Insurable interest on the eve of its legislative consolidation

It is still not too late to put into reverse gear

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Abstract

The law of insurable interest has been subject to intense debates during the last twelve years. This led to the publication of a draft Bill which restates the law. In this context, this work defies this institution analysing its very foundations. After getting over intuitive first impressions, mistrusts against gambling and fears against moral hazard do not stand. The same holds true for the idea of using this institution as a divider element, to distinguish insurance from other contracts. However, this does not mean that its supporters defend trivialities. Insurance firms should not gamble and insurance contracts must be distinguished from other financial instruments. The policy is sound, but the focus on the insurable interest is misplaced. On balance, the market will be better if private law is released from the constraints of this requirment, abolishing it, and transferring any attempt of regulation to the domains of public law.

Introduction

There is a relative level of clarity regarding what the insurable interest requirement entails. It has been characterised as a special kind of relationship which should exist between the insured or policyholder and the subject-matter of insurance, to such a degree that he will be benefited from its preservation or will suffer a disadvantage if it is lost.[1] However, this clarity becomes elusive when it comes to define its content (what, specifically, this relationship should be), and complicated when studying its timing and the consequences of its absence. It becomes even more ambiguous when drawing the line between this institution and the indemnity principle, since both play an active role at the time of determination of the insurer's liability in case of damage or loss under an indemnity policy.[2]

Since 2006, the English Law Commission and the Scottish Law Commission[3] have been devoted to the study of the insurable interest. Its intricacies are rooted in a mixture of common law and statutes. Close examination reveals that different types of insurance contracts are subject to different treatment, without apparent justification. Furthermore, after diving into the motivations of the eighteenth-century statutes and case-law, it is conspicuous that the insurable interest requirement emerged as an answer to the anxieties apropos gambling

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[1] Among others, John Birds, Birds' Modern Insurance Law (London: Sweet & Maxwell, 9th edn, 2013), 41; Mark Templeman, 'Insurable Interest: a Suitable Case for Treatment?' in B. Soyer (ed), Reforming Marine and Commercial Insurance Law (London: Informa, 2008), 187; James Davey, 'Insurable Interest – a Rule in Search of a Rationale' presentation at a BILA seminar at Lloyd's 18 September 2015.

[2] John Lowry and Philip Rawlings, 'Re-Thinking Insurable Interest' in S Worthington (ed) Commercial Law and Commercial Practice (Oxford: Hart Publishing, 2003), 335.

[3] Hereinafter the "Law Commissions".

and moral hazard, which hardly stand today. There are even gaps in the law, as it occurs with non-marine indemnity insurance, where there is no straightforward answer as to when the interest should exist, if it is still applicable at all.

Given this panorama, unsurprisingly the Law Commissions gave serious thoughts to the abolishment of the doctrine in its *tour de force* publication Issues Paper 4[4]. Though, the industry offered a strongly opposition to it, and given the Law Commissions' strategy of taking advantage of the special parliamentary procedure for uncontroversial Law Commissions bills, it had to face a Scylla and Charybdis dilemma. Either do nothing, or embrace the institution to restate it. The latter prevailed, and in 2016 a draft Insurable Interest Bill[5] was published for consultation. At the time of this work, according to the Law Commissions, the project is currently on hold due to other priorities within the team.[6]

Nevertheless, the purpose of this work is to make a final appeal in favour of the abolition of the institution. Although a restatement is far more desirable than the current state of the law, it will be posited that the market would be in a better place without the restrictions of an antiquated private law institution, which offers no utility in today's commercial world.

First, the work will attempt to decipher the historical development of the insurable interest, a crucial process to appreciate the approach of policy-makers and judges, and the struggles that the institution faced extending its arms from the marine insurance field to new lines of business. Part II will examine the content of the interest in both contingency and property insurance. Special consideration will be given to Lord Eldon's *ratio decidendi* in *Lucena v Craufurd*[7] and the liberalisation process that this requirement experienced during the last quarter of the twentieth century. The third part will offer an outline of the draft Bill, to then fully enter into questioning the very foundations of the institution, in light of the changes that the commerce has experienced since its inception in the eighteenth century. For that purpose, the arguments that justify the existence of the insurable interest have been depicted in three: (i) mitigation of moral hazards; (ii) gambling and regulation; and (iii) definitional function. One by one the arguments will be examined and refuted. Furthermore, it will be suggested that the institution should be abolished, taking into account the requirements of the market, the need of modernising the UK's insurance law[8], and the function and objectives of private law. The final section concludes.

[4] The English and Scottish Law Commissions, Insurance Contract Law Issues Paper 4 Insurable Interest <https://www.scotlawcom.gov.uk/files/1812/7981/4030/cpinsurance_issue4.pdf> (hereinafter "Issues Paper 4") accessed 6 March 2018.

[5] Hereinafter the "draft Bill", <https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2016/04/accompanying_notes_draft_Insurable_Interest_Bill_2016.pdf> accessed 6 March 2018.

[6] <https://www.lawcom.gov.uk/project/insurance-contract-law-insurable-interest/> accessed 6 March 2018.

[7] (1806) 2 Bos & Pul (NR) 321.

[8] As it has been made clear by the Law Commissions in Issues Paper 10 Insurable interest: updated proposals <http://www.lawcom.gov.uk/wp-content/uploads/2015/06/ICL10_insurable_interest_issues.pdf> para 3.17, (hereinafter, "Issues Paper 10") accessed 6 March 2018.

Part I: Inception and historical development. Parliament, judges, and the fear of despicable gambling

To analyse the minutiae of the insurable interest requirement, it is essential to examine its functions at its inception. However, it is not the purpose of this part to provide a conclusive review of its historical development. Such effort has been successfully done in the past.[9] The aim here is to offer a brief examination of the most relevant hallmarks of this institution, to provide the reader with the context in which the insurable principle emerged and operates today.

It is unclear whether the common law embraced an insurable interest requirement before the statutory activity against gambling that characterised the second half of the eighteenth century. For example, in 1692, at Chancery level, it was decided that a policy taken out by a lender to insure a vessel, on the basis of a bottom-rhea bond, without an interest on the ship or the cargo, was void.[10] Later, in 1743, Lord Hardwicke, worried about the potential of insurance to incentivise the burning of houses by insureds, declared in a property insurance case that:

> "[I]f the insured was not to have a property at the time of the insurance or loss, any one might insure upon another's house, which might have a bad tendency to burning houses. Insuring the thing from damage is not the meaning of the policy, it must mean insuring from damage, and she has suffered none.[11]"

However, these cases were somehow isolated,[12] and can be argued that judges were simply stating that, to be indemnified, the insured should have suffered a loss, sketching the indemnity principle. In fact, during this period of the common law history, it seems that the courts were settling general principles of contract law, with no bias against wagers.[13] This attitude led to the recognition and enforcement, in the marine sector, of policies where the parties agreed beforehand, the non-requirement of interest using phrases like "policy proof of interest" (ppi) or "interest or no interest". At this point, the courts were more preoccupied to uphold contracts rather than frustrating commercial expectations, focusing their attention on the benefits of the encouragement of trade[14] instead on the perceived evils of gambling.

This stance, favourable to commerce, suffered a parliamentary reversal in the mid-eighteenth century, with the enactment of the Marine Insurance Act 1745. This Act represented the first statutory recognition of the insurable interest requirement.[15] The 1745 Act was intended to require the interest at the time of the loss[16] and

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[9] Among others, Nicholas Legh-Jones, John Birds, David Owen(eds), *MacGillivray on Insurance Law Relating to All Risks Other Than Marine* (London: Sweet & Maxwell, 11th edn, 2012; Robert Merkin (ed), *Colinvaux's Law of Insurance* London: Sweet & Maxwell, 11th edn, 2016).
[10] *Goddard v Garret* (1692) 2 Vern. 269.
[11] *Sadlers' Company v Badcock* (1743) 1 Wils KB 10.
[12] In particular, *Goddard*, which was contradicted by further cases where wagers were enforced, e.g. *Assevieda v Cambridge (1710) 10 Mod 77; Harman v Van Hatton (1716) 2 Vern. 717; De Paiba v Ludlow (1721) 1 Comyns 361.*
[13] Robert Merkin, 'Gambling by Insurance – A Study of the Life Assurance Act 1774' (1980) 9 Anglo-Am L Rev 333.
[14] In *Sandlers' Company* (n 11), Lord Hardwicke said, "the common law leant strongly against these policies for some time, but being found beneficial to merchants, they winked at it".
[15] Albeit applicable to marine insurance on British ships and cargoes only, and without a definition.
[16] *Powles v Innes* (1843) 11 M & W 10.

not at the time of the inception.[17] Section 1 rendered null and void insurance contracts where the parties had dispensed the proof of interest. In so doing, the policy concerns against gambling commenced, as it was made clear in the illustrative preamble of the 1745 Act, which characterised *ppi* insurance as a "mischievous kind of gaming or wagering".

Yet, even during this period the courts were of the view that this statutory requirement was the exception.[18] In1774, the same logic behind the 1745 Act was extended to life and other contingency insurance[19] by the Life Assurance Act 1774, still in force today. Under this Act, the interest – devoided of definition – should exist at the time of inception of the policy but not at the time of loss,[20] declaring unlawful policies in which the name of the interested person, or the name of the person for whose use, benefit, or on whose account the policy was made, was absent.[21] The Act also declared null and void the policies concluded without interest.[22] There is even case law that considers such policies illegal,[23] with the result that the insured is not only impeded to claim under the policy, but also cannot recover the premium.[24] Then, it was the turn of the Marine Insurance Act 1788, the purpose of which was to terminate the practice of issuing policies on ships, goods, merchandise or effects without the name of the assured.

Up to this point, the insurable interest requirement was confined by statute to marine, life and other contingency insurance, leaving non-marine indemnity insurance free from its shackles.[25] However, in the nineteenth century the sentiment against gambling increased, leading to the enactment of the Gaming Act 1845, which did not require insurable interest, but declared that all contracts by way of gaming or wagering[26] should be null and void.[27]

At the beginning of the twentieth century, the Marine Insurance Act 1745 and the Marine Insurance Act 1788 (MIA 1788) – with respect to marine risks – were repealed by the MIA 1906, which offered the first statutory

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[17] *Rhind v Wilkinson* (1810) 2 Taunt 237.
[18] *Lawry v Bourdieu* (1780) 2 Doug. K.B. 468. cf Merkin (n 13) 336.
[19] The Life Assurance Act 1774 (LAA 1774) s 4, expressly excludes from the application of the act the insurance on ships, goods, or merchandises. Hence, it was discussed whether the act applies on indemnity insurance other than those expressly excluded, although it seems now the authority that its applicability is restricted to life and contingency insurance only: *Mark Rowlands Ltd v Berni Inns Ltd* [1986] QB 211, as per Kerr LJ. More recently, but by the Privy Council, *Siu (Yin Kwan) v Eastern Insurance Co. Ltd* [1994] 2 AC 199.
[20] The act does not expressly indicate when the interest must exist, yet s 1 and 3 of the act suggests that the interest must exist at the time of effecting the policy and at loss. However, since *Dalby v The India and London Life Assurance Co* (1854) 15 CB 365, it is clear that the interest must exist at the inception of the contract, and not at the date of the loss.
[21] LAA 1774, s 2.
[22] ibid s 1.
[23] *Harse v Pearl Life Assurance Co Ltd* [1904] 1 KB 558. Illegality was, according to the court, the effect of the words "no insurance shall be made" of the LAA 1774 s 1.
[24] cf Marine Insurance Act 1906 (MIA 1906), s 84(3)(c) in relation to Marine Insurance (Gambling Policies) Act 1909 (MIA 1909) s 1.
[25] Although, there were some secluded cases where the courts required the proof of interest solely based on their indemnity insurance nature: *Sadlers' Company* (n 11); *Lynch v Dalzell* (1729) 4 Bro Parl Cas 431.
[26] For a definition of gambling contract see *Carlill v Carbolic Smoke Ball Co* [1892] 2 QB 484.
[27] Gaming Act 1845 s 18.

definition of insurable interest, codifying what was considered, at the time, the authority: *Lucena v Craufurd*.[28]

The new millennium ushered in a wave of change, although with unexpected consequences in the realm of insurance. In 2005, the Gambling Act was passed, repealing, in general, the 1845 Act,[29] providing that "the fact that a contract relates to gambling shall not prevent its enforcement".[30]

While section 335(2) of the 2005 Act provides a saving provision for "any rule of law preventing the enforcement of a contract on the grounds of unlawfulness (other than a rule relating specifically to gambling)", when passing the Act, Parliament never discussed its implications with respect to insurance contracts, giving rise to one of the underlying issues analysed in this historical review: whether the interest is a common law or a statutory requirement.

In the case of life and other contingency insurance, Waller J explained in *Feasey* v *Sun Life Assurance Co of Canada*[31] that the lack of insurable interest was not necessarily synonymous with gambling. Thus, lack of insurable interest would render the policy void by virtue of the LAA 1774 and not for being considered a wager, leaving the insurable interest requirement for those types of insurance unaffected by the 2005 Act.[32] Similarly, in the case of marine insurance, section 4 of the MIA 1906 remains in force.[33] Hence, marine wager policies are still void after the 2005 Act.

In relation to non-marine indemnity insurance, section 335(2) of the 2005 Act prevents the application of section 335(1) when there is a rule of law. As mentioned, it is unconvincing that the courts were discussing the requirement of an insurable interest before its statutory recognition, and rather were engaging in discussions related to the indemnity principle. In fact, it was the first opinion of the Law Commissions that the 2005 Act removed, by accident, the requirement of "insurable interest in relation to non-marine indemnity insurance at the time of the loss in order to have an enforceable contract".[34] If the insurable interest requirement was born before the statutory activity of the second half of the eighteenth century, within the bosom of the common law, there is a case to support its survival after the enactment of the 2005 Act for non-marine indemnity insurance. However, after the previous historical analysis, the most compelling case seems to be the idea that the insurable interest was given birth to by Parliament and not by the common law, in line with the opinion of the Law Commissions. Hence, the enactment of this act entailed the inadvertent expulsion of this requirement from the English law with regard to non-marine indemnity insurance.[35] Furthermore, even for those who support the survival of this requirement in relation to non-marine indemnity insurance after the

[28] *Lucena* (n 7).
[29] The Gambling Act 2005 s 334, repealed s 18 of the Gaming Act 1845.
[30] Gambling Act 2005 s 335(1).
[31] [2003] Lloyd's Rep 1R 637.
[32] Merkin (n 9), 4-012.
[33] For the reasons of why the 2005 Act has not affected s 4 of MIA 1906, see Templeman (n 1), 195.
[34] Issues Paper 4 (n 4) para 6.2.
[35] The English and Scottish Law Commissions, Insurance Contract Law: Post Contract Duties and Other Issues – a Joint Consultation Paper (the Second Consultation Paper) <https://www.scotlawcom.gov.uk/files/3113/2429/7329/dp152.pdf> para 11.29, (the "Second Consultation Paper") accessed 6 March 2018.

enactment of the 2005 Act, there is no clarity as to when the interest should exist. There is no statute nor a clear common-law source to turn to.

Part II: The content of the requirement: its nature, timing, and the consequences of its absence

1. Insurable interest in contingency and indemnity insurance

In the field of life and contingency insurance there is no statutory definition of insurable interest. There is only an indication of the pecuniary nature of the interest in section 3 of the LAA 1774.

What is clear, is that the law has been influenced by the anxieties to prevent the "mischievous kind of gaming"[36] that the enacters of the 1774 Act perceived occurs when a life policy is effected without an interest; and to tolerate insurance on lives only when, supposedly, there will be no temptation of murder. Consequently, the 1774 act places definite restrictions on the lives that one may insure.[37]

But, notwithstanding the above, it is worth noting that the succinct 1774 Act does not restrict the assignment of the policy, allowing the circumvention of the act's formalities by means of assigning the policy to an uninterested party.[38]

In the case of indemnity insurance, the paradigm is property insurance, since the discussion becomes irrelevant when other types of policies, particularly liability insurance, is under an insurable interest analysis. Everyone has an undisputed insurable interest in his own potential legal liability.[39]

The words of Lord Eldon in *Lucena v Craufurd*[40] have become the orthodox approach on this issue. In his words, insurable interest amounts to "a right in the property, or a right derivable out of some contract about the property, which in either case may be lost upon some contingency affecting the possession or enjoyment of the party".[41] In Lord Eldon's view the nature of the relationship between the insured and the subject-matter of the insurance should be narrowed down to a present and enforceable right, emerging from a legal or equitable interest.[42] Later, section 5(2) of MIA 1906, codified this position with respect to marine policies, defining the content of this requirement.

[36] LAA 1774, preamble.
[37] When the subject-matter of the policy is the insured's own life see *Wainewright v Bland* (1835) 1 Moo & R 481; for the case of spouses see *Reed v Royal Exchange Ass Co* (1795) Peake Add Cas 70 and *Griffiths v Fleming* [1909] 1 KB 805. There is also a case supporting that a similar approach should be applicable in case of a "fiancé(e) insuring the life of his or her fiancé(e)", Birds (n 1), 46.
[38] James Davey, 'Dial M for Moral Hazard? Incentives to Murder and The Life Assurance Act 1774' (2014) 25 Ins LJ 120, 123.
[39] Birds (n 1), 56.
[40] *Lucena* (n 7), at 321.
[41] ibid 321.
[42] Hence, the beneficiary of a property under a will does not have an interest, since the benefit is only contingent. The testator may revoke the will. Similarly, a street vendor who relies on the clientele attracted by a public attraction housed in a building in front of his business, does not have an interest, Merkin (n9) 4-019.

Nonetheless, there are some caveats to be considered. The definition is confined to marine policies, and is non-exclusive,[43] although "it provides a useful insight into the requirement of insurable interest in insurance law generally".[44] In fact, 119 years after Lord Eldon's words, the House of Lords applied the test to its extreme consequences, in a case related to a fire policy. In *Macaura v Northern Assurance Company*,[45] the plaintiff sold the whole timber of his estate to a limited company, in consideration of fully paid up shares, becoming its unsecured creditor and sole shareholder.[46] He then effected five fire policies in his own name to insure the timber against fire. However, when the timber was subsequently destroyed by fire, the court rejected his claim due to the lack of insurable interest. It was held that, as a shareholder he did not have a "right to any item of property owned by the company, for he has no legal or equitable interest therein. He is entitled to a share in the profits while the company continues to carry on business and a share in the distribution of the surplus assets when the company is wound up". The same conclusion was reached when his position as creditor was considered. Even the fact that the timber was in his possession (it was being held on land of his property at the time of the loss) was dismissed, since as a bailee he had no legal liability towards the company in respect of its safe custody; "he had merely permitted their remaining upon his land". For the court, his interest amounted to a mere moral certainty. His claim to insure would have been properly supported if the policies had been taken out by the company and not by him; or if the plaintiff had decided to insure his shares against the risk of devaluation in case of destruction of the company's assets by fire,[47] or his right as creditor against the insolvency of his debtor derivable out of such loss.[48]

2. The judicial liberalisation process

Undoubtedly, the orthodox approach has its flaws, which mainly stem from its narrow and legalistic concept, attached to proprietary rights. It has been, consequently, the object of judicial[49] and academic[50] criticism, calling for its liberalisation. Ironically, the substance of this process has been found in the same landmark case where the narrow test commenced.

During the time of *Lucena*,[51] judges from lower courts and high-level officials were summoned to provide legal advice to the House of Lords. Among the judges, Lawrence J, seized the opportunity to reflect his view over the nature of the requirement, formulating the recognition of a moral certainty as sufficient element to

[43] Templeman (n 1), 196.
[44] John Lowry, Philip Rawlings and Robert Merkin, *Insurance Law Doctrines and Principles* (3rd edn, Oxford: Hart Publishing 2011), 180.
[45] [1925] AC 619.
[46] cf *Sharp v Sphere Drake Insurance (The Moonacre)* [1992] 2 Lloyd's Rep 501.
[47] *Wilson v Jones* (1867) LR 2 Ex 139.
[48] *Waterkeyn v Eagle Star & British Dominions Insurance Co Ltd* (1920) 5 Ll L Rep. 42
[49] *Stock v Inglis (1884)* 12 QBD 564.
[50] For the broadening of the requirement see Bertram Harnett and John V. Thornton, 'Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept' (1948) 48(8) Colum L Rev 116; AJ Campbell, 'Some Aspects of Insurable Interest' (1949) 27 Can Bar Rev 1; RA Hasson, 'Reform of the Law Relating to Insurable Interest in Property – Some Thoughts on Chadwick v Gibraltar General Insurance' (1983-84) 8 Can Bus LJ 114.
[51] *Lucena* (n 7).

fulfil it. This test has been later called the "factual expectation test". In the celebrated passage Lawrence J said:

> "[I]nterest does not necessarily imply a right to the whole, or a part of a thing, nor necessarily and exclusively that which may be the subject of privation, but the having some relation to, or concern in the subject of the insurance, which relation or concern by the happening of the perils insured against may be so affected as to produce a damage, detriment, or prejudice to the person insuring: and where a man is so circumstanced with respect to matters exposed to certain risks or dangers, as to have a moral certainty of advantage or benefit, but for those risks or dangers he may be said to be interested in the safety of the thing. To be interested in the preservation of a thing, is to be so circumstanced with respect to it as to have a benefit from its existence, prejudice from its destruction.[52]"

It can be appreciated when Lawrence J's *dictum* is compared with the "legal or equitable" formulation of Lord Eldon, that the concept of the former is wide enough to encompass a broader range of cases that the latter simply excludes. By doing so, Lawrence J recognises that ownership and interest are two different concepts, and that to determine whether the element of interest has been fulfilled, the focus of the judge should be on the following question: does the insured suffer a prejudice following the loss of the subject-matter? What would have been the answer to that question if this wider test would have been applied in the case of a salesman whose business relies on the continuing functioning of a public attraction, just in front of his store; or in the case of a sole shareholder who takes out insurance in his own name instead of the name of the company; or in the case of a farmer who only owns cultivated seeds but wants to insure the next season crops? In these cases, the answer would have been "yes".

Even before *Macaura*, it is possible to find voices among the judges about the inherent risks of a narrow test.[53] Within this process of liberalisation, there is a very illustrative case from the other side of the Atlantic, which represents a sound appraisal of the institution that showed to be very influential, way beyond its jurisdiction.

In *Constitution Insurance Company of Canada v Kosmopoulos,*[54] the Supreme Court of Canada held that "Mr. Kosmopoulos, as sole shareholder of the company, was so placed with respect to the assets of the business as to have benefit from their existence and prejudice from their destruction. He had a moral certainty of advantage or benefit from those assets but for the fire." Mr. Kosmopoulos was engaging in the business of

[52] ibid at 643.
[53] *Moran, Galloway & Co v Uzielli and Others* [1905] 2 KB 555, as per Walton J citing the *Digest of the Law of Marine Insurance* at 563, "the definition of insurable interest has been continuously expanding, and dicta in some of the older cases, which would tend to narrow it, must be accepted with caution."; *Stock* (n 49) as per Brett MR, "[i]n my opinion it is the duty of a Court always to lean in favour of an insurable interest, if possible, for it seems to me that after underwriters have received the premium, the objection that there was no insurable interest is often, as nearly as possible, a technical objection, and one which has no real merit, certainly not as between the assured and the insurer"; *Patterson v Harris* (1861), 1 B&S 336, 121 ER 740; *Wilson* (n 47).
[54] (1987) 1 SCR 2.

manufacturing and selling leather goods through a company especially set up for that objective. Besides being sole shareholder, he deemed himself the direct owner of the store and the assets, going as far as taking out a fire policy in his name and not in the name of the company, to insure the content of the business premises. Certainly, the insurer was aware of the facts that, technically, the company owned the store and assets. Though, when fire broke out resulting in the loss of the assets, they refused payment based on lack of insurable interest.

Wilson J was in charge of writing the judgment in this case, and in her analysis, she notably addressed many of the policy concerns that underpinned Lord Eldon's narrow test, including the uncontrolled multiplication of insurance as a deficient outcome of the moral certainty test. In *Lucena*,[55] Lord Eldon offered an illustrative example of his perception on this matter. In his words, Lawrence J's moral certainty test would have had the effect of allowing too many to insure over the same subject-matter. That would have been the case of the dock company, the dock-master, the warehouse-keeper and the porter, in respect of the ship.[56] Perhaps, Lord Eldon's apprehensions were related with the protection of insurers against their own profit appetite. Under that scenario, too much insurance would amount to a negative social outcome. However, that is not the approach that a court of civil jurisdiction should follow, As Wilson J pointed out, insurers "have always faced the difficult task of calculating" their liability when covering a particular event in order to decide whether to insure, and to calculate under an actuarial basis the premium; and "[i]f the insurer cannot estimate the likelihood of the loss occurring (…) then it does not have to write the policy".

That kind of assessment should be made by insurers and, should not be replaced by the courts. Furthermore, even if the policy concerns against gambling are taking into account, in Wilson J's opinion, lack of insurable interest is, at least, an odd and particular kind of defence. Only the insurer is authorised to decide whether to use this defence – "no public watchdog can raise it" – and it can be raised for reasons "completely extraneous to and perhaps inconsistent with those underlying the definition". In fact, *Macaura*, which contributed so much to the consolidation of Lord Eldon's narrow test, finds its origins in an arbitral proceeding where the insurers initially pleaded fraud but were unable to prove it.

Back in England, we can also find judicial attempts that have been trying to mitigate the effects of the narrow test.[57] In the *The Moonacre*,[58] deputy judge Colman QC, engaged in a different reading of the orthodox approach, particularly of its codification in section 5(2) of the MIA 1906. The facts of this case resemble those of *Macaura*.[59] Here, the insurers denied liability on the grounds of lack of insurable interest, raising as a defence the fact that the policy was taken out by the sole shareholder, not by the company. Yet, the court decided to recognise the existence of the requirement and held that the insurers were liable on the ground of two powers of attorney which conferred the right to use the yacht to the insured.

[55] *Lucena* (n 7).
[56] ibid at 651.
[57] For a recognition of Lawrence J's test before *Macaura* (n 45), see *Mark Rowlands Ltd* (n 19).
[58] *The Moonacre* (n 46).
[59] Mr Sharp took out a fire policy, in his own name, to insure the motor yacht Moonacre. The yacht was a company asset, which was incorporated due to tax reasons and two powers of attorney were issued in favour of Mr Sharp to authorise him to sail and manage the yacht. After having caught fire, the Moonacre became a constructive loss

Nevertheless, perhaps the most interesting English cases where a wider test has been embraced have been ones involving construction projects and the insurer's right of subrogation. In *Petrofina (UK) v Magnaload Ltd,*[60] it was discussed whether the insurer could exercise its subrogation rights against the subcontractors in a construction project, in the context of a contractors all risks (CAR) insurance policy effected by the main contractor, where subcontractors may face liability due to their potential negligence in case of damage to the works. The problem was that, at the time of the loss, the subcontractors did not enjoy any legal or equitable relation in respect of the works. The court held that this expectation amounted to an insurable interest in the CAR policy.[61]

Lawrence J's approach also finds resonance in the case *National Oilwell Ltd* v *Davy Offshore (UK) Ltd*,[62] where the central question was whether the plaintiff was a coinsured in the builders' all risks policy jointly with the defendant. Colman J, first, in the process of construction of the contract, held that the plaintiff was, indeed, a subcontractor although his role was limited to the delivery of goods, and, thus, qualified within the contractual concept of "other assured". Secondly, the fact that the plaintiff was a supplier who took no part in the construction at the project site, was not sufficient to argue that there was no insurable interest due to the lack of possessory or proprietary interest.[63]

Notwithstanding the above, the Court of Appeal has set a limitation in *Deepak Fertilisers and Petrochemical Corporation v Davy McKee (London) Ltd and ICI Chemicals and Polymers Ltd.*[64] While it recognised the broadening of the insurable interest requirement in the context of construction projects to accept that a subcontractor does have a "pervasive"[65] interest in the entire project, it held that the interest ended jointly with the works.

In relation to pure life insurance on the life of another, there have been no major innovations.[66] Nevertheless, in 2003 the Court of Appeal engaged in what can be arguably the most thorough analysis of the requirement since *Griffiths,*[67] in *Feasey*.[68]

In *Feasey* the defence of the P&I Club pleaded that the appeal should be dismissed based on the purpose of the 1774 Act, and its objective of terminating the mischievous kind of gaming that insurance on the lives of others without interest represents. However, Waller J rejected this approach. Insurance without interest does

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[60] [1983] 2 Lloyd's Rep 91.

[61] Lloyd J constructed his argument on the grounds of commercial convenience, similarly as it might have been in the case of a bailee who has a right to insure the whole, yet only can hold as in trust the portion of the indemnity attributable to the owner mortgagor.

[62] [1993] 2 Lloyd's Rep 582

[63] In his opinion, there is "no reason why [the subcontractor] should not, and every commercial reason why [the subcontractor] should, be able to insure against loss of or damage to the property involved in the common project not owned by him and not in his possession". The potential liability faced towards the common project – in the form of cessation of the subcontractor's contract in case of damage or loss to the works – was sufficient.

[64] [1999] 1 Lloyd's Rep 387.

[65] A hybrid form on interest, where "the claimant is entitled to claim not only for himself but also for the benefit of his coassureds in the full amount of the loss", *State of the Netherlands v Youell* [1997] 2 Lloyd's Rep 440.

[66] James (n 38), 130.

[67] *Griffiths* (n 37).

[68] *Feasey* (n 31).

not necessarily amount to gaming,[69] and Waller J shifted his to the wording of the policy rather than in the searching of a unitary concept[70] of the requirement applicable to all kinds of insurance, acknowledging that the concept of insurable interest will vary from policy to policy.[71]

The next issue in his asserting was how to uncover the legal nature of the interest. To resolve it, Waller J suggested three questions: "[w]hat is the subject of the insurance? What insurable interest does a person have in the subject of the policy? Does the subject embrace the insurable interest?"[72]

Therefore, and after characterising the policy as a hybrid form of insurance, not pure indemnity nor pure contingency,[73] Waller J accepted a broader concept of insurable interest.

Although pure life insurance on the life of another remains within the orthodoxy, *Feasey* has provided a unique opportunity to show the approach of a senior court towards a more liberal approach. It is true that the analysis of Waller J, in relation to property insurance, has the legal value of *obiter*. Nevertheless, his approach demonstrates that the balance is leaning in favour of the idea that contracts should be upheld and that English Courts are well prepared to conduct a satisfactory process of contractual interpretation, despite the insurable interest requirement. Insurable interest, in this regard, cannot be an obstacle and it should, when conflicting with these other principles, step back, or as we will argue, step aside.

Part III: The case for its abolition on the eve of its statutory consolidation

1. The draft Insurable Interest Bill

Since 2006, the insurable interest requirement has been in the sight of the Law Commissions. First, with an unprosperous consultation in 2008[74] about its repeal, and then with a more successful second consultation[75] in 2011 about its revamping. The latter, probably because not even the industry could deny a situation that has been characterised as a "confusing and illogical mess".[76] Thereafter, with the publication of Issues Paper 10[77] in 2015, the reforming path was resumed after a period of inactivity since 2012[78] Finally, for better or for worse, a draft Bill was published for consultation in 2016, which has been designed to give effect to the Law

[69] In fact, Waller J rearranged the discussion from one of "gaming or no gaming" to one of "interest or no interest". The real question was whether the P&I Club had an interest in the "original persons" lives and wellbeing.
[70] cf *Feasey* (n 31) [174] as per Ward LJ.
[71] ibid [97].
[72] Peter Havenga, 'Liberalising the Requirement of an Insurable Interest in (Life) Insurance' (2006) 18 SA Merc LJ 265.
[73] Peter (n 72) 270.
[74] Issues Paper 4 (n 4).
[75] The English and Scottish Law Commissions, Insurance Contract Law: Post Contract Duties and Other Issues – a Joint Consultation Paper (the Second Consultation Paper) <https://www.scotlawcom.gov.uk/files/3113/2429/7329/dp152.pdf> accessed 6 March 2018.
[76] 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 Insurance Law Reform (2007).
[77] Issues Paper 10 (n 8).
[78] The ILAG, a representative trade body that acted on behalf of life insurers, pushed forward the Commissions' review efforts, arguing that their members were being subjects of strong pressures to write policies that, under the strict application of the current law, may be considered void or even illegal, ibid para 1.3 and 1.4.

Commissions' latest proposal. This draft Bill stands in a broader attempt of modernisation that insurance English law has been experiencing during the last years, with the enactment of the Consumer Insurance (Disclosure and Representations) Act 2012 and the Insurance Act 2015 (IA 2015).

The basic rationale behind the draft Bill rests on the idea that a quasi-unified system of the law of insurable interest, in the form of a more flexible statutory restatement of it, would be the most uncontroversial solution to tackle the complexities and divergence of treatment that the application of the current law results in. However, it also represents the burial of the initial derogation intention, which was one of the options that the Law Commissions considered on Issues Paper 4 and which received wide opposition from the UK insurance industry, as it can be noted from the perusal of the Second Consultation Paper.[79] In doing so, it paves the way to the consolidation of the institution in a single statute. Yet, this approach is not devoid of difficulties.[80]

At the outset, it is important to stress the fact that the draft Bill has been designed only to unify the insurable interest system regarding life-related insurance[81] and other than (non-marine) life-related insurance.[82] Section 6 determines that the scope of the draft Bill excludes contracts of marine insurance, as defined by section 1 of the MIA 1906. It also repeals the LAA 1774, and takes advantage of the momentum to repeal the MIA 1788 and the MIA 1909.[83] Section 5 closes the circle, by declaring that any other rule of law, related with the requirement of insurable interest for the purposes of a contract of insurance, is replaced by the draft Bill.

Regarding life-related insurance, the interest is required at the inception of the contract.[84] However, the palette of individuals in whom the insured is considered to have an insurable interest has been extended. Section 2(2) adds to the current state of the law the individual that is, or is treated as, the child or grandchild of the insured; the individual that lives with the insured as a spouse or civil partner; a member of a pension or other group scheme if the insured is the trustee of the scheme; and the individual that is the beneficiary of the contract, including his nominee. The draft Bill also provides more flexibility when it is compared with the current pecuniary interest recognised by law. The draft Bill requires the insured to have a reasonable prospect to suffer an economic loss if the insured event occurs. Hence, a son would be authorised to take out insurance to cover the funeral expenses of his mother's death.[85]

In relation to policies other than (non-marine) life-related insurance the interest is also required at the inception of the contract[86] but for a claim to be payable, the interest must also exist at the time of the insured event.[87] Furthermore, in line with the proposal made in Issues Paper 10,[88] the insured can either have the

[79] The Second Consultation Paper (n 101).
[80] For the sake of completeness, the following lines will be focused on an examination of the main parts of the draft Bill. Nevertheless, for a critical analysis of it see Franziska Arnold-Dwyer, 'Insurance Law Reform by Degrees: Late Payment and Insurable Interest' (2017) 80(3) MLR 489.
[81] Draft Bill s 1.
[82] ibid s 3(1).
[83] ibid s 7.
[84] ibid s 2(1).
[85] *Harse* (n 23).
[86] Draft Bill s 3(1).
[87] ibid s 3(2).
[88] Issues Paper 10 (n 8) para 2.40 and 2.41.

interest on the subject-matter when entering into the contract, or have a reasonable prospect of acquiring it during its term.[89] Regarding the content of the interest, the draft Bill provides a non-exhaustive list[90] of circumstances where the insured can stand, mirroring the technique used in section 5(2) of the MIA 1906, but embracing what the courts and scholars have described as the factual expectation test,[91] extracted from the analysed *dictum* of Lawrence J and approved by the Court of Appeal in *Feasey*.

Furthermore, the sanction due to the lack of interest in the form and time prescribed by the draft Bill, is that the contract is void and not illegal, for both life-related and other than life-related (non-marine) insurance contracts. Hence, the insured affected by the defence of lack of insurable interest raised by the insurer, can rest assured that the premium will be returned, with one exception. Section 4 declares that the insurer need not return the premium paid by the insured, if the insured made an untrue statement about the relevant insurable interest, or knew that the statement was untrue or did not care whether the statement was true or not. The exception is consumer insurance contracts,[92] for which section 4(1) does not apply if "it would be unfair to the insured to retain the premiums".[93]

2. A critical appraisal of the insurable interest requirement

The draft Bill, as it stands, still needs some time to mature. The Law Commissions' strategy is to take advantage of the special parliamentary procedure for uncontroversial Law Commissions bills. Yet it is expected that the Law Commissions will issue a final report, gathering the stakeholder's answers and comments to the short consultation on the draft Bill. It is also likely that, in consideration of the feedback received from stakeholders, the draft Bill will be subject to corrections and amendments. Therefore, it is unrealistic to expect that the draft bill will be crystallised into an act earlier than the middle of this year.

Given the above, and considering that it is still not too late, the purpose of this work is to warn that, given the objective of modernising UK insurance law, it would be sensible to shift the debate around the institution.

The focus will be now on attempting an appraisal of the past and current arguments that supports the retention of the insurable interest requirement. For that purpose, the arguments have been depicted in three categories: (i) mitigation of moral hazards; (ii) gambling and regulation; and (iii) definitional function.[94] Also, across the analysis, it will be proposed that the discussion for the retention of the requirement lacks a holistic approach, where a special consideration of the place and functions that the insurable interest serves (if it still serves any purpose) within the context of private law should be taken into account.

[89] Draft Bill s 3(1)(a) and 3(1)(b).
[90] ibid s 3(3).
[91] ibid s 3(3)(d).
[92] ibid s 4(3).
[93] ibid s 4(2).
[94] It is worth noting that Issues Paper 10 provided four arguments for the retention of the insurable interest requirement: (i) it is a hallmark of insurance, in the sense that it is part of its definition; (ii) it reinforces market discipline against speculation; (iii) it acts as a barrier against invalid claims; and (iv) it may help to define where insurance is located for regulatory and tax purposes. For a critical analysis of these arguments, see Gary Meggit, 'Insurable Interest – the Doctrine that would not Die' (2015) 35(2) LS 287ff.

2.1. *Mitigation of moral hazard*

Anxieties regarding moral hazard were pivotal within the judicial debate that underpinned the origins of the insurable interest requirement. Judges were enthusiastic to intervene in contracts to impede the perceived peril of allowing insurance business where there was no evident connection between the insured and the subject-matter of insurance. In their view, the happenchance of promoting, or even causing, the realisation of the insured event by an uninterested insured would be increased if the courts of civil jurisdiction had been ready to enforce such contracts. That would lead, the argument continues, to socially undesirable outcomes, such as the deliberate burning of houses or the murder of people due to the insured's appetite for an undue profit. Hence, they felt compelled to introduce regulatory controls in the realm of private law. However, as the following analysis will show, it is clear today that these considerations do not stand and, probably, some of them never did.

Intertwined with the idea of the role of the law and the addressing of public policy issues, is the punishment and deterrence objectives. A sound public policy should not only achieve an effective punishment against an individual that has engaged in unacceptable social conduct. It should also try to achieve a deterrent objective, discouraging others from committing the offence. Therefore, the next question is whether the insurable interest can achieve a deterrent objective. Are people deterred from burning houses or committing murder if there is an insurable interest requirement when they engage in insurance business? Certainly not.

Criticising the current position on life insurance and the LAA 1774, professor Davey posits that "murders for life insurance are rare, and even when they do occur, the insurable interest rules do little to prevent them".[95] Criminal phenomena are extremely complex. At the very least, criminal law stands in a better position to deter criminal activities. And in the absence of an insurable interest requirement, the concerns to prevent a criminal from receiving a payout in spite of having caused the relevant death in the context of a life policy are already addressed by the public policy rule according to which a criminal will not find the court's support to recover the profits of the crime.[96] Under Part 2 of the Proceeds of Crime Act 2012, courts have the power to confiscate them.

In the context of property insurance, the moral hazard argument may be similarly challenged. Bertram Harnett and John V. Thornton brought down the myth around the temptation to destroy property, with a logic that is still valid today.[97] Without a proper reflection on the matter, it is easy to conclude that people without interest on the subject-matter would have an enhanced temptation to destroy the insured property in order to benefit from the insurance. Nevertheless, people do not only burn down houses with or without interest. In fact, the existence of an insurable interest between them and the subject of insurance places them in a favourable position to devise its destruction.

[95] Davey (n 38) 147.
[96] Templeman (n 1), 213.
[97] Harnett and Thorton (n 50), 1181ff.

Moreover, on grounds of invalid claims, the same logic applies. Criminal sanctions are much more likely to deter fraud than an insurable interest requirement. Ultimately, albeit not exempt of criticism,[98] insurance law has its own system to confront fraudulent claims. It has also been suggested that, on grounds of moral hazard, insurable interest can still be justified, as it aligns the interest of the insurer and the insured in the preservation of the insured subject-matter, making the insured "more likely to safeguard insured property against loss or damage and less likely to cause a loss deliberately or fraudulently".[99] However, it is not convincing that an argument based on a probability is sufficient to support the institution, especially when the law already provides the insurer with a mechanism to incentivise the insured to be diligent.

Although with a mitigated severity after the enactment of the IA 2015,[100] warranties still play an important role to promote the safeguard of the insured subject-matter, if properly designed and drafted by insurers. It can also be argued that a much more desirable social outcome will derive from the use of warranties. Warranties will be typically drafted by insurers; hence, they will be subject to the strict rules of contractual construction, allowing the courts to demand clarity and consistency, failing which, they will favour a less draconian interpretation of the term.

Probabilities are uncertain and fallible in essence. Their success relies in the behaviour of an unreliable insured. On the other hand, warranties and contract construction place the burden on the insurers, incentivising them to analyse and understand the risk, in order to draft an effective clause.[101] If the insured failed to comply the warranty, the cover is suspended and any damage or loss occurred while the breach was not remedied will be uncovered. Ultimately, causation rules[102] will impede a claim to be prosperous if the cause of the loss or damage was the fault of a negligent insured.

Furthermore, it should be determine whether the market is capable of addressing this issue by itself. Insurers make money by trading risk for certainty, and their success, when competing in the market, will depend on their capability to reduce, or internalise moral hazards.[103] By charging higher premiums, insurers will segregate those who present a risk where moral hazards are higher and, alternatively, if segregation is not

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[98] See Philip Rawlings and John Lowry, "Insurance Fraud and the Role of the Civil Law" (2017) 80(3) MLR 510.

[99] Arnold-Dwyer (n 106) 502.

[100] The old law automatically discharged the insurer from further performance if a warranty was breached and entitled him to seek damages in case of loss that arises from it, MIA 1906 s 33(3). Today, under IA 2015 s 10, the effect of a breach of a warranty is the suspension of the cover until it is remedied. Furthermore, insurer will still be liable if the insured shows that the breach of the warranty did not increase the risk of the loss that occurred, IA 2015 s 11.

[101] This would be the case of a continuing promise to maintain a functioning sprinkler system when the concern is to protect the premises against fire, *Ansari v New India Assurance Ltd* [2009] EWCA Civ 93.

[102] Failing a definition in the relevant contract MIA 1906 s 55(1), provides that "the insurer is liable for any loss proximately caused by a peril insured against, but, subject as aforesaid, he is not liable for any loss which is not proximately caused by a peril insured against".

[103] Jacob Loshin, 'Insurance Law's Hapless Busybody: A case against the insurable interest requirement' (2007) 117(3) Yale L J 474. The author provides a sensible explanation of how, counterintuitively, the insurable interest requirement creates perverse incentives for insurers to (i.) increase moral hazards (and create new ones); and (ii.) incentivise them to exploit insureds. Furthermore, it provides inefficiencies in the insurance market as a whole.

feasible, insurers will reduce those moral hazards, using contractual techniques imposed by market forces instead of courts.[104]

2.2. Gambling and regulation

Incited by the Parliament, bias against gambling also explains the special eagerness of the eighteenth and nineteenth century judges, in intervening in contracts of insurance where no interest was found, or, at least, not an interest as it is orthodoxly understood. However, after the passing of the Gambling Act 2005, nobody can deny the legitimacy of gambling as a business activity, pre-empting the necessity of camouflaging wagers as insurance.

However, there is a strong case for arguing that insurance companies should not gamble. In fact, they cannot. Insurance business is subject to a dual regulatory regime. Under the oversight of the Prudential Regulation Authority (PRA)[105] insurance firms are subject to prudential regulation; and under the oversight of the Financial Conduct Authority (FCA) insurance firms are subject to conduct of business regulation[106] to ensure high standards of conduct, promote the protection of policyholders and preserve market integrity. Insurance business is a regulated activity under the Financial Services and Markets Act 2000 (PRA-regulated Activities) Order 2013, and a firm that wishes to carry on, is required to apply to the PRA for authorisation. Firms that have been authorised to insure, are only authorised to engage in predetermined classes of insurance, and must comply with capital requirements and reserves that seek to protect the soundness and solvency of insurance firms.[107]

If the regulatory regime is regarded as unsatisfactory, it is difficult to see why the insurable interest requirement, an institution that belongs to the realm of private law, could or should play any role in achieving a public policy objective. Waller J, in *Feasey*[108] was emphatic in clarifying that gambling was not the antithesis of insurable interest. Furthermore, even if the insurable interest does play a minor role in addressing this issue, it is certainly misplaced. The insurable interest requirement has been designed as a defence that "can only be raised at the whim of the insurers",[109] driven by commercial reasons and not by public policy. Furthermore, the draft Bill does not address this problem, as an insurer can still be negligent during the formation phase of the contract, insuring a risk where the insured does not have an interest, or does not have a reasonable prospect of acquiring it during the term of the contract. There is no positive duty on the insurer's shoulders nor will any public body police it.

[104] eg deductibles, coinsurance, coverage limits, and coverage exclusions, ibid 506.
[105] Whose objective is "contributing to the securing of an appropriate degree of protection for those who are or may become policyholders", Financial Service Act 2012 s 2(C)(2).
[106] See FCA Handbook, Insurance: Conduct of Business sourcebook (ICOBS) and Principles for Business (PRIN).
[107] Solvency II Directive.
[108] *Feasey* (n 31).
[109] Lowry and Rawlings (n 2) 362.

However, there are improvements coming from the field of regulation, in particular the Insurance Distribution Directive[110] which recasts the 2002 Insurance Mediation Directive. The IDD represents a minimum harmonizing directive. Its objective is to promote a level playing field across the participants in insurance sales and to raise the regulatory standards for the protection of consumers faced by firms who pursue insurance (and re-insurance) distribution activities and auxiliary insurance intermediation activities in the Union, who fall within its scope.[111]

Under the IDD regime, the negligence of an insurance distributor during the formation phase of an insurance contract is addressed in its article 20. Prior to the conclusion of a contract, the insurance distributor shall comply with a series of obligations which seek to regulate their business conduct *vis-à-vis* their customers, including (i) the identification of the demands and needs of the customer based on the information obtaind from him; (ii) the provision of objective information about the insurance product in a comprehensible form to allow the customer to make an informed decision; and (iii) the obligation to propose a contract consistent with the customer's insurance demands and needs. When the insurance distributor services include advice, during the formation phase of the contract the insurance distributor shall provide a personal recommendation, setting out the reasons of why that specific product would best meet the customer's demands and needs.

In the UK, the FCA published on January 2017 the Policy Statement 18/1,[112] which explains how the IDD will be implemented in the UK and sets out the changes that will be effected to various parts of the FCA Handbook to this end.[113]

2.3. *Definitional function*

In relation to the interconnection of the insurable interest requirement and regulation, some scholars argue that the requirement serves a definitional function,[114] which allows the differentiation of insurance from other contracts such as betting and financial contracts, including parametric products when they are structured as derivative contracts. According to this line of thought, the definitional function would be sound since all these contracts are subject to different regulatory regimes. Thus, a boundary is needed, and the insurable interest

[110] Hereinafter the "IDD".
[111] IDD, art 1.
[112] FCA Policy Statement 18/1, "Insurance Distribution Directive implementation – Feedback and near-final rules for CP17/23, CP17/32, CP17/33, CP17/39 and near-final rules for CP17/07", <https://www.fca.org.uk/publication/policy/ps-18-1.pdf> accessed 6 March 2018.
[113] The European Commission proposed to delay the application date of the IDD, which is currently under consideration by the European Parliament and the European Council under accelerated legislative procedure. The UK government, in turn, has announced that the Insurance Distribution (Regulated Activities and Miscellaneous Amendments) Order 2018 will be delayed, waiting for the outcome of this proposal. Therefore, the FCA will not be able to complete these rules until the Order comes into force. Under the current proposal, the application date of the IDD might be pushed-back to 1 October 2018. Nevertheless, Member States are still required to transpose the IDD into national law by 23 February 2018, the original date, < https://www.gov.uk/government/consultations/transposition-of-the-insurance-distribution-directive> accessed 6 March 2018.
[114] See Arnold-Dwyer (n 106); Davey (n 1). A similar function can be concluded from the so-called "Potts opinion" <http://www2.isda.org/search?headerSearch=1&keyword=robin+potts> accessed 6 March 2018.

requirement would be called upon to fill the gap. Similarly, positioning the requirement within a statutory definition of insurance contracts would help to identify it for tax and accounting purposes.

However, historically, the main flaw of the requirement has been the elusive nature of its content. When Lord Eldon believed that he could grasp the intricacies of the requirement, he was unable to foresee the consequences that his words would have today. It has been examined how the courts have been compelled to resort to the more flexible and liberal words of Lawrence J, to be attuned to a commercial reality that is far more complex than the world that Lord Eldon experienced in the early nineteenth century.

Besides, the statutes that have tried to delineate the requirement have not been bold enough as to provide an exhaustive definition. Even the draft Bill is incapable of achieving the challenge. Therefore, it is questionable whether such an elusive concept can serve a definitional function.[115]

The courts have recognised the difficulties of the challenge and have been reluctant to offer exhaustive definitions by reference to the requirement. They even have gone to stress the disadvantages in engaging in such a conundrum. Megarry V-C, in *Medical Defence Union Ltd v Department of Trade*,[116] although referred to the insurable interest requirement, doubted whether it was even possible to attempt a definition,[117] and later Templeman J in *Department of Trade and Industry v St Christopher Motorists' Association Ltd*[118] recognised that such an effort inherently involves drawbacks. His words are as valid today as when they were pronounced: "it is undesirable that there should be [an all-embracing definition], because definitions tend sometimes to obscure and occasionally to exclude that which ought to be included".[119] Considering the fast-paced growth that financial innovation has been experiencing in the last years, it is doubtful that an exhaustive definition will provide any useful purpose for the coming years. Regulatory guidelines, on the other hand, provide the required flexibility that neither the common law, nor the statutes, can offer.

The predecessor of the FCA, the Financial Service Authority (FSA) considered that the insurable interest requirement was not a key element to identify a contract of insurance.[120] Furthermore, as was stressed in Issues Paper 4, the FSA offered sound guidance on how to identify it. First, the assumption of risk by the provider was branded as a descriptive feature. Second, it is more likely to regard a contract as insurance if "the amount payable by the recipient under the contract is calculated by reference to either or both of the

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[115] This line of thought is intimately related to an old dilemma: Does the insurance contract require an exhaustive definition in the UK legal system? Channel J in the hallmark case of Prudential Insurance Co v Commissioners of Inland Revenue [1904] 2 KB 658, had to deal with the problem of defining insurance contract, but instead of a definition he tried to identify the characteristics of a contract of insurance. In doing so, it is true that he included the presence of an insurable interest. Nonetheless, in the author's opinion, he did it to justify a different characteristic, namely, the fact that the insured event has to be prima facie adverse to the interest of the assured. Even that last characteristic was somewhat odd, considering that the case was related to the identification, for tax purposes, of a life policy that covered the assured's own life.

[116] [1980] Ch 82.

[117] "I do not know whether a satisfactory definition of a 'contract of insurance' will ever be evolved. Plainly it is a matter of considerable difficulty. It may be that it is a concept which is better to describe than to attempt to define", ibid 95.

[118] [1974] 1 WLR 99.

[119] ibid 101.

[120] FSA Policy Statement 04/19, "The identification of contract of insurance" <http://www.fsa.gov.uk/pubs/policy/ps04_19.pdf> accessed 6 March 2018.

probability of occurrence or likely severity of the uncertain event”[121] or “if the contract is described as insurance and contains terms that are consistent with its classification of a contract of insurance, for example, obligations of the utmost good faith”.[122] Finally, a contract would be less likely to be regarded as insurance “if it requires the provider to assume a specific risk (that is, a risk carrying the possibility of either profit or loss) rather than a pure risk (that is, a risk of loss only)”.[123]

In fact, this guidance serves quite well to distinguish insurance from other types of contracts and, although the regulation of financial services in the UK has changed, there is no evidence that the FCA has reformed its view on the matter.[124] Risk management derivative contracts, a type of financial contract, shares with insurance the economic function of risk transfer. However, the price is determined by the response of the underlying asset to the market forces of supply and demand. Instead, in insurance, the premium is determined on an actuarial basis. Regarding betting contracts and speculative derivatives, the transferred risk could be qualified as a specific risk, which carries the possibility of profit or loss, and not a pure risk of loss as in insurance. Similarly, in *Carlill*,[125] although it seems to support the idea that the insurable interest assists in this matter, a careful consideration of Hawkins J’s words shows that what really distinguishes wagering from insurance is the fact that the risk exists, in the former, due to the contract (without the wagering there is no risk), and not independently, as in insurance (where the contract transfers a pre-existing risk, which will continue to exist with or without the contract).[126]

3. The abolition

Throughout this work both the historical and current pillars of the insurable interest law have been defied, concluding that neither of them stands by itself. Yet, it would be unreasonable to expect that any legal requirement should work flawlessly. However, when the flaws of a requirement cause more inefficiencies than the requirement itself creates benefits, it is reasonable to question it, including its very existence and ask if the market would be in a better position without an insurable interest requirement.

Certainly, the abolition of an insurable interest requirement seems to be counterintuitive. Even if we put the concerns against moral hazard and gambling aside, to insure an unowned house or the life of a stranger feels odd and against our everyday experience. However, those perceptions should be left aside, since what we are dealing with is a technical device the ultimate consequence of which is a private law sanction, namely, the invalidation of a contract; and as seen above, *sometimes* its illegality.

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[121] ibid para 6.6.8 G (1).
[122] ibid para 6.6.8 G (3).
[123] ibid para 6.6.8 G (2).
[124] Today, the FCA, following the criteria of the FSA, does not make any reference to the insurable interest requirement in PERG 6: Guidance on the Identification of Contracts of Insurance <https://www.handbook.fca.org.uk/handbook/PERG/6.pdf>
[125] *Carlill* (n 30).
[126] ibid at 490-492.

In relation to contingency insurance, a stark list of people allowed to insure the lives of one another, based on shared (and presumed) ties of love and affection, is plainly anachronistic. First, it is an unjustified rupture of the autonomy principle. No effective solution to any public policy objective is addressed by it. Secondly, even in the minds of the eighteenth-century policy-makers, why would the law have to decide when those ties of love and affection do or do not exist?[127] All-embracing lists of relationships is not only a too presumptuous policy destined to fail, it is also an improper intrusion into an intimate aspect of the human sphere. It seems to be more in line with a modern society to release the private law from this kind of restriction, and let prospective assureds insure if they estimate that an event related with a life policy will adversely affect their interests. Private law should not determine the economic choices of people.[128] Yes, it feels awkward that a stranger enters into an insurance contract to cover another's life. But, even without a system of consent provided by the individual whose life is being insured,[129] practice has shown that, when appropriate, the market has been capable of addressing this issue, as in the case of standard domestic life insurance policies. The Association of British Insurers and the British Medical Association have an agreed code that requires medical reports to be in place, which in practice means that the individual will have to, indirectly, provide his consent.[130]

In the field of indemnity insurance, the abolition of the insurable interest requirement has the advantage that there are no emotional reactions against it. Furthermore, its abolition is supported by the idea that the indemnity principle is enough.[131] According to this principle, the insured can only recover the pecuniary loss actually suffered, hence he must show that the occurrence of the insured event caused the alleged pecuniary loss. Therefore, any requirement of insurable interest at the time of loss becomes redundant.

Moreover, there are comparative and success cases where the requirement has been partially or totally removed. In Australia, Part III of the Insurance Contract Act 1984 (ICA 1984), regulates the institution for life insurance and non-life non-marine insurance. Section 16 of ICA 1984 eliminated the need for an insurable interest at inception in a contract of general insurance,[132] and section 17 clarified that "the insurer is not relieved of liability under the contract by reason only that, at the time of the loss, the insured did not have an interest at law or in equity in the property". Later, in 1995, the Life Insurance Act 1995 and the Life Insurance (Consequential Amendments and Repeals) Act 1995, eliminated section 19 of ICA 1984[133] and inserted a revised version of section 18 to eliminate the requirement regarding life insurance. Finally, section 10 of ICA 1984 clarified that "[a]n insurer under a contract of insurance is not relieved of liability under the contract by reason only that the names of the persons who may benefit under the contract are not specified in the policy document".

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[127] Davey (n 38) 147; Templeman (n 1) 224.
[128] Malcolm Clarke, 'An Introduction to Insurance Contract Law' in J. Burling and K. Lazarus (eds), Research Handbook on International Insurance Law and Regulation (Cheltenham: Edward Elgar, 2011) 28.
[129] Which was one of the tentatively proposals of Issues Paper 4 (n 4) para 7.79.
[130] Davey (n 38) 174. The code can be found here <http://www.financial-ombudsman.org.uk/news/pdf/medical-information-and-insurance.pdf> accessed 6 March 2018.
[131] Templeman (n 1); Clarke (n 128) 30; Lowry and Rawlings (n 2) 361ff.
[132] ICA 1984 s 11(6).
[133] Which declared a list of categories of insurable interest for life insurance.

All these reforms encountered strong opposition from the industry. Nevertheless, it has been explained that neither of them caused an economic detriment and that the insurance industry has, nevertheless, flourished throughout the years.[134] Similarly, in New Zealand, "ss 6 and 7 of its Insurance Law Reform Act 1985 abolished the law of insurable interest for life policies and limited it for indemnity policies".[135] Meanwhile, in the UK, policy-makers have not been bold enough as to eliminate a private law requirement which is problematic and unfit for purpose, and to rely on alternative tools in the realm of public law to achieve its stated objectives.

Conclusion

It has been shown that the current state of the law is complex, obscure and that it provides disparate results depending on the type of insurance. In some case, no straightforward answer is provided at all. Even the content of the requirement has not been uncontroversial. Sixty-one years after the enactment of the Marine Insurance Act 1745, Lord Eldon set out the boundaries of the institution in *Lucena,*[136] requiring the presence of a legal or equitable interest in the subject-matter of insurance. The orthodoxy prevailed, and in 1925 Lord Eldon's words were settled in *Macaura*.[137] But not for long. The strictness of his concept eventually guided some to engage in different readings, as occurred in *The Moonacre*[138] and *Stock*.[139]

What seemed to be incipient in the nineteenth century was evident in the last quarter of the twentieth century. An increasingly complex economy, with transactions that are far more sophisticated than those that set the standard at the time of *Lucena* and *Macaura*, made the orthodox approach unsuitable for a world marked by innovation. *Petrofina*[140] and *National Oilwell Ltd*[141] are two illustrative examples of how English courts, in spite of the presence of an anachronistic legal requirement, uphold legitimate commercial expectations of – in this case – subcontractors. In doing so, they embraced Lawrence J's liberal concept, based on a moral certainty of advantage or benefit in case of preservation of the subject-matter of insurance, as well as foreign courts have done, to ameliorate the consequences of Lord Eldon´s approach.

However, this work has attempted to go beyond this process of liberalisation, questioning the very foundations of the requirement. On grounds of moral hazard, it has been observed that neither the past nor the current justifications stand. Regarding life insurance, the intricacies of criminal behaviour are too complex to expect that the insurable interest requirement has any relevant role in reducing murders. On the other hand, predefined lists of relationships authorised to seek insurance is plainly an anachronistic legislative technique. Regarding property insurance, insureds will continue destroying the thing insured, with or without interest.

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[134] Meggit (n 120) 297 and 298; Merkin (n 102) para 8.7.
[135] ibid 298 (Meggit).
[136] *Lucena* (n 7).
[137] *Macaura* (n 45).
[138] *The Moonacre* (n 46).
[139] *Stock* (n 49).
[140] *Petrofina* (n 78).
[141] *National Oilwell Ltd* (n 62).

There is even a case for arguing that people with a legal or equitable interest will have more incentives to defraud their insurers than those who do not have it. In fact, insurance law has other devices to discourage the behaviour of negligent or fraudulent insureds, which also have the positive externality of encouraging insurers to engage in properly understanding risks. Nor is there a need to disguise wagers in the form of insurance: gambling is now a legitimate activity. Similarly, although the delimitation of insurance and other financial contracts is a sound regulatory policy, it is not convincing that an inherently elusive institution can provide any assistance, and it is simply not convenient to expect that an exhaustive definition will provide any solution. Regulatory guidelines, on the other hand, adequately meet the objective.

Hence, the abolition of the insurable interest requirement emerges as a sensible approach. In property insurance, the indemnity principle already requires proving a sort of interest in the form of loss at the date of the insured event. In life insurance, a *laissez-faire* system would remove the artificiality of a class-based model, encouraging people to seek insurance when it deems appropriate. The discomfort of having a stranger insuring one's own life would be addressed as a matter of underwriting.

By proposing the abolition of the insurable interest requirement, this work can be mistakenly considered as representing a bias against insurance regulation. Certainly, its abolition would remove an important restraint against financial innovation. Yet, the safety and soundness of insurers, as well as their conduct towards their client, remains as important as ever, and perhaps even more in relation to consumers who want insurance where there is no evident interest. They can be particularly susceptible to purchasing unsuitable products. Nevertheless, policy-making requires precision. The insurable interest requirement is placed at the heart of private law, whose objective is to ensure that people will perform their promises, compensating the losses that arise from a breach. But when policy-makers pretend that it would be sensible to use it to achieve public-policy objectives, the outcome is the misuse of the requirement. *Macaura* is an example of how insurers who suspected fraud but were unable to prove it, raised the lack of insurable interest as a technical defence. Nonetheless, even when there is no suspicion of fraud, insurers will use the defence driven by commercial motives and not to achieve public-policy objectives. If the system of insurance regulation is deemed to be defective, private law is simply not capable of providing a remedy, since it is its backbone and not the other way around. Regulation in the field of suitability and appropriateness assessments, on the other hand, represents the correct policy path, including the issuance of guidelines to help the market to distinguish insurance from other financial products.Is in thisfield where further investigations and legislative efforts should be directed *Sutor, ne ultra crepidam*.

Therefore, even though the draft Bill is at an advanced stage, the course can still be redressed. First, the draft Bill should be dropped as a pawn sacrifice. Second, the abolishment of the insurable interest requirement should be the next chess move. The fact that this path to the statute book will have no shortcuts should not be an excuse.