the sense that insurers will evaluate such factors and may utilise further questioning of the insured with regard to their actual interest, to be able to accurately price the risk and the amount of cover that they are prepared to offer.

- 3.30 ILAG suggested:

Cohabitees should be used as an example of natural affection, rather than a narrow definition. It is important to build flexibility into such definitions to allow an extent of future proofing.

- 3.31 Arguing against the extension, Ian Howgate distinguished between marriage and cohabitation. He argued that in the case of marriage there was a:

reasonable prospect (it was more likely than not) that the insurable interest [in one's spouse] would survive for the length of a long term insurance contract like life insurance. As a result it was not unreasonable to sell a long term insurance to people in this permanent sort of relationship which had financial consequences if it ended prematurely. The same certainly cannot be said for people just living together.

- 3.32 Mr Howgate argued that any extension of the categories of insurable interest, and particularly the extension to cohabitants was

an invitation for life companies to sell unnecessarily high levels of life cover for ridiculously unsustainable terms to unwitting customers who then split up and cancel the policy.

Children

- 3.33 **Proposal 13:** We proposed that:

- (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.

- 3.34 Of 12 consultees who addressed this point directly, 11 agreed or broadly agreed with our proposals.

- 3.35 Reinsurance Group of America (RGA) emphasised the importance of this extension for protection rather than pure life insurance, noting:

the many instances where valuable critical illness and other living benefits have been extended to children and children's claims now account for 2-4% of all of paid critical illness claims. Payment of living benefits has a significant impact on the quality of life and the quantum of these benefits should be left to the prudent underwriter to decide.

- 3.36 The ABI noted the need for insurer discretion to avoid moral hazard in cases of pure life insurance:

For investment bonds we support the proposal that parents should be entitled to insure the lives of their children of whatever age – indeed if the concept has to be retained for these products, we suggest this be drawn as widely as possible. However, for other products, we have some concerns with the proposal that parents have automatic insurable interest in their children. We would certainly expect insurers to be able to use their discretion, not least depending on their risk appetite.

- 3.37 On the value of the policy, CLLS agreed that a statutory cap was not necessary:

because an insurer should/will in practice refuse to write a policy which places an unrealistic valuation on a child's life.

- 3.38 Ian Howgate, disagreeing with the proposed extension to children, said:

In 20 years reviewing sales in the life industry I have never seen a justifiable instance of where there was any purpose for insuring a minor at all, let alone to some uncapped level. If there is a need which could be proved by there being a financial relationship and dependency then that dependency can be valued, an insurable interest can be shown and it should not be exceeded.

Grandchildren

- 3.39 We asked a specific question about whether people should be entitled to take out insurance on the lives of their grandchildren without evidence of financial interest.

- 3.40 25 consultees answered this question, of whom 22 agreed or broadly agreed that individuals should have an automatic insurable interest in their grandchildren.

- 3.41 RGA said:

a prudent underwriter will be able to decide if there is a real insurable interest and they will also be able to determine the quantum of this interest.

3.42 Heather Thomas said:

I think that grandchildren should be included to deal with cases where, as a result of the death and/or divorce of the parents, the grandparents have a very active relationship with the grandchildren. In the ordinary way, it would make little economic sense for grandparents to take out such insurance, but prohibiting the possible might put the exceptional cases at an unnecessary disadvantage.

3.43 Standard Life focussed on investment-linked insurance contracts. They explained:

These contracts will continue until the death of the last surviving life assured, unless they are surrendered ... To maximise flexibility and to avoid the contract being brought to an end prematurely, good financial advice is to have a number of lives assured and for those lives assured to include individuals that are likely to outlive the policyholder.

3.44 For this reason they supported the right of insureds to name grandchildren as lives insured.

3.45 Canada Life thought that investment bonds should be treated differently:

For investment bonds, if an insurable interest is still required, we support the widening of the permitted relationships to include not only grandchildren and parents / children but also other blood relatives such as siblings. For pure insurance policies then we believe an element of financial interest should exist as there is a greater risk of moral hazard for this type of business.

3.46 Arguing strongly against this extension, Ian Howgate asked:

[W]hat can the benefit or ethical motive possibly be other than to the insurer or a gambler?

Parents

3.47 We did not propose that children should be able to insure the lives of their parents without evidence of financial loss. However, some consultees suggested that this might be a further appropriate extension of the “natural affection” category which does not require economic interest to be demonstrated.

3.48 Aon said it could:

see potential benefit and market opportunity for children taking out insurance on their parents (or potentially even grandparents) due to a combination of an ageing population and less fall back on the State, for example for funeral expenses, care home costs etc.

3.49 ILAG referred to the Dilnot reforms which were “expected to provide a catalyst for new products to meet long term care needs.” It suggested that:

[t]he current legal definition of insurable interest has held back markets from developing products to satisfy these needs.

3.50 John Potter thought children should have an insurable interest in their parents but only

to the extent that they will lose financially by such deaths, if they are not of an earning age, or at university, or will wish to fund funeral costs should parental funds be insufficient to pay for such.

Group schemes

3.51 Proposals 14 and 15: We proposed that:

- (1) a trustee of a pension or other group scheme should have an unlimited insurable interest in the lives of the members of the scheme.
- (2) 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.

3.52 Of 11 consultees who commented directly on these proposals, 10 supported them.

3.53 MetLife commented:

Any uncertainty in the group employee benefits market that lingers following the case of *Feasey v Sun Life Assurance Co* [2003] would be resolved by [these] proposals and we support them.

3.54 Similarly, Royal London said:

We support the Law Commission’s recommendations here and would like to see clarity being delivered to group insurance markets. Group insurance provides valuable cover to millions of people in the UK and contract certainty is welcomed.

3.55 The ABI strongly supported the proposals. They suggested extending the employer-related proposals

to similar business situations but where there isn't a strict employer / employee relationship such as company and director and partnership and partner.

3.56 Ian Howgate did not agree with any extension of the categories of insurable interest and argued that insurable interest should be based on the economic interest test.

Repealing section 2 of the Life Assurance Act 1774

- 3.57 **Proposal 16:** Section 2 of the Life Assurance Act 1774 provides that a life insurance policy is unlawful unless the name of the person who benefits from life insurance is stated in the policy. We proposed the repeal of this section.
- 3.58 Only seven consultees commented on this proposal, but all of these agreed. The ABI said:

Where the insurer fails to enter the name of the beneficiary as a statutory requirement, the claim could technically be declined. This is unfair and unnecessary. However, it is important that the parties to the contract are still stated in the contract to ensure contract certainty.

A new statutory requirement for insurable interest

- 3.59 **Proposal 17:** We proposed that there should be a statutory restatement of the requirement of insurable interest in life insurance to replace the requirements set out in the Life Assurance Act 1774. We suggested that this should also include a non-exhaustive list of circumstances in which an insurable interest exists.
- 3.60 All eight consultees who directly addressed this provision agreed. CLLS said:

There remains a strong body of opinion that there should be a requirement of insurable interest for the purpose of life assurance. We agree that the present definition is confusing and could usefully be simplified. In the context of life assurance, we do not disagree that a list of non-exhaustive examples could be helpful, reflecting the extensions set out in the Consultation Paper.

- 3.61 Several consultees commented that the list must be non-exhaustive. For example, the Lloyd's Market Association (LMA) stressed:

Any list should be very clearly non exhaustive, flexible and should allow for innovation.

Consequences of lack of interest

- 3.62 **Proposal 18:** We proposed that, if an insurable interest is not present, the policy should be void but not illegal. Eight consultees commented directly on this proposal. They generally agreed, although the ABI said:

We do not think this should apply to investment bonds. Otherwise, we tentatively agree that if an insurable interest is not present, the policy should be void but not illegal. However there is a lack of certainty about the implications of a policy being found to be void.

Severability

- 3.63 **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. Only six consultees commented, generally agreeing. The IUA advised that:

there may be practical difficulties in reallocating premium in such risks, on the basis that the risk was initially rated, placed and packaged as an overall product.

Timing of interest

- 3.64 **Proposal 20:** We suggested that, for life insurance, insurable interest must be present at the time of the contract. In contrast to our proposals on indemnity insurance, we suggested that it need not be present at the time of the loss in order to make a claim.

- 3.65 All eight consultees who commented on this agreed.

- 3.66 RGA said:

This would follow current practice and the prudent underwriter should be able to determine if they believe an insurable interest exists at the time the contract is taken out. Leaving this test to be dealt with at the claims stage is an unnecessary burden on both the insurer and insured and is likely to lead to delay at a time when the financial assistance provided by the insurance is most needed.

- 3.67 CLLS agreed that

in the context of contingency insurance, insurable interest must be present at the time of the contract but need not be present at the time of the loss. It would destroy the traded life settlement market and also the recent proposals for sale of annuities if this were to be introduced.

APPENDIX: LIST OF RESPONDENTS

Aegon UK

Aon UK Limited

Franziska Arnold-Dwyer

Association of British Insurers (ABI)

Bar Council

British Insurance Brokers' Association (BIBA)

British Insurance Law Association (BILA)

Professor John Birds

BLM LLP

Canada Life

Andrew Carrick

Insurance Law Committee of the City of London Law Society (CLLS)

Malcolm Clarke

Direct Line Group

DWF LLP

Financial and Legal Insurance Company Limited

Ruth Gilbert

Group Risk Development (Grid)

Ian Robert Malcolm Howgate

Investment & Life Assurance Group Limited (ILAG)

International Underwriting Association (IUA)

Linklaters LLP

Lloyds Banking Group – Insurance Division

Lloyd's Market Association (LMA)

Gary Meggitt

MetLife

John Potter

Reinsurance Group of America (RGA)

Royal London

RSA

Standard Life

Heather Thomas

Weightmans LLP