

Home thoughts, from Abroad.

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Asking the right questions

The Law Commission continues its investigation of English insurance law with an issues paper on the subject of insurable interest. It opens up some fundamental questions about the nature of insurance contracts but the Commission has shied away from answering them.

1. The existing law on insurable interest

The existing law has been shaped by repugnance from insurance on the lives of others with whom the proposer has no connection, the moral hazard of such cover and the risk of (almost literally) putting a premium on murder. These concerns seem archaic but may have contemporary relevance.

Currently, English law deals haphazardly with indemnity and non-indemnity policies.

So far as *non-indemnity* policies are concerned, the Life Assurance Act 1774 renders void policies on lives “and other events” if they are made without an insurable interest. This is normally taken to deal with all non-indemnity policies: both life and valued policies such as conventional accident cover. An insurable interest for the purposes of life cover has always been quite restricted. It extends to:-

- Interests arising out of natural love and affection – but limited to spouses so that, for example, parents and children cannot insure each others' lives.

- Interests arising out of a potential financial loss – such as creditors and joint debtors but only to the extent of the actual loss. This renders the legal status of key man cover uncertain under English law.
- Interests arising out of statutory provisions such as the Civil Partnership Act 2004 (permitting life insurance between civil partners as well as spouses), the Married Women’s Property Act 1882 (which creates a statutory trust of policies effected for spouses and children) and a number of other specific statutory provisions.
- An indeterminate category of interests not fitting into those set out above where the common denominator seems to be some sort of pecuniary loss.

Where *indemnity* policies are concerned, the position used to be that the insured must have a legal or equitable interest in the property insured or a liability arising in respect of such an interest. The Marine Insurance Act 1745 renders marine policies void where there is no insurable interest and also, oddly, makes it a criminal offence to effect such a policy. The position as regards non-marine indemnity policies was until 2005 governed by section 18 Gaming Act 1845 which made all gaming and wagering contracts void. However, the Gaming Act was repealed by the Gambling Act 2005 with the unintentional result (or so it seems) that for non-marine indemnity policies it is probably no longer necessary for there to be an insurable interest. In practice, of course, an indemnity policy will only indemnify the insured for the losses it has actually suffered (the “indemnity principle”) so the absence of the requirement for an insurable interest is somewhat academic. Note however that the indemnity principle is rather less demanding than the requirement for an insurable interest which requires a specific legal or equitable interest in the property insured.

This approach differentiates indemnity and non-indemnity insurance. However, an important result is that it leads to uncertainty about the status of reinsurance: is it an indemnity or liability policy or is it just a further policy on the insured subject matter?

2. Proposals for reform

So far as life cover is concerned, the Commission broadly supports the retention of the concept of insurable interest. It tentatively proposes that the following should be deemed to have an insurable interest in a life:

- Any person - in his or her own life or that of his or her spouse or civil partner

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- Any person cared for or dependent on his or her guardian – in the life of his or her guardian
- Any parent – in the life of his or her adult child
- Any person – in the life of his or her cohabitant

The Commission goes on to ask whether this assumption should be extended to others such as parents of minor children, fiancées, siblings, grandparents and grandchildren.

It is further proposed that where there is a relationship of natural affection, the policyholder should be permitted to insure for an unlimited amount.

Where the insurable interest is supported by a pecuniary interest, the Commission tentatively proposes that the requirement should be relaxed to the reasonable expectation of pecuniary or economic loss on the death of the life insured – in contrast to the current requirement for a pecuniary interest recognized by law. It is also tentatively proposed that the insured should be able to insure for the reasonable expectation of the loss. This is intended to resolve current uncertainty over key man cover.

It is also tentatively proposed that a final category of life insurance should be permitted with the consent of the life insured although the Commission has asked whether the cover should be limited to the expected loss or the cover to which the life insured has consented.

Turning to indemnity cover, it is proposed that the requirement for insurable interest should be abandoned leaving the indemnity principle to govern the position. The Commission has asked whether insurers should be obliged to check that policyholders have an expectation of loss at the outset of a policy or whether that can be left to the regulatory authorities.

The Commission has also gone on to make various tentative consequential recommendations:-

- A contract for non-indemnity life insurance without insurable interest should be void, not illegal. The result would be that the premiums paid by the proposer would be returnable.

- Composite policies should be deemed to be severable so that a composite policy comprising life cover without insurable interest and indemnity cover would not be completely void: only the life cover would be treated as void.
- The criminal offence under the Marine Insurance Act 1909 of effecting a marine policy without interest should be abolished.
- The current legal entitlement of insurers to avoid a policy where there has been a failure to observe the requirement for the names of persons interested in a policy to be noted on it should also be abolished.

3. Conclusions

The Law Commission's proposals are mainly concerned with life cover. However, they do raise, if only by implication, some serious questions about other forms of cover. Just what is it that distinguishes an insurance contract from any other contract? The requirement for an insurable interest has always been part of the academic "textbook" answer to this question. Consequently, one might expect the Commission to consider a statutory definition of insurance if the requirement for an insurable interest is to be abandoned for an important part of the insurance market. With a blurring of the edges between insurance and other financial products, this question achieves some importance.

However, the Commission has avoided any attempt to define an insurance contract thereby following the reluctance of earlier legislators to do so. There may be very good reasons for that reluctance in a market where commercial forces move a lot faster than the legislative process. Nevertheless, it is a remarkable feature of English law that it makes almost no attempt to define an insurance contract despite the existence of an extensive and sophisticated body of rules governing to such contracts.

4. Participation

Please let us know if you have any views on these proposals. If implemented, they will be important and will affect the insurance market in this country fundamentally in the years to come.

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It would be particularly helpful to learn the views of North American insurers not just on these proposals but also those in the next issues paper – the duty of good faith in the post-contractual context. Hitherto, this has been an almost unknown concept on this side of the Atlantic. That is in marked contrast to North America and we should be interested in your views and experience.

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This is a brief summary of the Law Commission's proposals and is not intended to be a complete statement of them or of the existing law. You should not rely on it without seeking legal advice.

The experience of other jurisdictions is always interesting and helpful. If any of you have any observations on the contents of our newsletters or the proposed reforms, please let us know. We can, if you wish, make representations on your behalf to the Law Commission.

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