The Doctrine of Insurable Interest in Life Insurance: A Fling of the Past or Till Death Do Us Part?

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Summary

The arguably archaic world of insurance law has recently undergone a significant list of changes as a result of a thorough review by the Law Commission and Scottish Law Commission. As part of this extensive review the Commissions considered whether the time had come to end the longstanding relationship between the doctrine of insurable interest and life insurance policies; however, the conclusion that has been reached is by no means this radical. In light of the Commissions' proposals to merely tweak the doctrine, this paper analyses the downfalls of the insurance interest doctrine in the context of its application to life insurance policies. In doing so, the disturbing conclusion is reached that the operation of the doctrine in fact facilitates the very moral hazard concerns it was established to curb. With this in mind, thoughts are taken across the globe to Australia in order to consider whether the UK would benefit from following in the footsteps of our Australian counterparts by abolishing the doctrine altogether – the results are positive. The evaluation concludes that divorcing insurable interest from life insurance policies will not have an adverse impact but will instead offer desirable commercial and social advantages.

Introduction[1]

Civil society, as we know it, has become the guardian of humanity. However, whilst modern times may reflect a polarised shift in social attitudes towards the value of human beings and life; historically, the lives and rights of others were not always regarded as sacrosanct; a hierarchical structure separated those at the pinnacle of society from those at the bottom who were "inferior and insignificant". The fictional story surrounding the notorious character of Chichikov, masterfully created by a Russian novelist, Gogol,[2] was reflective of the then long-standing and widespread acceptance of treating human beings as tradable commodities. Prior to their emancipation, the Russian Empire allowed landowners to own serfs who, as property of landowners, were bound to work on the estate of their master and could be loaned and hired with the same ease as today's mechanical equipment.[3] This privilege, however, was one for which the landowner was taxed. Invariably, the working conditions experienced by the serfs were inhumane and an early death was often imminent. In light of the fact that the gentry were taxed on the serfs they owned and also taxed on *dead* serfs due to a misalignment between the recording of the Russian census and the tax collection, Chichikov devised a controversial business strategy whereby he purchased dead serfs, relieving their masters of an unnecessary and unwelcome tax burden, in return for which he was sure to receive strong business contacts and prospects of strong future profits. Clearly, in the eyes of Chichikov, a character keen on expanding his business contacts and prospects at any cost, the death of such serfs was profitable.

[1] The author would like to thank Professor John Lowry, Professor of Law at UCL, and Edmund Townsend, Barrister at Law at Farrer's Building Chambers, for their comments and critique; all omissions and errors, however, remain the author's own.

[2] Nikolai Gogol, *Dead Souls*, (Wilson, B. (ed) Hogarth, D. (Translation)), (Mundus Publishing, 1936).

[3] Robert Sears, *An Illustrated Description of the Russian Empire*, (Robert Sears, 1857), 525-527.

The tale of Chichikov can be interpreted as a metaphorical demonstration of one of the main reasons behind the introduction of insurable interest to life insurance policies: the prevention of moral hazard.[4] This paper both questions and challenges the application of the age old doctrine in modern times.

The law of insurance, and indeed the insurance relationships that follow, are largely governed by a contractual document outlining the rights and obligations of the parties. To this end, insurance law is often regarded as a "sub-species" of contract law.[5] However, the social and economic impacts of insurance law have led to a particular list of requirements that must be satisfied by both insureds *and* insurers which are not familiar to the general law of contract.[6] One such requirement is that of insurable interest which will be the focus of this paper.

The author wishes to emphasise that, whilst the focus of this paper is predominately on the matter of *life* insurance, insurable interest applies equally to *indemnity* insurance relating to goods and, *per se*, whilst the two have developed separately both judicially and legislatively, they often share common principles and short mention will be made within this paper to indemnity insurance with regard to these principles and also for the sake of comparing the differences that have emerged between the two types of insurance.

In recent years, the Law Commission, working alongside the Scottish Law Commission, has been tasked with reviewing the current state of insurance law and establishing proposals for reform with the aim of ensuring that insurance contract law caters for modern insurance needs, strikes the correct balance between the interests of the insurers and insureds, and allows both such parties to be aware of their rights and obligations.[7] Part of this reform has been to consider whether the current structure and makeup of insurable interest, both in the context of indemnity and non-indemnity insurance, is appropriate, and, if not, whether changes should be sanctioned or the requirement should be abandoned altogether. The Law Commissions have concluded that insurable interest has become outdated in the context of modern society and commercial needs. However, far from abolishing the requirement for insurable interest in the context of life insurance, the Law Commissions have proposed numerous reforms that will tweak it.[8] Conversely, the Law Commissions had originally proposed the abolition of the requirement of insurable interest in the context of indemnity insurance on the grounds that the matter could be satisfied by the indemnity principle;[9] this abolition has since been abandoned in the recent consultation.[10] This paper submits that whilst a number of the reforms to life insurance are welcome in that they address the *specific* problems they are intended to remedy, the underlying *general* problems render insurable interest unfit for the purpose it was intended to serve and there is a case for abolition.

Chapter 1 of this paper begins by taking a step back in time to ascertain the rationale behind the interest; such rationale will then form an underlying theme throughout the discourse. In Chapter 2 the case for reforms is reconsidered with a critical evaluation of the statutory provisions and the subsequent judicial interpretations; it is concluded that the doctrine no longer faithfully serves the rationale identified in Chapter 1 and has instead become a murderer's charter. Chapter 2 also considers the strength of the reforms proposed by the Law Commissions and arrives at the dismal and disturbing conclusion that the insurable interest doctrine may be incapable of existing harmoniously alongside the contemporary insurance industry. The penultimate chapter of this paper considers the abolition of the doctrine of insurable interest in light of the approach taken in Australia. The final section provides some concluding remarks.

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[4] Gary Salzman, 'Murder, Wagering, and Insurable Interest in Life Insurance', (1963) 30(4) *Journal of Insurance* 555, 557 – Salzman notes that the other major rationale behind the development of the doctrine was the desire to prevent wagering and gambling (at 557) – discussed in the following chapter.
[5] Peter MacDonald Eggers QC, '*The Past and Future of English Insurance Law: Good Faith and Warranties'* (2012) 1(2) *UCL.J.L.and.J.* 211, 211.
[6] *Ibid.*
[7] Law Commission & Scottish Law Commission, Insurable Interest (Insurance Contract Law Issues Paper 4, 14th January 2008), para 1.1. – Cited hereinafter as "Issues".
[8] *Ibid*, para 7.40.
[9] *Ibid*, para 7.50.
[10] Law Commission & Scottish Law Commission, 'Insurance Contract Law: Post Contract Duties and Other Issues' (Joint Consultation Paper, 20th December 2011), Part 12 (paras. 12.22-12.31). – Cited hereinafter as "Consultation Paper".

The Development of Insurable Interest and the Rationale Behind the Requirement

Life insurance contracts are not a contemporary phenomenon but have been around for many years. Historically, the definitions of life insurance contracts have varied by nuanced theoretical disagreements as opposed to substance; in general terms, however, it can be summarised that a life insurance policy is an agreement between the insurer and the insured that, in return for the payment of premiums, the insurer agrees to pay the insured a set sum of money in the event of the death of or injury to the life insured or, if death or injury does not occur, a payment of an annuity until death or a one-off fixed amount payable on a stipulated date.[11]

Insurable interest is the requirement for the insured to have an "interest" in the subject matter of the insurance contract. Commonly, the definition that academics have attributed to the doctrine of insurable interest is: "the legal right to insure, arising out of a financial relationship, recognised under law between the insured and the subject matter of insurance".[12] More specifically, in the context of life insurance, the insurable interest doctrine requires the insured to demonstrate that they will suffer a financial loss as a result of death or injury to the life insured.[13] As Professor Birds has rightly noted, there are exceptions to this rule that allow for the insured to insure the life of another without the need to *prove* the existence of a pecuniary financial interest and they have been deemed to remain outside the "mischief aimed at by the 1774 Act and hence outside its scope".[14]

The requirement for insurable interest, however, has not been around since the dawn of the insurance contract. Historically, prior to the introduction of the Marine Insurance Act 1745,[15] there existed no legislative requirement that the insured must have an interest in the subject matter; however, the courts took differing views in relation to the validity of insurance contracts made without interest, regardless of whether such contracts contained clauses stating "interest or no interest".[16] For example, whilst in 1692 the Court of Chancery held such contracts to be void for lack of interest,[17] the comments of King CJ. in a later case recognised that insurance policies bearing the "interest or no interest" clause were becoming increasingly common and prohibiting them would have hindered a profitable and growing insurance industry.[18]

Preventing Moral Hazard

However, it soon became a concern of Parliament that the insurance industry was becoming the platform for those wishing to insure on subject matters in which they had no interest. It was against this backdrop that the doctrine of insurable interest was adopted in the context of marine insurance, first being fostered by the MIA 1745. Evidence of the concern generated by the links between moral hazard and the institution of insurance law can be best demonstrated by citing preamble of the MIA 1745, which states:

> 'It hath been found by experience, that the making of insurances, interest or no interest, or without further proof of interest than the policy, hath been productive of many pernicious practices, whereby great numbers of ships, with their cargos, have been fraudulently lost or destroyed."

It was not until 1774, nearly three decades after the introduction of the insurable interest doctrine to marine insurance, that the same doctrine was made a requirement in the case of life insurance through the enactment of the Life Assurance Act 1774.[19] In the years preceding the enactment of the LAA 1774, it was not uncommon to find contracts insuring the lives of criminals who were standing trial and faced potential execution if found guilty, and insuring the lives of celebrities and other figures of high standing when it became known that they

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[11] Erskine Dickson, 'Insurable Interest in Life' (1896) 44(2) *Am.L.Reg.* 65, 65-66.
[12] Shashidharan Kutty, *Managing Life Insurance,* (PHI Learning Pvt. Ltd. 2008), 84.
[13] Keith Purvis, *English Insurance Texts: Words of the Week,* (Verlag Versicherungswirtsch, 2010), 26.
[14] John Birds, *Insurance Law in the United Kingdom,* (Kluwer Law International, 2010), 65.
[15] Hereinafter "MIA 1745".
[16] James Oldham, *English Common Law in the Age of Mansfield,* (University of North Carolina Press, 2005), 141-142.
[17] *Goodhart v. Garrett* (1692) 2 Vern. 269 cited in Oldham, J. *op. cit,* 142.
[18] *Depaba v Ludlow* (1720) 1 Com. 360. cited in Oldham, J. *op. cit,* 142..
[19] Hereinafter "LAA 1774".

were severely ill and on their death beds.[20] The insurance industry had therefore created what some deem a dangerous link between mortality and capital gain.[21]

A demonstration of such an activity can be seen in the case of *Gilbert v Sykes.*[22] In *Sykes* a contract was made which gambled upon the life of the foreign ruler, Napoleon Bonaparte, the court however refused to uphold and enforce the contract and instead rendered it illegal, reasoning that such a refusal came in the light of the danger that, if the contract were to be enforceable in a court of law the parties may be encouraged to take such steps as would advance their own positions – which would most likely involve his murder or some conspiracy thereof (it is notable that the bet on Bonaparte's life arose from a conversation assessing the probability of him being assassinated).[23] Therefore, the substantive arising of insurable interest as an obstacle to insurance or gambling contracts on the lives of third parties' without interest arose on the virtues of "immorality and impolicy".[24]

Social Attitudes Opposing Wagers

Beyond the prevention of moral hazard seen above, the other underlying rationale behind the doctrine of insurable interest was the aim to prevent wagering. In fact, the preamble of the LAA 1774 is a strong indication that the prevention or deterring of wagering may well have been the rationale at the forefront of the legislator's mind. The preamble reads:

> "Whereas it hath been found by experience that the making insurances on lives or other events wherein the assured shall have no interest hath introduced a mischievous kind of gaming"[25]

When considering the nature of a contract for life insurance, it is somewhat difficult to understand the distinction between a contract for insurance and a wager.[26] However, the distinction, between the contract of insurance containing a legally accepted insurable interest, and a contract for "wager" where such an interest was found to be lacking, is not an axiomatic one flowing from the meaning of the word "wager" but instead is a creature of law and culture.[27] The true distinction between a wager and an insurance contract with interest involves interpreting "wager" in an "invidious" manner:[28] The accurate distinction therefore polarises the *transfer of risk* from the *creation of a new risk* – the former being a contract of insurance with interest and the latter being a wager in its "invidious" sense.[29]

The basis behind Parliament's aversion of wagering in the LAA 1774 becomes less perplexing when appreciation is given to the cultural and social values that were in play at the time of the Act. Historically, as discussed above, there was a judicial acceptance of contracts of wager and they were becoming increasingly common in the market. However, this culture soon changed and society's tolerance of gambling significantly diminished.[30] Notably, life insurance was not regarded as a wager during its early years when the product was limited and only used by the aristocracy.[31] However, as the insurance business expanded and grew exponentially, life insurance became available to the working classes and this, in the eyes of wider society, presented a new challenge, a new danger, and a new need for reform.[32]

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[20] Thomas Mortimer, *Every Man His Own Broker,* cited in Hugh Fegan, 'Notes on the Development of the Doctrine of Insurable Interest' (1919) 8(1) *Geo.L.J.* 1, 5-6.
[21] See also the Preamble of the LAA 1774 quoted below: fn.25.
[22] 16 East 50.
[23] *Ibid.*
[24] Thomas Starkie *et al, A Practical Treatise on the Law of Evidence: and Digest of Proofs in Civil and Criminal Proceedings,* (Volume 3) (Wells and Lilly, 1826), 1656.
[25] Preamble LAA 1774.
[26] Dickson, E. *op. cit,* 66.
[27] James Davey, 'The Reform of Gambling and the Future of Insurance Law' (2004) 24(4) *L.S.* 507, 507.
[28] Dickson, E. *op. cit,* 66.
[29] Davey, J. *op. cit,* 509.
[30] Roger Munting, 'Social Opposition of Gambling in Britain: a Historical Overview' (1993) 10(3) *The International Journal of the History of Sport* 295.
[31] Pat O'Malley, 'Imaging Insurance: Risk, Thrift, and Life Insurance in Britain' in Tom Baker and Jonathon Simon (Eds.) *Embracing Risk: The Changing Culture of Risk and Responsibility,* (University of Chicago Press, 2010) 97, 99.
[32] *Ibid.*

Furthermore, during the 18th Century, the notion that persons could conduct their lives in a manner which meant that they were not contributing to society but instead earned a living through wager was looked upon with great disfavour.[33] Concern in this matter was related to the act of gambling and its potential to erode the painstakingly built foundations of social order; it was believed that gambling encouraged what were then regarded, and in some cases still are, anti-social activities such as "idleness" and "theft".[34] Such anxiety was not limited to the 18th Century; writing in 1918, Patterson links wagering with the creation of "social parasite[s]" which generate antagonism amongst the working community who earn their living through employment.[35]

A Change of Approach? – An Evaluation of the Gambling Act 2005

However, even Patterson's comments in 1918 are now outdated and the attitude towards gaming may have changed. S.18 of the Gaming Act 1845[36] operated to strike out policies on ships and goods with no interest. However, the enactment of the Gambling Act 2005[37] has arguably made the GA 1845 redundant. The GA 2005 evidences a change in attitude which is important in the context of the reforms that are proposed by the Law Commissions and on any general discussion regarding the relationship between modern society and the doctrine of insurable interest.

S.18 of the GA 1845 bluntly struck out as null and void any contracts for gaming or wager which could not therefore form the subject matter of an action in a court of law; this was deemed to apply to insurance contracts made without interest.[38] In a bold legislative strike, with perhaps somewhat unintended consequences on insurable interest in indemnity insurance,[39] S.335 GA 2005 turns the tables on the older legislation and stipulates that gambling contracts can be enforced.

However, one should avoid falling into the trap of reading too far into the GA 2005 by interpreting the Act as a reflection of a complete change in societal attitudes towards gaming. Hostility and anxiety towards gambling remains and is demonstrated by a recent decision of Newham Council. In tough times like these, where unemployment levels are soaring and desperation is rife, there has been a notable rise in the number of bookmakers occupying the high streets. In a recent case heard at Thames Magistrate Court, Goldspring DJ. overturned the decision of Newham Council refusing to approve a licence allowing a bookmaker to take over a premises in the area. The Council's decision was based on concerns that betting shops pave the path for crime and anti-social behaviour. Newham Council, however, has not conceded defeat and is considering having the decision subjected to a judicial review in the High Court.[40]

This brief and selective walk through the history on the establishment and development of insurable interest brings us to the present day where the Law Commissions have consulted on the changes and put forward several amendments. The brief historical excursion has allowed us to learn that whilst contracts of insurance without interest, technically pure "wagers", were not void and were indeed enforceable, an undesirable cocktail containing the events that led to concerns in relation to potential moral hazard and the society's aversion towards the perceived detriments associated with wagering led to the creation of the insurable interest doctrine. However, moving the clock forward by over two centuries would suggest that much of the previous distaste towards gambling and wagering has been eroded as society has adopted a markedly different stance on the matter which can call the requirement for the insurable interest doctrine into question. However, the GA 2005 is by no means an indication that either the undesirable activities that arose from wagering and gambling or the societal concerns that follow have been diminished. Given the fine line between insurance and wagering, any reforms that follow need to strike a fine balance so as to not offend the existing societal attitudes and concerns.

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[33] *Ibid*.
[34] *Ibid.*
[35] Edwin Patterson, 'Insurable Interest in Life' (1918) 18(5) *Colum.L.Rev.* 381, 386.
[36] Hereinafter "GA 1845".
[37] Hereinafter "GA 2005".
[38] Issues, para 2.12.
[39] Professor Robert Merkin, 'Reforming Insurance Law: Is there a Case for Reverse Transportation?' A Report for the English and Scottish Law commissions on the Australian Experience of Law Reform (2007), 78.
[40] Randeep Ramesh, 'Newham Council Told to Accept Betting Shop it Rejected', (The Guardian, 17th June 2013), <http://www.guardian.co.uk/society/2013/jun/17/newham-betting-shop-paddy-power> [accessed: 18th June 2013].

The following section of this paper, with the above history in mind, exchanges the stethoscope for a scalpel in order to dissect the insurable interest doctrine to appreciate its inner workings and establish where it has failed in the context of life insurance.

The Current Law: The Surrounding Issues and Proposals for Reform

The rationale behind the doctrine of insurable interest reflected an increasing concern that life insurance contracts concluded without interest were catalysts for moral hazard and encouraged reprehensible wagering. The task of this chapter of the paper is to examine the legislation alongside the case law that the insurable interest doctrine has generated in order to determine whether moral hazard and wagering was curbed by the doctrine; such an analysis proves that the Law Commissions were correct to express concern with the manner in which both the legislation and case law have served the aims of the doctrine. This chapter also critiques the extent to which the Commissions' proposals work to re-align the doctrine of insurable interest with its original aims. By taking a scalpel to the legislation and the manner in which its principles have developed within the case law, this section concludes that whilst the problems within both the birth DNA and the later-developed adolescent characteristics of the insurable interest doctrine are severe enough to give rise to a cause for concern and indeed have inhibited the fulfilment of the original aims, the Law Commissions' proposals may be a step in the right direction but they are by no means sufficient.

As the "DNA" of the doctrine in the context of life insurance can be traced back to the LAA 1774, it is prudent to begin with a brief description of the provisions of this incredibly short statute. The Act begins by stipulating that no policy shall be made without interest on the lives of another and any policy contravening this provision shall be null and void.[41] Oddly, the statute also stipulates that a policy where the name of the interested party is not stated will be unlawful[42] - the purpose of this is unclear and the Law Commissions have proposed to repeal it.[43] With regard to the amount that can be recovered: that LAA 1774 holds that no more can be recovered from the insurer than the value of the interest.[44] The final provision merely limits that ambit of the Act by stipulating that it has no application to policies for matters including ships and goods.[45] Whilst the length of the statute may leave the reader rejoicing at its simplicity, the discussion below demonstrates how its silence does not satisfy the "less is more" approach.

What Constitutes Valid Insurable Interest?

Perhaps the most thorough changes proposed by the Law Commissions are in relation to widening the category of what constitutes insurable interest. Before praising the work of the Commissions, however, it is prudent to consider the current problems and their manifestations.

Whilst the LAA 1774 introduced a requirement to demonstrate an insurable interest in the life assured, the Act itself stopped short of marking the exact boundaries of what would constitute a valid insurable interest. The silence of the Act however, should not be taken as a criticism of the legislature but instead a sympathetic utterance at the issues faced when trying to reach a definition; this difficultly is demonstrated by the fact that a powerfully constituted Court of Appeal, with the benefit of two centuries of judicial development, has recently noted that it is difficult to define insurable interest in a manner that applies to all situations.[46] The problem, however, associated with such legislative silence is that it has led to significant judicial discourse on the matter, not all of which has proven satisfactory. This subsection also considers the proposition that consent should be a factor of insurable interest, and finds that this is also plagued with potential difficulties that undermine its purpose.

As Merkin summarises, the guiding principle in relation to defining a valid insurable interest in the context of life insurance has always centred on the need to show a pecuniary loss unless the insured life can be categorised

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[41] S.1 LAA 1774.
[42] S.2 LAA 1774.
[43] Consultation Paper, paras. 13.108-13.110.
[44] S.3 LAA 1774.
[45] S.4 LAA 1774.
[46] *Feasey v Sun Life Assurance Corporation of Canada* [2003] EWCA Civ 885, per Waller LJ, para 66.

into a few narrow relationships – the so-called "natural affection" cases.[47] The situations under which the insured can insure on a life without needing to demonstrate that a financial loss will arise on the death of the life insured include insuring one's own life,[48] the life of a husband,[49] or the life of a wife.[50] In the eyes of Farewell LJ, the sentiment that gave rise to such exceptions to the need to show an ensuing pecuniary loss on death was that "a husband is no more likely to indulge in "mischievous gaming" on his wife's life than a wife on her husband's."[51] In the late 1990s, research demonstrated that 47% of the women murdered in the UK had a spousal relationship with the principal suspect.[52] It is therefore respectfully submitted that the conclusion drawn by his Lordship was likely to be weak at the time it was made and is refuted in more recent times by statistical data. Furthermore, as will be discussed in the following chapter of this paper, it is questionable whether insurance is the correct branch of law to police and deter the behaviour of society. In the absence of the narrow relationships described above, a pecuniary interest must be demonstrated. Whilst these relationships may have seemed acceptable in the past,[53] the exceptions have become outdated and need modernisation in a way that reflects contemporary family relationships which fit uneasily with cases decided against the backdrop of traditional family structures.

Unfortunately, the pecuniary interest requirement has retained the narrow stance in relation to insurable interest and the test propounded by the judiciary has required the insured to show that a *legal obligation* existed from which death would result in a loss. The unduly narrow nature can be demonstrated with references to cases such as *Harse v Pearl*,[54] where a son wished to insure on the life of his mother to cover her funeral expenses and the court held he was not legally *obliged* to facilitate the funeral and therefore could not demonstrate a pecuniary interest; and *Halford v Kymer*,[55] where a father was not deemed to hold a pecuniary interest in the life of his son by claiming he *expected* his son to care and provide for him in his old age. On the converse, it has been recognised that employees can insure on their employers and vice versa, with the interest being limited to the notice period,[56] and creditors on the life of their debtors with the limitation of the value of the debt.[57]

The narrow definition of insurable interest, therefore, does not necessarily reduce moral hazard by any desirable methods; it does, however, narrow the scope of life insurance policies in a manner that has not been welcomed by the insurance industry. As a leading author on the subject points out, the insurance industry has long flouted such a narrow definition; for example, through allowing employers to insure their employers for values significantly exceeding relatively miniscule notice periods[58] and allowing *parents* to insure on the lives of their *children* within travel insurance policies where pecuniary legal obligations cannot be demonstrated.[59]

Furthermore, does limiting the insurable amount to a pecuniary interest limit moral hazard? One fears not. Take the hypothetical creditor insuring on the life of a debtor for the value of the debt, on the face of it the creditor will receive no more on the death than he would through repayment. However, what of the situation where he would receive less if the debtor stays alive due to his financial difficulties, but would receive the full amount on death? The moral hazard seems to arise again – the matter is further discussed below in relation to the timing of insurable interest.

The Law Commissions have thus considered widening the natural affection category to allow insurable interest without economic loss to arise in the following relationships: parents in their children under the age of 18, cohabitants, and trustees of pension group schemes in their members.[60] The Law Commissions have further proposed to abandon the restrictive "legal obligations" test for pecuniary interest and have instead suggested

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[47] Professor Robert Merkin, 'Gambling by Insurance – A Study of the Life Assurance Act 1774' (1980) 9 *Anglo-Am.L.Rev.* 331, 337.
[48] *Wainwright v Bland* (1835) 1 Moo. & R. 481.
[49] *Reed v Royal Exchange Assurance Co.* (1795) Peake Ad.Cas. 70. Cited in Merkin, R. (1980) *op. cit,* 338.
[50] *Griffiths v Fleming* (1909) 1 K.B. 805.
[51] *Ibid,* 821.
[52] Patsy Richards, 'Homicide Statistics' (1999) Paper 99/56 Parliamentary Research Paper, 17. Available: <http://www.parliament.uk/documents/commons/lib/research/rp99/rp99-056.pdf> [accessed: 21/07/2013].
[53] Merkin, R. (1980) *op. cit,* 339.
[54] *Harse v Pearl* [1904] 1 K.B. 558.
[55] (1830) 10 B&C 724.
[56] *Hebdon v West* (1863) 3 B & S 579; and *Simcock v Scottish Imperial Insurance Co* (1902) 10 SLT 286.
[57] *Ibid.*
[58] Birds, J. (2010), *op. cit,* 65-66.
[59] John Birds, *et al* (Eds.) *MacGillivray on Insurance Law,* (11th ed, Sweet & Maxwell, 2011), para 1-049.
[60] Consultation, paras. 13.77-13.107.

replacing it with a reasonable expectation requirement that asks whether the policyholder can demonstrate that there was a reasonable expectation that they would retain an economic benefit from the preservation of the life, or incur an economic loss in the event of death.[61] The transition to the wider test did not give rise to any substantial concerns from a policy perspective[62] and the proposals should be praised for recognising that many modern family relationships, including long-term cohabitees,[63] were often unable to fulfil the natural affection or pecuniary interest requirements and therefore were unable to insure on the lives of others; this is a particularly important fact given the sheer number of couples now choosing to live as cohabitees as opposed to marrying.[64]

The Law Commissions' proposals also line up with the approach taken by the Financial Ombudsman Service which has for a frequently indulged in practices such as declaring as valid insurance policies on the lives of cohabitees.[65] For too long there has been a divorce between the rigidity of the law and the flexibility of the Financial Ombudsman Service, the latter being able to provide results which are based on fairness as opposed to strict rules;[66] the difference in approach had led to an unwelcome addition of inconsistency to the insurable interest field. It is not just the Ombudsman that has taken it upon itself to sacrifice the application of the legal rules on insurable interest, Merkin and Steele note that various life investment products that have infiltrated the market in recent years have "at best sidestepped, and at worst ignored" the rules on insurable interest and have achieved regulatory approval.[67] This is no doubt a reflection that the insurable interest rules, if applied, can work to frustrate commercial innovation.

Having seen the view taken by the Financial Ombudsman Service, the need for Parliamentary reform with regards to satisfying the requirements for insurable interest can be further derived from *both* the majority judgements and the dissenting judgement of Ward LJ in the Court of Appeal decision of *Feasey*. In a brief summary of complicated facts: a Protection and Indemnity Club ("Steamship Mutual") insured its members for any liabilities they would sustain as a result of the death or injury of employees and others on their vessels. A reinsurance deal was then struck between Steamship Mutual and Lloyd's syndicate in which a first party policy was created whereby the Lloyd's would pay a fixed sum on the event of injury or death occurring. Reinsurance was again brought about between Lloyd's syndicate and Sun Life Assurance Co. ("Sun Life"). During a dispute, it was alleged Steamship Mutual, the original P&I Club, lacked insurable interest in the lives insured. When the dispute fell on the ears of the Court of Appeal, the majority judgement of Waller LJ helpfully segmented the various cases of insurable interest into four categories depending on the *subject matter* of the insurance; the table below demonstrates Waller LJ's conclusions:

Group	**Subject Matter**	**What does the Policy Cover on Construction**	**Test for Establishing Insurable Interest**
1[68]	An item of property.	Recovery of the value of the property.	The insured must demonstrate a legal or equitable interest in the property.
2[69]	The life of a particular person.	Recovery a sum on the death of that person.	The insured must demonstrate that a pecuniary loss flowing from a legal obligation will or might be suffered on the death of the life insured.
3[70]	Cases involving an item of property where the subject matter was an adventure.	Recovery extends beyond the value of the property and to "such insurable interest as the insured has".	The insured must satisfy the factual expectation test.
4[71]	An item of property or	Recovery on the construction of the	For life insurance policies a

[61] *Ibid,* paras. 13.66 and 13.69.
[62] Responses, para 6.2.
[63] Consultation, paras. 13.102-13.103 – the Commissions have, however, proposed that there should be a requirement for cohabitees to have lived together for five-years prior to the taking out of insurance.
[64] *Ibid,* para 13.88.
[65] Rob Thoyts, *Insurance Theory and Practice,* (Routledge, 2010), 30.
[66] Joanna Benjamin, 'The Narratives of Financial Law' (2010) 30(4) *Oxford Journal of Legal Studies* 787, 800.
[67] Professors Robert Merkin and Jenny Steele, *Insurance and the Law of Obligations,* (Oxford University Press, 51.
[68] *Feasey, op. cit,* para 81.
[69] *Ibid,* paras. 82-86.
[70] *Ibid,* paras. 87-89.

	a life.	policy for a sum on death or destruction of property.	pecuniary loss need not be shown in the case of certain relationships, such as that of a spouse. In the case of items of property, something less than a strict legal or equitable interest will suffice.

Undoubtedly, as the Law Commissions have also commented,[72] Waller LJ interpreted and summarised the law on insurable interest, especially in the context of the 3rd and 4th group outlined above, with incredibly wide tests for the establishment of an interest. Whilst the evidently wide approach taken by Waller LJ demonstrates how the judiciary has been keen to circumvent the frustration caused by the narrow approach taken by previous case law and avoid the commercial restrictions it gives rise to, there has been a notable concern by both Ward LJ, in his dissenting judgement,[73] and Professor John Birds,[74] that this was a task for Parliament or the now Supreme Court, and Waller LJ's widening of insurable interest has disregarded older binding authorities on the matter.

However, the changes to the natural affection test, namely to include the parent-child relationship, cohabitees, and pensions trustees have given rise to grave causes for concern which revert the discussion back to the original rationale behind the insurable interest doctrine. For example, Naomi Talisman, a respondent to the Law Commissions, argued that it would be "morally wrong" to encourage parents to insure on the lives of their children in light of the fact that the children are dependent on their parents for care and support.[75] An equal argument on the grounds of moral hazard was put forward for cohabitees.[76]

For the sake of completeness it should also be mentioned that the Commissions have proposed a new statutory requirement for insurable interest in life assurance that would replace the LAA 1774 and encompass the reforms[77] in a way that provides clarity and certainty to an otherwise obscure area of law that hides itself under more than two centuries of case law.

The Commissions had previously suggested the idea of a third manner, separate from natural affection and pecuniary loss, through which insurable interest could arise: consent of the life assured.[78] The requirement for consent has previously been championed by many acclaimed academics who felt uneasy that a policy on the life of another could be obtained without the consent of the life assured.[79] Rejection of the earlier proposal is based largely on the valid concern that consent could be obtained via unethical means, such as duress and dishonesty, and thus undermine the purpose of requirement.[80]

We are, therefore, at a crossroads where the insurable interest doctrine struggles to strike an appropriate balance between preventing moral hazard and adapting to suite modern social needs; by favouring the latter the Commissions are fuelling the moral hazard concerns the doctrine sought to reduce.

Timing of Insurable Interest and the Proliferation of the Secondary Insurance Market

The legislative silence continues in relation to determining the time at which insurable interest must be shown, and, once again, the matter has been left in the hands of the judiciary; the following analysis demonstrates how the result that has been reached is partially unsatisfactory and, consequently, invites moral hazard. However, mere criticism is seldom helpful and, therefore, a suggestion for reform in the form of requiring interest to be

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[71] *Ibid*, paras. 90-96.
[72] Consultation Paper, para 11.90.
[73] *Feasey*, *op. cit*, para 192.
[74] Professor John Birds, 'Insurable Interest – Orthodox and Unorthodox Approaches' (2006) Mar *J.B.L.* 224, 230-231.
[75] Law Commission & Scottish Law Commission, 'Summary of Responses to Second Consultation Paper: Post Contract Duties and Other Issues. Chapter 3: Insurable Interest' (February 2013) para 7.5 – cited hereinafter as "Responses".
[76] *Ibid*, 7.23.
[77] *Ibid*, para 13.111.
[78] Issues, para 4.28.
[79] Merkin, R. (1980) *op. cit*, 339.
[80] Consultation, para 13.60.

shown at the time of loss is considered but the conclusion that is reached is that the timing of insurable interest will present problems regardless of any reforms.

The case in question, in which the timing of insurable interest in life insurance was determined, was that of *Dalby v India & London Life Insurance Co*.[81] *Dalby* concluded that the insurable interest requirement need only be shown at the outset of the contract and, therefore, no such requirement need be satisfied at the time of loss. *Prima facie*, the reasoning behind the decision, namely that the principle of indemnity is incompatible with life insurance where it is rarely possible to calculate the loss suffered with any great accuracy, allows the judgement to hold its ground.[82] Furthermore, the wording of S.1 LAA 1774, which states that no contract "*shall be made*" [emphasis added] without interest, is also supportive of the judgement in *Dalby*[83] and the issue of timing has been confirmed in the Court of Appeal's thorough analysis of the relevant case law in *Feasey*.[84]

However, the implications of *Dalby* are concerning and the decision has been vehemently criticised on these very grounds.[85] Put simply, as the policyholder insuring on the life of another need not show interest at the time of loss, there is a strong danger that if the interest terminates after the policy has been purchased the knowledge that the insurer will pay without objecting to a subsequent lack of interest gives rise to the very moral hazard that the doctrine seeks to prevent.[86] As Merkin has demonstrated, the requirement to show insurable interest at the inception of the contract and not at the time of loss allows unmeritorious claims to be valid: for example, a husband or wife initiating a policy on their spouse, potentially going through a volatile divorce, and then still being able to claim on the policy post-divorce; there is an evident rise of moral hazard whereby the potential of financial gain coupled with hostile relations gives rise to an incentive to murder.[87] Equally, another example is that of a creditor insuring on the life of a debtor: the pecuniary interest that the creditor has is the debt that is owed to him; however, because this need only be shown at the inception of the policy, the mere fact that the debt has been repaid in full does not prevent the creditor from claiming on the policy; once again, this gives rise not only to moral hazard but also to concerns of "double indemnity".[88]

However, pinning the blame plainly on the case law may not be appropriate. A thorough examination of the historical discourse reveals that the courts did at one point require the insurable interest in a life to be held at the time of loss;[89] however, in the absence of legislation to the contrary and the fact that insurers were ignoring judicial utterances that required interest to be present at the time of loss and instead paying out when the interest had diminished; it was concluded that "custom [had] conquered the law".[90] Both *Feasey* and *Dalby* have been labelled controversial, with support from the fact that *Feasey* was not a unanimous decision but one that split the Court of Appeal 2-1.[91] However, it has also been noted by the judiciary that reforming insurable interest is the job of Parliament.[92]

The controversial nature of *Dalby* and the longstanding judicial and legislative stalemate that followed has generated much academic activity advocating the requirement to show insurable interest at the time of death.[93] Upon first consideration, the requirement to demonstrate an interest at the date of the loss would remove the moral hazard concerns that have troubled many academics; the simple matter being that upon the termination of an insurable interest the insured party would not be able to claim on the policy and this would curb any criminal motives that may arise. However, the discussion that follows demonstrates that such an approach would give rise to further issues.

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[81] (1854) 15 C.B. 365.
[82] *Ibid.* See also: Pat O'Malley, 'Governmentality and Risk' in Jens Zinn (ed), *Social Theories of Risk and Uncertainty: An Introduction*, (John Wiley & Sons, 2009) 52, 58.
[83] Brian Murphy, *et al. Houseman's Law of Life Insurance,* (Bloomsbury Publishing, 2011) (4th ed), 74-75.
[84] *Feasey, op. cit,* para 97.
[85] Merkin, R. (1980) *op. cit,* 331.
[86] Issues Paper, para 7.94.
[87] Merkin, R. (1980) *op. cit,* 345-346.
[88] *Ibid,* 347.
[89] *Godsall v. Boldero* (1807) 9 East 72.
[90] Edwin Patterson, *Essentials of Insurance Law,* (McGraw-Hill, 1957), 163-164.
[91] Peter Havenga, 'Liberalising the Requirement of an Insurable Interest in (Life) Insurance' (2006) 18 *S.Afr.Mercantile.L.J.* 259, 260.
[92] *Feasey, op. cit,* para 192, per Ward LJ (dissenting).
[93] Merkin, R. (1980) *op. cit,* 340; see also: Peter Nash Swisher, 'The Insurable Interest Requirement for Life Insurance: A Critical Reassessment' (2004-2005) 53 *Drake.L.Rev.* 477, 522-532.

When proposing a radical reform which would require insurable interest to be held at the time of loss, the proliferation of the secondary insurance market (where policies are assigned to companies post-inception)[94] and the impact such a proposal would have on such a secondary market require careful consideration. In the eyes of certain academics, the ability to instigate an insurance policy with interest at the outset and then to sell it to third parties presents a grave concern because the transferee or assignee need not show an insurable interest upon loss which thus allows them to claim without any interest and fuels moral hazard.[95] Equally, it is for similar reasons that the practice of assigning life insurance policies and stranger-originated life insurance (STOLI) in the US has divided federal courts, with some ruling that policies cannot be assigned because this reincarnates the very moral hazard concerns that the insurable interest doctrine was initiated to prevent.[96] However, the concerns in the US are not replicated in the UK. The hostility towards assignment and STOLI in the US stems from the fact that the policies transferred are largely those of persons aged over 65 and vulnerable – clearly there is a strong moral hazard which would encourage the ill-minded transferee to accelerate the death for personal gain; on the other hand, UK policies for life insurance, as investment products, tend to have accumulated guarantees at the time of sale which reduces the moral hazard doctrine and the market is concentrated towards the securitisation and transfer to corporate entities.[97] Clearly, the nature of the two secondary markets is different alongside the regulation; the UK secondary market has been regulated by the FSA[98] and it is recognised that disturbing such a lucrative market would be inappropriate.[99] Therefore, the concerns expressed by learned academics, such as Merkin,[100] have to be placed into context given the fact that Professor Merkin's article was *published* in 1980, whereas the secondary market for insurable interest had only gained pace with regards to transfers to companies and syndicates in 1989 and much progress with regards to regulation and licencing has been achieved since.[101]

Clearly, the timing of insurable interest is a critical factor in both determining how effective the doctrine is in preventing the rise of the moral hazard and also the impact on the operation of the secondary market for insurance policies – unfortunately, the two are polarised in the timing they require and this has placed the reform agenda on the matter in state of checkmate.

The Impact of a Lack of Insurable Interest and the Insurer's Duty to Investigate?

Having ascertained that the LAA 1774 is a statute of few words, this silence continues in relation to the impact of a policy taken without interest. Beyond a rather predictable provision that the policy is to be declared "null and void",[102] which is to be taken as merely reinstating that the insured cannot recover from a policy which lacks the requisite interest,[103] the statute does not prescribe any further sanction, leaving the small matter of what is to happen to already-paid premiums.[104] Once again, the silence of the statute is filled by the ruling of the courts; arguably, however, the decision of the court was far from satisfactory and offends the above-discussed rationales that underpin the existence of the doctrine.

Contrary to the normal law of contract and restitution, the court held premiums already paid on a policy without interest would not be recoverable and would remain with the insurers.[105] This decision is problematic on three grounds. Firstly, it seems unfair that the insured should not be able to claim back the paid premiums when the motive and reason behind insuring on the life of another without interest was based on a mistaken understanding of a law that is both complex and unfortunately vague (a mistake demonstrated by the facts of the very decision

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[94] Nadine Gatzert, 'The Secondary Market for Life Insurance in the United Kingdom, Germany, and the United States: Comparison and Overview', (2010) 13(2) *Risk Management and Insurance Review* 279.
[95] Merkin, R. (1980) *op. cit,* 350.
[96] *Pruco Life Ins. Co. v. Brasner,* Case No. 10-80804,U.S. Dist. Ct S.D.
[97] Gatzert, N. *op. cit,* 280.
[98] The new UK regulatory regime has replaced the FSA with the FCA (Financial Conduct Authority) and the PRA (Prudential Regulation Authority) – see Laura Cox, *et al.* 'The United Kingdom Regulatory Reform: The Emergence of the Twin Peaks' (2012) *C.O.B.* 1.
[99] Issues, para 7.94.
[100] *Supra* fn.47.
[101] Gatzert, N. *op. cit,* 282.
[102] S1 LLA 1774.
[103] Merkin, R. (1980) *op. cit,* 353.
[104] *Ibid.*
[105] *Supra*, fn.54.

that held premiums irrecoverable).[106] Secondly, it seems unjust that the insured should be penalised and the insurer should profit if it was aware of the lack of a relevant interest at the point the policy was taken out.[107] Thirdly, the most concerning reason, possibly stemming from the last objection to the decision in *Harse,* is the fact that allowing the insurer to retain already paid premium incentivises the insurer to agree to insure where no valid interest can be shown and hence, in reality, the insurer was never on risk, this allows the creation of policies which can encourage and facilitate moral hazard based on a falsified understanding that the insurer shall pay out and offends the original rationale of the doctrine.[108]

In light of these problems, the Law Commissions have proposed that policies taken out without interest shall not be declared illegal but instead will be void and the policyholder will be able to recover the premiums already paid under the policy.[109] *Per se*, this helps remedy situations such as *Harse*, where the insured was mistaken as to the ability to take out insurance and was unaware of the existence or details of the insurable interest requirement. However, respondents to the Law Commissions' proposals do not agree. With regards to the practice of rendering policies without interest as void and not illegal, a number of respondents were in favour of the proposals but thought they would be of little impact in practice as insurable interest is generally queried at the outset and not policed from thereon.[110] However, in reality, the insured will be seldom comforted by a refund of premiums in the event that they were accounting on a successful claim to pay for expensive funeral or care costs. Therefore, a policy being void as opposed to illegal derives limited positive benefits for the mistaken insured.

From the other side of the argument, a very different problem has stemmed from insurers being able to declare that policies without interest are illegal and premiums cannot be recovered and, in light of this problem, a rather radical proposal for reform has been put forward by certain academics which deserves analysis. A great deal of mischief can arise from the fact that the insurers have insured on a life whilst knowing that no legally recognised insurable interest is present and therefore the policy is illegal. Stripping the argument back to the bare bones and "DNA" of the doctrine, it is paradoxical to claim that one of the fundamental purposes of the insurable interest doctrine is to reduce the moral hazard associated with insuring the life of another if the insurer then proceeds to allow a third party to insure without interest and therefore flout the law. Insurers who turn a blind eye to the doctrine and insure in the absence of an insurable interest run the risk of allowing moral hazard to build in that an insured with murderous intentions, who lacks the benefits of a legal education and its intricate workings within the insurance context, may be under the impression that the insurance policy will pay on the death of the insured life.

In response to this rather unfortunate situation described above, which evidences a concerning disconnect between the insurance industry and the legal concepts that govern it, there have been some suggestions that insurance companies should be required to ensure that an insurable interest exists and severe penalties should follow where an insurer issues a policy with the knowledge that there is no relationship which could give rise to an interest and no pecuniary loss is likely to follow.[111] In theory, imposing a duty on insurers with liability to follow for breach seems the most obvious way of stopping such (grossly) negligent and lackadaisical practices in which insurers stand to benefit and the insureds and lives insured both stand to lose. Academics have argued that insurers have the resources and legal knowledge to be able to enquire and identify whether an insurable interest exists and, for this reason, there is a strong case that the onus should be on the party with the greater resources to ensure the law regarding insurable interest is adhered to.[112]
Tortious liability being imposed on insurers for issuing policies without interest would not, if ever enacted, be unique to the UK; the policy has been incredibly popular in the US.[113] The token US case in this matter has been that of *Liberty National Life Insurance Co. v Weldon;*[114] its tragic facts should be mentioned. An aunt by marriage insured on the life of her niece, as opposed to failing to attempt to make any enquiries as to the existence of valid insurable interest, the insurers were in fact aware of the lack of it but issued a policy

[106] *Ibid.*
[107] Jacob Loshin, 'Insurance Law's Hapless Busybody: A Case Against the Insurable Interest Doctrine' (2007-2008) 117 *Yale.L.J.* 474, 477.
[108] *Ibid.*
[109] Consultation, paras. 13.111-13.116.
[110] Responses, paras. 9.9-9.11.
[111] It should be noted that such proposals have *not* stemmed from the Law Commissions recent reform efforts.
[112] Merkin, R. (1980) *op. cit,* 339.
[113] Richard Duesenberg, 'Insurer's Tort Liability for Issuing Policy without Insurable Interest -- A Comment' (1959) 47(1) *Cal.L.Rev.* 64, 64.
[114] 267 Ala. 171, 100 So.2d 696 (1957).

nonetheless. The aunt murdered her niece a week after the policy was taken out. The appeal court affirmed the decision of the court at first instance and held that the insurers were liable as issuing a policy on the life of another without interest gives rise to a danger for the insured life; a danger which sadly materialised in this case. The court concluded that, as a result of the risk created, the insurer was under a duty to ensure there was a valid interest before issuing the policy; in certain situations the courts have gone as far as to hold that the insurer issuing a policy which lacked interest was a proximate cause of the murder.[115]

However, reciting the facts of an American case does not constitute an endorsement for the adoption of such a policy in the UK. One of the fundamental problems with the imposition of such a liability on insurers stems from the ambiguity of the doctrine and the difficulty involved in enquiring into the existence of an insurable interest.[116] Therefore, in light of the ambiguity and complexity of the doctrine, Loshin has noted that the realistic application of any liability on the insurer would be limited to the context of requiring a finding of bad faith, something which requires elements such as "intention" or "reckless disregard", and is difficult to prove.[117]

Beyond this fundamental problem limiting the effectiveness of any duty on insurers to investigate and any liability that follows, there exists an economic and corporate governance argument which disfavours such a duty and concurrent liability. It is submitted by the author of this paper that the imposition of such an onerous duty with the possibility for harsh sanctions, even based on the argument that insurers have greater resources, is flawed in light of a business analysis of the insurance industry. The insurance industry is largely similar to any substantial business sector and, to this end, many of the corporate governance considerations that apply to company law have equal application in the context of insurance firms; just as the insurance contract is a subspecies of contract, the insurance company is nothing more than one of the subspecies of general companies. Corporate governance literature has become increasingly familiar with the term the "Delaware effect"; in brief, the "Delaware effect" is the term coined to describe the phenomenon by which jurisdictions compete to attract businesses by reforming their laws in a manner that is more business-friendly than their competitors.[118] The insurance industry and its regulators are not immune from the dangers associated with this phenomenon. In a recent publication released by the Association of British Insurers,[119] it has been observed that London is no longer *the* preferred home of the world's major insurance companies; analysis demonstrates that London is finding it difficult to compete with both its European counterparts and international competition from economic and ever-developing goliaths like China and the United States, and is no longer regarded as *the*, or *the only*, international hub for the insurance industry.[120] The point to be made in relation to imposing a duty with a consequential liability for breach is that it is likely to both increase transactional costs through the process of enquiring as to the existence of insurable interest and the dangers of incurring a penalty in the event that the insurer is found liable for breaching an imposed duty.

Interestingly, the issue of increased costs also plagues the US. Where a contract is merely unenforceable (without added liability) on the grounds of a lack of insurable interest the balance comes between the "social evil" which manifests in the moral hazard argument and the other interest of the law not interfering with a concluded contract; in this context the moral hazard argument prevails and triumphs over the public policy requirement to hold the parties to their contractual agreements.[121] However, it has also been noted that there are different interests at play in the context of imposing a liability. A tortious duty on the insurer can result in insurers either increasing the cost of future policies or declining to insure such policies due to the increased costs involved.[122] In the context of the US, due to the comparative lack of a welfare state, life insurance policies play a

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[115] *Overstreet v. Kentucky Central Life Insurance Company* 950 F.2d 931 (4th Cir. 1991), mentioned in: John D. Ingram, 'An Insurer's Duty to Investigate' 3 *FSU Business Review* 31, 35.
[116] Loshin, J. *op. cit,* 501-502.
[117] *Ibid.*
[118] John Vella, "Sparking Regulatory Competition in European Company Law: A Response", in Rita de la Feria and Stefan Vogenauer, (eds.) *Prohibition of Abuse of Law: A New General Principle of EU Law?*, (Hart, 2010), 107.
[119] Hereinafter "ABI".
[120] ABI, 'Identifying the Challenges of a Changing World: The Trends Facing Insurers Towards the 2020s' (ABI, 2013) <https://www.abi.org.uk/~/media/Files/Documents/Publications/Public/JoinTheDebate/Identifying%20the%20Challenges/Identifying%20the%20challenges%20of%20a%20changing%20world%20Full%20document.ashx> [Accessed: 11th July 2013]. See also: Anthony Hilton, 'Long Slog to Make Insurance Effective' (9th July 2013) *Evening Standard* 36, 36.
[121] James Farrier, 'Torts – Duty of Insurer to Investigate Insurable Interest' (1959) 19(2) *La.L.Rev.* 555, 557.
[122] *Ibid.*

vital part in society and therefore ensuring they are not restrictively expensive and are readily available to support the expenditure related to funerals and care is imperative.[123] From a comparative perspective, this is what has traditionally differentiated the role of life insurance in the US from the UK; whilst it serves a necessary and admirable social purpose in the US, life insurance is predominately used as an investment device to generate an income and the social costs have traditionally been upheld by the welfare support system that gained pace after the second world war.[124] However, in light of the current coalition government's drive towards austerity in a bid to cut the UK's budget deficit, it is envisaged that the UK will experience a limited and gradual transition whereby reliance will be removed from the welfare state and instead placed upon private and state insurance policies; such a move would entail life insurance shifting away from its current investment role and leaning towards the social tasks that it's US counterpart undertakes.[125] In light of such prospective changes, the imposition of a duty with liability may be unsuitable due to the increased costs involved.

Care needs to be taken, however, when formulating the argument against the imposition of a tortious duty on insurers. As has been seen in the US, an argument based purely on the increased burden that investigation will entail for insurers, without public policy concerns in relation to the impacts of increased costs, is likely to be expelled as paradoxical. For example, in *Weldon*, the increased burden argument was struck down by the court which, in return, declared that it is no more of a burden on the insurer to investigate the existence of an interest *before* the contract is concluded than it is for them to make the same enquiries when faced with a claim.[126]

Taking a step back and putting down the analytical scalpel with which we have thus far dissected the inner workings of the insurable interest doctrine demonstrates that the conclusions that can be drawn are disturbing. The evident problem with any proposal to reform the doctrine is that there always exists a "but". Playing the devil's advocate is rarely a desired role in any circumstance; however, where legal reform is concerned, the devil's advocate often plays the most useful role in substance. The doctrine was designed to prevent wagering and counter the moral hazard through which one could profit from the death of another. However, the silence of the legislation left the matter to be developed by the courts and this happened in a piecemeal and fragmented manner which has not worked effectively to counter the most deadly profit venture of all. The much-anticipated reforms formulated by the Law Commissions are likely to fall short of providing any meaningful progress in terms of fulfilling the original aims. In light of the historic and on-going problems and the obstacles to reforms discussed above, the next section of this paper considers whether the more radical path should be taken and insurable interest be consigned to the history books; as has happened in Australia.

To Follow in Australian Footsteps - Is it Time to Abolish the Doctrine?

The doctrine of insurable interest can have its origins traced back to UK legislation propounded as a result of 18th Century parliamentary observations which identified instances of and demonstrated growing concerns against the moral hazard and the encouragement of wagering that generated by the insurance industry, but this does not mean that the insurable interest doctrine remained a unique and exclusive feature of UK law. A brief glance at the various foreign statutes shows that the doctrine of insurable interest migrated from its island of birth and was quickly duplicated by various jurisdictions with numerous amendments.[127] However, it has also been the case that certain jurisdictions, such as Australia, have come to the conclusion that insurable interest is no longer necessity to the insurance institution and radical steps have been taken in facilitating its abolition. The aim of this chapter is to consider whether the UK would benefit from following in the footsteps of fellow jurisdictions and removing the doctrine altogether.

The Mechanisms of Comparative Legal Theory

Before beginning on what will turn out to be an argument with international dimensions for the severance of all ties between the UK and the doctrine of insurable interest, it is prudent to take a short moment to appreciate the comparative law methodology and the manner in which it functions.

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[123] John Myles, 'When Markets Fail: Social Welfare in Canada and the United States' in Gøsta Esping-Andersen (Ed) *Welfare States in Transition: National Adaptations in Global Economies,* (SAGE, 1996) 116, 116.
[124] *Ibid*, 122.
[125] Hilton, A. *op. cit*, 36.
[126] *Op. cit*, fn.104, 708.
[127] Examples include: Ss.5-6 Marine Insurance Act 1909 (Australia); S.68 Insurance Act 1938 (India) since repealed by the Insurance (Amendment) Act 1950 (India); and S.3205 New York Code.

Whilst contrary views have been presented by a minority on the workings of the comparative theory,[128] it is widely accepted that, when considering whether the laws and principles applied in a foreign jurisdiction should be adopted in a home or subject jurisdiction the task involves more than a mere carbon-copying exercise whereby the laws and principles are blindly accepted as compatible.[129] Instead, the widely-accepted approach to comparative law recognises that, when considering whether or not to adopt and apply foreign laws and principles, care needs to be taken to appreciate the differences in culture, economy, and politics between the subject jurisdictions – the substantial truth is that where there are such differences between two jurisdictions this can lead to a situation where a law that works well in the parent jurisdiction may be a catastrophic failure in the adopting jurisdiction.[130]

The Insurable Interest Doctrine and its Relationship with Australia

Interestingly, the insurable interest doctrine in Australia, for both indemnity and non-indemnity insurance, was for a long time nothing more than a mere duplication of the English MIA 1745 and LAA 1774.[131] The discussion that follows demonstrates, however, that having grappled with the same issues in relation to insurable interest that the UK and its legislative constituents have, the Australian approach had previously implemented a number of the reforms which are proposed by the English and Scottish Law Commissions today and, in light of the failures of such reforms, freed the insurance industry of its restrictive companion. It is argued that the similarities between the two jurisdictions, coupled with market pressures on an international scale, provide a compelling reason for the UK to abandon its current pursuit of yet another round of piecemeal reforms and instead to follow in the more radical footsteps of Australia.

When the insurable interest doctrine formed an integral part of Australian law, it too was established for similar purposes to those which compelled the prescription of the doctrine in the UK; namely (1) to discourage the activity of wagering on lives through insurance, (2) to discourage the destruction of the subject matter of the policy for the purposes of financial gain and (3) to prevent the recovery of more than the value of the interest.[132]

We have seen that the Law Commissions in the UK have proposed the widening of the definition of insurable interest in order to catch several modern and traditional relationships under which insurance could not be obtained in the past, such as the parent in the case of the child; however, for Australia this was enacted some 68 years ago in the Life Insurance Act 1945[133] where insurable interest was expanded to include the following relationships:

1. The parent of a child under the age of 21
2. Spouses
3. Any person dependent on support from the life insured
4. Companies in employees.
5. Those able to show a pecuniary interest in the life assured.[134]

However, following a damning appraisal of the doctrine which acknowledged that there was a deep problem with regards to the timing of insurable interest (the prevention of moral hazard requiring it on death and assignment preferring it to only be required at the inception of the policy) the Australian Law Reform Commission examined which of the two aims should be best served and concluded that:

> "The need to allow policyholders to use policies as a form of property, together with the uncertainty that would be introduced into insurance practice if the policyholder were

[128] Alan Watson, *Legal Transplants: An Approach to Comparative Law,* (University of Georgia Press, 1974), 21-31.
[129] Otto Kahn-Freund, 'On Uses and Misuses of Comparative Law' (1974) 37(1) *M.L.Rev*. 1.
[130] *Ibid.*
[131] Sharo Atmeh, 'Regulation not Prohibition: The Comparative Case Against the Insurable Interest Doctrine' (2010) 32(1) *NW.J.Int'l.L.&.Bus.* 93, 136.
[132] Atmeh, S. *op. cit,* 136.
[133] Hereinafter "LIA 1945".
[134] S.86 LIA 1945.

> required to have an interest at the date of death of the life insured, constitute[s] an adequate justification for not restricting the existing freedom of assignment.[135]

The requirement for insurable interest in life insurance policies was then abrogated in Australia by the Life Insurance Act 1995 (Australia). The LIA 1945 is similar, though not identical, to the reforms to the definition of insurable interest that have been proposed by the Law Commissions which seek to widen the natural affection and loosen the test for pecuniary interest. Yet, following the reforms which widened the doctrine in 1945, Australia still felt the need to repeal it.

In a similar vein to the approach taken by Australia, its neighbours in New Zealand legislated for the abolition of the insurable interest doctrine in the context of both life and indemnity insurance within the Insurance Law Reform Act 1985 (New Zealand).[136] It has been noted that, rather like Australia, the abolition of the doctrine of insurable interest in the context of life insurance for New Zealand has been largely free from any "ill-effects".[137] Notably, New Zealand has used wagering legislation to fill a void that would otherwise have been left by abolishing the insurable interest doctrine whereby insurance contracts could be used for the purposes of undesirable wagering transactions.[138]

Is the Australian Approach Compatible with the UK?

English law has long recognised that various subspecies of contract law require special considerations which may afford stronger regulation and imply terms which offend the principle of freedom of contract. Employment law is a strong example of such a subspecies of contract where the law has intervened to curb the strong bargaining power of the employer in order to recognise the social importance of employment.[139] The contract for life insurance can be seen to hold similar social importance. However, it is to be noted that significant economic, political and social forces have altered the role that is now played by the life insurance policy. As was noted above,[140] the welfare state has transformed the insurance policy from a contingency on the death of a loved one or key person and has instead taken a stronger role as an investment product. A similar experience was noted in Australia where the transition saw traditional policy, designed to provide death and funeral benefits,[141] transform into an investment tool deployed for the purposes of being assigned, securitised, and profited from.

It has been noted that the Australian securitisation market for insurance policies benefited strongly as a result of the alteration of the insurable interest legislation in 1995, with comments that it has become one of the biggest markets operating outside of the US.[142] Further observations and calculations have also laid to rest any concerns that the removal of the insurable interest requirement may have a detrimental impact on the profit margins of insurance companies; in fact, the figures for Australia have previously suggested that the Australian insurance market continues to grow in size and profit.[143] In the light of these statistics, alongside the knowledge that the secondary market for life insurance policies generates significant domestic revenue, and the fact that the timing of insurable interest can *either* cater for the secondary market or the reduction of moral hazard, but not both, there is a strong case for the abolition of an otherwise unworkable doctrine.

A theme that has run throughout this paper has recognised that there is a friction between two very different aims, on the one hand the prevention of moral hazard, and on the other hand the proliferation and nurturing of a secondary market for life insurance policies; both requiring polarised policies in relation to insurable interest. Having noted that there is an economic need to favour the needs of the secondary market, are we providing a disservice to society by disregarding the concerns of moral hazard which remain a real threat to society in this

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[135] Australian Law Reform Commission, *Insurance Contracts*, (1982, Report No.20, Australian Government Publishing Service), para 145, 87-88.
[136] Section 6, Insurance Law Reform Act 1985 (New Zealand).
[137] Merkin, R. and Steele, J. *op. cit,* 51; see also: Margaret C. Hemsworth, 'Life Assurance and the Cohabitant: The Law Commission's Reforms on Privity' (1998) 57(1) *C.L.J.* 55, 60.
[138] David S. Kelly and Michael L. Ball, *Principles of Insurance Law and Australia and New Zealand,* (Butterworths, 1991), 33-34.
[139] *Johnson v Unisys* [2001] IRR 279, per Lord Hoffman [para 35].
[140] *Supra* fn.113.
[141] Professor Robert Merkin, 'Australia: Still a Nation of Chalmers?' (2011) 30 *U.Queensland.L.J.* 189, 190.

[142] Atmeh, S. *op. cit,* 139.
[143] *Ibid.*

modern age? It is argued that this is not the case. In Australia, the insistence on the requirement of insurable interest on the grounds of preventing a moral hazard was regarded by some as no longer being persuasive;[144] the same can be argued for the UK. Opinions have been put forward by certain scholars, with whom the current writer agrees, that it is not the job of civil law, namely insurance law, to police the murderous intentions of the few – instead, this is a job for the criminal justice system.[145] In fact, the argument goes as far as to note that he who is not deterred by the criminal sanctions associated with murder will seldom be stopped from carrying out his sinful deed by the consideration of the doctrine of insurable interest – an argument that gains further credibility given the vague and largely unknown nature of the insurable interest doctrine[146] and the fact that insurers have failed to positively enquire as to whether a valid interest exists at the time of the contract. Simply put: "[…] nobody can be deterred by something he knows nothing about".[147]

For the sake of completeness, it should be mentioned that the Law Commissions were initially concerned that the insurable interest requirement had a new job: distinguishing contracts of non-indemnity insurance from credit default swaps; and that abolishing the doctrine would lead to regulatory issues between the two types of contract.[148] However, following a response from the FSA, it became clear that this is no longer the case that an insurable interest is not used by regulators for this purpose, thus the matter does not present an obstacle.[149]

Legislators are right to be wary of making major reforms to legislation that has such a deep-rooted social and economic impact. However, if Parliament were to consider abolishing the insurable interest doctrine in the context of life insurance it has the benefit of not being the first to undergo such a radical set of reforms and thus is able to evaluate the success abolition has had within a jurisdiction with similar social and economic values.

Concluding Remarks

Chichikov, the notorious character we encountered in the introductory remarks of this paper, and the anecdotal evidence of ships being sunk and goods being destroyed are but a few examples of the reasons why the insurable interest doctrine was first introduced by legislators to its long-term friend: insurance law. The relationship shared by the two of them was not doomed from the start. Wagering and moral hazard were noble reasons for the encounter and the concerns expressed by legislators were both real and socially damaging.

However, the insurable interest charter was bare to say the least. The Act itself has been criticised by several academics on the grounds of its vagueness. The LAA 1774's silence left the task of determining the inner workings of the doctrine with the judiciary and what came about can be best summarised as piecemeal developments that have regrettably fallen short of fulfilling the original aims of the doctrine, especially in relation to the reduction of moral hazard.

The Law Commissions' progress in relation to insurance law as a whole should be commended. The insurance law that we came to know was based on an industry and culture that was centuries old, which has since changed, and a concurrent change in the legislation was long overdue. Whilst quantity constraints have prevented every known issue and every proposal relating to insurable interest from being scrutinised, the selective discussion above has shown that significant and polarised problems are present and circumventing them through reform is a difficult and often impossible task. Widening of the definition of the insurable interest represents a significant step forward which has recognised that modern commercial and social needs differ significantly from those that prevailed in the 18th Century. Yet this is not a cue for celebration. Firstly, both the historic ambit of insurable interest and the proposed extensions to modern relationships work under a naïve assumption that certain relationships present a naturally low level of moral hazard; a presumption that is not supported by the statistical evidence. Secondly, The Law Commissions have fallen short when it comes to realigning the legislation with the modern contextual surroundings within which the insurance industry now operates. By failing to address fundamental issues, such as the time at which insurable interest in the context of life insurance needs to be

[144] Kenneth Sutton, *Insurance Law In Australia,* (LBC Information Services, 1999), 531 cited in Atmen, S. *op. cit,* 138.
[145] Craig Brown and Julio Menezes, *Insurance Law in Canada: A Treatise on the Principles of Indemnity Insurance As Applied in the Common Law Provinces of Canada,* (Carswell, 1982), 74.
[146] Salzman, G. *op. cit,* 558.
[147] *Ibid.*
[148] Issues, paras.7.6-7.17
[149] *Ibid*, para 7.15.

shown, there is a danger that, whilst lessons may have been learnt, the insurance industry will be condemned to repeating the same mistakes that have plagued the insurable interest doctrine in the context of life insurance for over two centuries. The battle between two powerful and polarised objectives, such as the prevention of moral hazard and the nurturing of a strong secondary market, can often be like choosing between offspring. The difficulties encountered when imposing liabilities on insurers for failing to enquire as to the existence of an interest, and the harm can follow by the said activity, bring to life the corporate governance concerns that further inhibit effective reform.

As the penultimate section of this paper has demonstrated, there is an alternative to choosing between the two objectives: abolition of the doctrine of insurable interest in the context of life insurance. The argument for the abolition of the doctrine gains momentum in the context of life insurance when compared against the anecdotal evidence that one can derive from the history of the same doctrine in Australia. A comparison reveals that the UK, whilst a forerunner in the establishment of a doctrine aimed at stopping moral hazard and wagering in relation to the lives of others, has lagged behind jurisdictions that were late in adopting the doctrine. The Australian and UK life insurance markets have a great deal in common; as do the social settings under which they reside. Therefore, this paper advises the UK to abort its current pursuit of yet more piecemeal reforms put forward by the Law Commissions and instead follow in the more radical footsteps of jurisdictions such as Australia who could otherwise become strong and threatening competitors to a key industry in the UK. As for the moral hazard concerns that naturally play on the human mind, this is a job for other branches of law, including the criminal law, and, as such, the abolition of the insurable interest doctrine will not leave a black hole or elevate the life insurance industry into a charter for murderers.

The law of insurable interest in life insurance is evidently old and arguably outdated. When we learn of the motives of the likes of Chichikov, the businessman keen to purchase dead serfs; and the aunt in *Weldon*, who procured a life insurance policy on the life of her niece only for the sake of killing her for financial gain, we, as human beings, are inclined to feel hostile towards the institution that "facilitates" such motives and killings – the insurance industry. However, the old maxim of "hard cases making bad law" may come to mind. As demonstrated by the above analysis of the law and reforms that have taken place and are proposed, structuring the legal framework of insurance law in a manner that gratifies the original rationales behind the doctrine is difficult by itself, adding on the requirement of maintaining the law to a standard that avoids insurers moving their seats to more insurer-friendly jurisdictions makes the task nigh-on impossible. In all, the Law Commissions' proposals represent a few small steps for man, but fall short of a giant leap for mankind.