The legal nature of parametric insurance: is it truly a contract of insurance?

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Abstract

This article examines whether parametric insurance products fall within the legal definition of a "contract of insurance" under English law. It analyses common law principles, statutory frameworks, and regulatory interpretations, contrasting these with the flexible structure of parametric products. The paper explores implications for the legal concepts of risk transfer and insurable interest, and for regulatory compliance, highlighting the tension between innovation and legal certainty.

Key words

parametric insurance; Insurtech; contract of insurance; insurance law; risk transfer; risk transformation; Marine Insurance Act 1906; Consumer Insurance (Disclosure and Representations) Act 2012; Insurance Act 2015; financial services regulation; insurance regulation; regulatory compliance; regulatory definition; Financial Services and Markets Act 2000.

1. Introduction

Parametric insurance pays out a pre-agreed sum when pre-agreed triggers are met. It has existed since the late 1990s.[1] Its primary purpose is to quickly provide capital[2] to an insured[3] on the occurrence of a catastrophic loss, such as an earthquake or flood, which can be difficult to predict and/or quantify using traditional methods. Parametric insurance is also used in situations where it may not be possible to obtain insurance at all.[4] However, even where such difficulties exist, parametric insurance is typically used to complement traditional insurance programmes. Examples of situations in which parametric insurance products may be suitable include: agricultural losses, losses arising from extreme weather events, climate change, and, most notably in 2020, losses arising from global pandemics. With the increased attention on digital transformation in the insurance sector, parametric insurance products are fast becoming a key product for insurance companies. It is also beginning to penetrate the

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[1] Daniel Brettler, and Timothy Gosnear, 'Parametric Insurance Fills Gaps Where Traditional Insurance Falls Short' (*Insurance Journal*, 9 January 2019) <www.insurancejournal.com/news/international/2020/01/09/553850.htm> accessed 4 January 2026.

[2] Alex Kaplan, Holland Walls, Robert Patterson, and Kelly Greene, 'How Parametric Products Benefit Catastrophic-Driven Risk Transfer' (*AmWINS*, 19 March 2020) <https://www.amwins.com/resources-insights/article/how-parametric-products-benefit-catastrophe-driven-risk-transfer_09-18> accessed 4 January 2026.

[3] The terms insured, assured, and policyholder are often used interchangeably.

[4] Matthew Grant, 'Parametric Insurance: Is it the Future?' (*Insurance Thought Leadership*, 7 May 2020) <https://www.insurancethoughtleadership.com/parametric-insurance-is-it-the-future/> accessed 4 January 2026.

consumer insurance market, often as a standalone insurance product. For example, FloodFlash Limited, an InsurTech start-up which delivers sensor-based parametric insurance solutions for losses arising from flooding, made headlines during the early part of 2020 when it paid out claims relating to Storm Ciara in just one day after the flooding occurred.[5] In 2022, FloodFlash paid a claim in 3 hours and 50 minutes from when its sensor was triggered by flooding.[6] Other such examples include Blink Parametric, which delivers parametric insurance solutions for losses arising from travel disruption, Sensible Weather, which is designed to provide cover where weather-related disruptions impact outdoor activities, and Parametrix Enterprise Solutions, which is designed to pay out to cover costs associated with business interruptions caused by cloud outages.

Parametric insurance "fill[s] the gaps where traditional insurance falls short".[7] Fundamentally, though, where traditional general insurance products typically indemnify an insured for their actual losses, under the indemnity principle,[8] a parametric insurance product does not. In the case of a policy written on an indemnity basis, the insured suffers a loss, presents a claim to its insurers, the loss is examined/adjusted by the insurers, and the exact loss is paid out by the insurer subject to the terms, conditions, and exclusions, of the contract. A parametric insurance product, by contrast, pays out a predefined sum according to an objective 'trigger' which is agreed upon at the precontractual stage, so it is "relatively straightforward to establish objectively whether the conditions of payment have been fulfilled".[9] In some cases, a parametric product pays out before a loss occurs, allowing the insured to take steps to avoid or minimise a potential loss. For example, the United Nations and the government of Fiji jointly developed the 'Anticipatory Action Framework for Tropical Cyclones in Fiji' which uses forecast data to provide financial support and other types of support before cyclone damage even occurs.[10]

Simple parametric insurance will have a single trigger, for example a delay to a journey of X minutes or greater. More complex arrangements may have multiple, or layered, triggers. For example, a layered trigger could be linked to the existence of a hurricane, within a predetermined geographical location, which produces wind speeds in excess of a certain speed (miles per hour, or otherwise). More complex multi-layered triggers may exist – for example, hurricane speeds of between 111mph – 129mph will trigger a payment of £X, but if the same hurricane speeds subsequently reach between 130mph – 156mph, it will trigger an increased payment of £Y. The wording of the contract may or may not contain an anti-stacking clause.

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[5] Luke Gallin, 'FloodFlash pays claims one day after storm Ciara' (*Reinsurance News*, 11 February 2020) <https://www.reinsurancene.ws/floodflash-pays-claims-one-day-after-storm-ciara/> accessed 4 January 2026.
[6] Kirsty Hume, 'FloodFlash break claims record, paying client in full under 4 hours after flooding' (*FloodFlash*, 2 December 2022) <https://floodflash.co/floodflash-pay-claim-in-under-4-hours/> accessed 4 January 2026.
[7] Daniel Brettler, and Timothy Gosnear, 'Parametric Insurance Fills Gaps Where Traditional Insurance Falls Short' (*Insurance Journal*, 9 January 2019) <www.insurancejournal.com/news/international/2020/01/09/553850.htm> accessed 4 January 2026.
[8] Though for reasons explored within this paper, the indemnity principle is not strictly required to be present for a contract to be defined as a contract of insurance.
[9] Morten Broberg, 'Parametric Loss and Damage Insurance Schemes as a Means to Enhance Climate Change Resilience in Developing Countries' (2019), Climate Policy, 693.
[10] United Nations Office for the Coordination of Humanitarian Affairs and Government of Fiji, 'Fiji Tropical Cyclones - 2023 Anticipatory Action Framework (2023)' (15 November 2023) < https://www.unocha.org/publications/report/fiji/fiji-tropical-cyclones-2023-anticipatory-action-framework> accessed 4 January 2026.

The operation of a parametric insurance product is generally more predictable than traditional insurance since the triggers are objectively measured and easily validated. The value of payments is also predetermined. However, this rigidity can produce arbitrary outcomes for both insurers and insureds alike. Let us take the above hurricane example and assume that all triggers are met, but the maximum recorded hurricane speed was 110mph. It is very likely that the insured has still suffered a loss (and perhaps a catastrophic loss), but due to the rigidity of the parametric insurance policy, the insured will not receive a payment. On the other hand, it is equally possible for an insured to receive a payment from an insurer which may vastly exceed the loss actually suffered by the insured. The position could be ameliorated; for example, a parametric insurance contract containing a clause stipulating that a quantifiable loss must have occurred in excess of a *de minimis* threshold. However, this is not easily reconciled with the purpose of parametric insurance which aims to deliver capital quickly to the insured. Moreover, it may be difficult to predict whether a parametric insurance product will cover each loss as anticipated and so a solution could be to combine a parametric product with traditional insurance to avoid a gap in cover.

Despite the growth in the use and development of parametric insurance products, in 2016 the Law Commissions[11] stated that they had not seen any detailed legal analysis of parametric insurance products,[12] and nor has any detailed legal analysis taken place since. This paper will initially examine the present jurisprudence on what constitutes a contract of insurance in England and Wales, and why such an examination may be necessary. It will then consider whether parametric insurance products fall within the present definition of a contract of insurance. This paper does not attempt to provide a legal definition of parametric insurance; indeed, a legal definition of what constitutes parametric insurance does not exist. It is debatable whether such definition is strictly necessary: on the one hand, the characterisation as a contract of insurance has legal, regulatory and fiscal consequences, but on the other hand parametric products can be structured so as to meet the definitional elements of a contract of insurance. What will be clear from this examination is that parametric insurance may fall within the traditional definition of a contract of insurance, and carry with it certain legal and regulatory requirements, or it may not, depending on how the contract is structured.

2. Legally defining ‘contract of insurance’

2.1. Overview

Insurance is a mechanism in which an insured transfers the risk of an uncertain loss happening, of which the severity is also uncertain, with the certainty that, by the insured paying a fixed premium to an insurer, an insurer will indemnify the insured for the actual loss, subject to the agreed limits of cover.[13] In the case of life insurance, the uncertainty relates to when the death of the insured may occur, and the value of the payment is typically pre-determined under the terms of the contract rather than by reference to any loss. In its basic form, the premium is ‘pooled’ into what is known as a ‘premium pool’ from which the losses of the few are paid out from the funds

[11] Jointly the Law Commission of England & Wales and the Law Commission of Scotland.
[12] Law Commission and Scottish Law Commission, *Insurable interest and parametric policies* (April 2016), page 1.
[13] Robert Merkin, *Insurance Law: An Introduction* (1st edn., Taylor and Francis, 2007).

provided by all policyholders.[14] For this reason, a contract of insurance is also described as a contract of speculation, or an aleatory contract. Other types of speculative/aleatory contract exist, such as wagers, derivative contracts, and guarantees. This chapter examines why it can be critical to distinguish a contract of insurance from any other form of speculative/aleatory contract, and how such an examination can be achieved.

It is well documented that the phrase 'contract of insurance' lacks a unified and comprehensive legal definition.[15] Defining what constitutes a contract of insurance is not straightforward and a satisfactory definition has been described as being elusive.[16] Merkin suggests that the precise meaning of 'contract of insurance' rarely requires examining,[17] though some commentators have suggested that the task of attempting to define a contract of insurance is inescapable owing to the significant legislative reform in this area of law over the last decade.[18]

The starting position is that the law relating to contracts of insurance falls within the general law of contract[19] but there are features concerning contracts of insurance which differentiate them from general contracts. Indeed, three pieces of legislation apply directly to the terms of a contract of insurance, but not any other types of contracts, being: (1) the Marine Insurance Act 1906, (2) the Consumer Insurance (Disclosure and Representations) Act 2012, and (3) the Insurance Act 2015. Therefore, it is essential to be able to precisely identify when a contract falls within the definition of a contract of insurance. Most notably, because contracts of insurance are described as being contracts of utmost good faith,[20] imposing an obligation upon both the insurer and the insured to act in good faith during the pre-contractual stages of the relationship,[21] such as the duty of fair presentation in commercial contracts of insurance,[22] and a duty to take reasonable care not to make a misrepresentation to an insurer in consumer contracts of insurance.[23] The duty of good faith also governs the relationship between contracting parties throughout the balance of the contract of insurance; however, the precise nature of this duty is more complicated and nuanced.[24] Other key characteristics which distinguish ordinary contracts from contracts of insurance is the status of warranties, and the remedies an innocent party may be entitled to claim arising from a

[14] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-002.
[15] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-002; Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020), chapter 6.
[16] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-001.
[17] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-002.
[18] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-001.
[19] *Cehave v Bremer* [1976] QB 44, 71; Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-002.
[20] Marine Insurance Act 1906, s.17.
[21] The precise application of the duty of utmost good faith has undergone substantial reform, and its application differs between commercial and consumer contracts of insurance.
[22] Insurance Act 2015, s.3.
[23] Consumer Insurance (Disclosure and Representations) Act 2012, s.2(2).
[24] Peter MacDonald Eggers and Simon Picken, *Good Faith and Insurance Contracts* (4th edn., Routledge 2018), 61; Jonathan Hopkins, 'Business Interruption, Late Payments, and Bad Faith' (2020) 133 BILAJ.

breach of contract of insurance[25] which are dealt with specifically in the legislative regimes governing commercial and consumer contracts of insurance.[26]

Not only is it essential to ascertain whether the contract in question is a contract of insurance to understand the obligations between the contracting parties, it is also essential since certain activities relating to contracts of insurance are subject to regulation under the Financial Services and Markets Act 2000. In particular, "effecting" and "carrying out" contracts of insurance as principal are regulated activities;[27] where such activities are carried out by an unauthorised entity in breach of the general prohibition in s.19 of the Financial Services and Markets Act 2000, the resulting contract may be rendered unenforceable.[28] Moreover, insurers must not carry on any commercial business other than insurance business and activities directly arising from that business.[29] There are different accounting and taxation treatments applicable to contracts of insurance.[30] For example, an insured may be required to pay insurance premium tax in accordance with Part III of the Finance Act 1994, a breach of which can attract criminal and regulatory sanctions.

2.2. Legislative definition

Section 1 of the Marine Insurance Act 1906 defines a contract of marine insurance as, "contract whereby the insurer undertakes to indemnify the assured, in manner and to the extent thereby agreed, against marine losses, that is to say, the losses incident to marine adventure." However, this definition is self-contained such that it only applies to marine losses.

There is no comprehensive definition of "contract of insurance" contained within legislation that applies to all contracts of insurance. Two principal statutes governing the operation of insurance contract law, namely the Consumer Insurance (Disclosures and Representations) Act 2012 and the Insurance Act 2015, which both represent the most significant reform of insurance contract law in over a century, do not contain any definition, or guidance, on what constitutes a contract of insurance.

The Financial Services and Markets Act 2000, which, crucially, regulates insurance activities, also lacks a definition. Other less obvious statutes where a definition is missing includes the Unfair Contract Terms Act 1977, where a contract of insurance is carved out from the remit of the Act,[31] and the Third Parties (Rights against Insurers) Act 2010, which covers the transference of benefits and obligations under a contract of insurance to a

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[25] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-002.
[26] See Consumer Insurance (Disclosures and Representations) Act 2012, Schedule 1, and Insurance Act 2015, Schedule 1.
[27] Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) ("RAO"), Article 10.
[28] Financial Services and Markets Act 2000, s.20 and s.26; see also Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-001. Breach of the general prohibition is a criminal offence under s.23 of the Financial Services and Markets Act 2000 and is punishable by an unlimited fine and up to two years' imprisonment.
[29] PRA Rulebook, 'Conditions Governing Business', r.9.1 (as at 4 January 2026) < https://www.prarulebook.co.uk/pra-rules/conditions-governing-business/31-12-2025> accessed 4 January 2026.
[30] Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020), chapter 6.
[31] Unfair Contract Terms Act 1977, Sch. 1, para. 1(a).

third-party claimant where the insured becomes insolvent. Templeman J suggested that the imposition of a definition could have the adverse consequence of obscuring, or excluding that which ought to be included.[32] Conversely, Birds suggests that the lack of a definition of "contract of insurance" means that the UK regulators, that is the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"), have a considerably wide degree of discretion which can only be effectively challenged in court by means of declarative proceedings against the regulators.[33] In practice, it is more likely that non-insurers will seek a declaration where the regulator is claiming that a contract it has issued is in fact a contract of insurance.

Where legislation has attempted to provide a definition, it is typically self-serving and narrow. For example, the Counter-Terrorism and Security Act 2015 introduced an amendment into the Terrorism Act 2000 which makes it an offence for insurers to make a payment under a contract of insurance if they know or have reasonable cause to suspect, that an indemnity (or purported indemnity) of an insured's underlying loss arose wholly or partly in response to a demand for the purposes of terrorism.[34] The offence is inextricably linked to how a contract of insurance is defined within the inserted passage, "[t]he insurer *under an insurance contract* commits an offence if…".[35]

Somewhat helpfully, although broad in scope and therefore susceptible to dispute, s.17A(5) of the Terrorism Act 2000 provides the following definition:

> "*In this section* "insurance contract" means a contract under which one party accepts *significant insurance risk* from another party ("the policyholder") by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder" (emphasis added).

It is evident from the deployment of the phrase "[i]n this section…" that this definition is to be narrowly applied to the operation of terrorism offences in connection with contracts of insurance and within the meaning of s.17A of the Terrorism Act 2000. It is curious to note that legislators transposed the definition used within the International Financial Reporting Standard 4,[36] which, as documented within the Explanatory Note to the Counter-Terrorism Act 2015, is an accounting standard described as being, "…an industry accepted definition of "insurance contract" and extends to reinsurance contracts".[37] There is no further explanation as to what 'industry standard' means, but it is considered that it does not extend into the insurance or legal sectors as this paper illustrates.

As previously mentioned, the Financial Services and Markets Act 2000 is a significant piece of legislation since it governs and regulates activities pertaining to contracts of insurance which include the "effecting" and "carrying

[32] *Department of Trade and Industry v St Christopher Motorists' Association Ltd* [1974] 1 ALL ER 396.
[33] John Birds and Katie Richards, *Birds' Modern Insurance Law* (13th edn., Sweet & Maxwell, 2025), 1-09.
[34] Terrorism Act 2000, s.17A(1).
[35] ibid.
[36] Explanatory notes to the Counter-Terrorism Act 2015, 221.
[37] ibid.

out" of contracts of insurance as principal.[38] A breach of the Act may render the contract of insurance unenforceable[39] and can also attract criminal and regulatory sanctions. However, even though this piece of legislation creates a complex system of supervision and regulation,[40] there is no exhaustive definition of what constitutes a contract of insurance for the purposes of the Act. Article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544) ("RAO") defines a contract of insurance as "any contract of insurance which is a contract of long-term insurance or a contract of general insurance" which is further defined in Schedule 1 to the RAO. Unhelpfully, this definition is circular.[41] The Schedule provides lists of classes of general and long-term insurance products which fall within the scope of the Financial Services and Markets Act 2000, but does not set out any criteria for determining whether a particular contract is such a contract of insurance.

Deane points out that the definition at Article 3(1) also expressly includes examples of types of contracts which may not be contracts of insurance at common law (such as fidelity bonds, annuities, and guarantees) where they are effected by a non-bank and not merely incidental to some other business of the issuer, and Deane also notes that the definition excludes certain funeral plan contracts which would typically fall within the common law definition of a contract of insurance (although such plans are now regulated separately by the FCA).[42] Similarly, Article 12 of the RAO excludes from the scope of Article 10 certain types of vehicle breakdown insurance, while acknowledging that such contracts are in fact contracts of insurance.[43]

It is plain to see that, where the legislature has considered and provided for a definition of contract of insurance, it is generally self-serving for the purpose of the specific statute in question. Indeed, in respect of the definition contained within Article 3(1) of the RAO, it appears as though it is at odds with the common law definition of a "contract of insurance" with respect to certain types of contracts, in some cases depending on who issues the contract rather than its terms.

2.3. Common law definition

Almost all of the decided case law concerning the definition of a contract of insurance centres on whether or not the business was subject to insurance regulation or tax regulation.[44] Birds notes that only one or two cases are principally concerned with the operation of the insurance contract itself.[45] Judges tend to prefer to describe

[38] RAO, Article 10.
[39] Financial Services and Markets Act 2000, s.20 and s.26; Robert Merkin, *Colinvaux's Law of Insurance*, (14th edn., Sweet & Maxwell, 2025), 1-001.
[40] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-001.
[41] Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020), chapter 11.
[42] Practical Law Financial Services, 'What is a contract of insurance?', (Practical Law UK, Practice Note 9-504-7521, 2021); Financial Markets Law Committee, 'The words "similar contracts of guarantee" in the definition of "a contract of insurance" in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001' (2022) < https://fmlc.org/wp-content/uploads/2022/08/FMLCRE1.pdf> accessed 18 January 2026.
[43] It is notable that the approach of Article 12(1) of the RAO is to provide that "a contract of insurance" is excluded from Article 10(1) or 10(2) if it meets the criteria set out in Article 12, rather than to state that such a contract is not in fact a contract of insurance.
[44] John Birds and Katie Richards, *Birds' Modern Insurance Law* (13th edn., Sweet & Maxwell, 2025), 1-09.
[45] ibid.

features of a contract of insurance such as in the case of *Department of Trade and Industry v St Christopher Motorists' Association Ltd*,[46] and Megarry V.C. suggested in the case of *Medical Defence Union v Department of Trade* that a contract of insurance is a concept which is better described than defined[47] and, thus, a contract of insurance must be considered from the perspective of its substantive purpose.[48]

In the leading case[49] of *Prudential Insurance Co. v Commissioners of Inland Revenue*,[50] Channell J provided a number of key features which are required to be present for a contract to be defined as a contract of insurance:

> "It must be a contract whereby for some consideration, usually but not necessarily for periodical payments called premiums, you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event. Then the next thing that is necessary is that the event should be one which involves some amount of uncertainty. There must be either uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time there must be uncertainty as to the time at which it will happen. The remaining essential is that which was referred to by the Attorney-General when he said the insurance must be against something. A contract which would otherwise be a mere wager may become an insurance by reason of the assured having an interest in the subject-matter—that is to say, the uncertain event which is necessary to make the contract amount to an insurance must be an event which is prima facie adverse to the interest of the assured. The insurance is to provide for the payment of a sum of money to meet a loss or detriment which will or may be suffered upon the happening of the event."

Channell J's judgment has stood the test of time, and the relatively recent case of *Equitas Insurance Ltd v Municipal Mutual Insurance Ltd*[51] affirms this position. There are aspects of Channell J's definition which require individual examination.

2.3.1. Consideration/premium

As previously touched upon, fundamentally a contract of insurance is a contract. Therefore, consideration is a key element of all contracts to be enforceable.[52]

In consideration for transferring the risk to an insurer, the insured pays over what is known as a premium (although it does not have to be described as such in the contract). A characteristic of an insurance premium is that the value of the premium is not calculated with reference to the value of the insurer's actual performance under the contract, but to the likelihood that performance will be required. MacGillivray illustrates the difference with reference to

[46] [1974] 1 ALL ER 396.
[47] [1979] 1 ALL ER 421.
[48] *Lee v Jones* (1864) 17 CB (NS) 482; Peter MacDonald Eggers, and Simon Picken, *Good Faith and Insurance Contracts* (4th edn., Routledge, 2018), 1.22.
[49] Robert Merkin, *Insurance Law: An Introduction* (1st edn., Taylor and Francis, 2007).
[50] [1904] 2 KB 658.
[51] [2019] EWCA Civ 718.
[52] *Currie v Misa* (1875) LR 10 Ex 153; *Thomas v Thomas* (1842) 2 QB 851.

an engineer's remuneration; if the engineer undertakes work for remuneration that is fixed without reference to work actually undertaken, then the contract may be one of insurance.[53]

In consideration for the premium, an insurer agrees to hold the insured harmless to prevent any loss occurring. This principle is commonly described as a legal fiction since it is not possible for an insurer to comply with such promise.[54] This principle is also known as the 'risk transfer' criterion for defining a contract of insurance which is not developed in Channell J's definition.[55]

2.3.2. Benefit/indemnity

A contract of insurance must commit the insurer to an obligation to pay, or an equivalent obligation to confer a benefit to the insured such as a promise to provide services or non-monetary benefits.[56] Therefore, if under a contract an 'insurer' is only obliged to consider whether to make a payment, or equivalent, and that payment is at the absolute discretion of the 'insurer', then the contract in question does not meet the definition of a contract of insurance. This is illustrated in the case in *Medical Defence Union v Department of Trade*[57] - members could call upon the Medical Defence Union to provide costs in defending and paying claims which its members faced. The Medical Defence Union paid such costs at its absolute discretion, according to its constitution, and even though it was rare that it exercised such discretion not to pay out, the contract between the Medical Defence Union and its member did not fall within the definition of a contract of insurance. A mere requirement to consider making a payment upon the occurrence of a loss is not sufficient.[58] The FCA has cast some doubt over the status of discretionary contracts, stating that: "this may involve circumstances where we consider the discretion to have no real content or to be an unfair term. In these cases, our view is that the contracts should properly be categorised as insurance".[59] However, despite stating that "this issue was first publicly raised in June 2019", at the time of writing the FCA does not appear to have taken any action in response to such concerns, and a number of discretionary products continue to be provided, including to consumers.

The concept of indemnity has been described by Brett LJ as "the controlling principle in insurance law".[60] Furthermore, in the case of *Callaghan v Dominion Insurance Co*[61], it was stated that an essential element to the definition of a contract of insurance is for an insured, "…to be put by the insurer into the same position in which the insured would have been had the event not occurred, but in no better position". However, although the principle

[53] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-002.
[54] *Teal Assurance Company Limited v W R Berkley Insurance (Europe) Limited and another* [2013] UKSC 57. An examination of the 'hold harmless' principle is outside the scope of this paper; see *Firma C-Trade SA v Newcastle Protection and Indemnity Association, The Fanti; Socony Mobil Oil Inc v West of England Shipowners Mutual Insurance Association (London) Ltd, The Padre Island (No 2)* [1990] All ER 702, 717.
[55] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-018.
[56] *Department of Trade and Industry v St Christopher Motorists' Association Ltd* [1974] 1 ALL ER 396.
[57] [1979] 1 ALL ER 421.
[58] John Birds and Katie Richards, *Birds' Modern Insurance Law* (13th edn., Sweet & Maxwell, 2025), 1-11.
[59] FCA Perimeter Report, published 15 July 2022 and updated 25 March 2025, accessed 7 January 2026 < https://www.fca.org.uk/publications/corporate-documents/perimeter-report#lf-chapter-id-firm-business-models-general-insurance-perimeter>.
[60] *Castellain v Preston* (1883) 11 QBD 380, 386.
[61] [1997] 2 Lloyd's Rep 542.

of indemnity underscores most contracts of insurance, it is not an essential criterion for a contract to be classified as a contract of insurance,[62] for example, a life insurance policy does not typically provide an indemnity. Instead, a predetermined figure is paid out on surrender or on the death of a life assured.[63] Merkin argues that there are numerous factors which, due to their operation, diminishes the notion that the indemnity principle is paramount, such as: the application of a deductible, a limit of indemnity, valued policies (where instead of an indemnity, a payment of a fixed pre-determined figure is paid upon the occurrence of an uncertain event), "new for old" policies, and contingency policies.[64] This position is further supported by the Law Commissions.[65]

2.3.3. Uncertain event

A contract of insurance is based on fortuity. Therefore, the benefit/indemnity[66] must be payable upon the occasion of an event, which is either uncertain as to whether it will happen, or when it will happen,[67] and outside the control of the insurer and the insured. Uncertainty is a necessary requirement of a contract of insurance.[68]

2.3.4. Insurable interest

The Law Commissions describe the presence of insurable interest as a "hallmark" of insurance.[69] Arnold-Dwyer argues that the wording and operation of the Marine Insurance Act 1906 has the effect that the lack of an insurable interest (discussed later in this paper) renders a contract of marine insurance void; this means that the Marine Insurance Act 1906 requires the presence of an insurable interest for the contract to fall within the definition of a contract of insurance.[70] Birds notes that it is a basic requirement of any contract of insurance unless it is lawfully waived.[71] In its basic form, insurable interest means that the insured must have a particular relationship with the subject matter insured, the absence of which will render the contract illegal, void, or unenforceable, or will prevent a valid claim under the contract.[72] Arnold-Dwyer illustrates that earlier cases are inconsistent as to the consequence of an absence of an insurable interest.[73] Arnold-Dwyer also concludes that "the existence of an interest in the insured subject-matter is a definitional characteristic of contract of indemnity insurance".[74]

[62] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-015.
[63] ibid.; *Todd v Alterra at Lloyd's Ltd* [2016] FCAC 15; *Chubb Insurance Company of Australia Ltd v Robinson* [2016] FCAFC.
[64] Robert Merkin, *Insurance Law: An Introduction* (1st edn., Taylor and Francis, 2007).
[65] Law Commission and Scottish Law Commission, *Issue Paper 4 – Insurable Interest* (January 2008).
[66] Though, as discussed, a strict indemnity is not a mandatory requirement.
[67] Such as life insurance policies; *Gould v Curtis* [1913] 3 KB 84; also see *Prudential Insurance Co v Commissioners of Inland Revenue* [1904] 2 KB 658.
[68] John Birds and Katie Richards, *Birds' Modern Insurance Law* (13th edn., Sweet & Maxwell, 2025), 1-12.
[69] Law Commission and Scottish Law Commission, '*Insurance Contract Law: Post Contract Duties and other Issues'* (Law Com CP No 201, December 2011), 12.6; Law Commission and Scottish Law Commission, '*Issue Paper 10 – Insurable Interest: Updated Proposals'* (March 2015), 2.3.
[70] Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020), chapter 11.
[71] John Birds and Katie Richards, *Birds' Modern Insurance Law* (13th edn., Sweet & Maxwell, 2025), 3-01.
[72] ibid.
[73] Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020); *Goddard v Garrett* (1692) 23 ER 771; *Lynch v Dalzell* (1729) 4 Bro PC 431; *Sadlers' Company v Badcock* (1743) 2 Atk 554.
[74] Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020); see also *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38 where Lord Mance said that a credit default swap agreement with no insurable interest is not, legally speaking, credit insurance.

However, non-indemnity insurance contracts are treated differently. For example, in life insurance, insurable interest is only required at inception of the contract.[75] As such, if insurable interest is lost during the balance on the life insurance policy, it is still enforceable such that the existence of insurable interest is not a definitional aspect of non-indemnity insurance as it is for indemnity insurance.

2.4. Regulatory definition

As previously stated, effecting and carrying out of contracts of insurance are activities which are regulated under the Financial Services and Markets Act 2000, but the Act does not define what constitutes a contract of insurance. A circular definition is provided within Article 3(1) of the RAO:

> "any contract of insurance which is a contract of long-term insurance or a contract of general insurance, and includes—
>
> (a) fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds or similar contracts of guarantee, where these are—
>   (i) effected or carried out by a person not carrying on a banking business;
>   (ii) not effected merely incidentally to some other business carried on by the person effecting them; and
>   (iii) effected in return for the payment of one or more premiums;
>
> (b) tontines;
>
> (c) capital redemption contracts or pension fund management contracts, where these are effected or carried out by a person who—
>   (i) does not carry on a banking business; and
>   (ii) otherwise carries on a regulated activity of the kind specified by article 10(1) or (2);
>
> (d) contracts to pay annuities on human life;
>
> (e) contracts of a kind referred to in article 1(2)(e) of the first life insurance directive (collective insurance etc.); and
>
> (f) contracts of a kind referred to in article 1(3) of the first life insurance directive (social insurance);
>
> but does not include a funeral plan contract (or a contract which would be a funeral plan contract but for the exclusion in article 60)"

Further difficulty arises with the above definition, since it extends the definition to includes fidelity bonds and contracts of guarantee which are not generally considered to be contracts of insurance at common law (if they were, the wording in Article 3(1) referencing them would be superfluous), and excludes certain funeral plans which would be considered contracts of insurance law at common law.[76] As stated earlier in this paper, definitions

[75] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 4-016.
[76] Financial Conduct Authority's Perimeter Guidance manual, 5.3.2 G.

found in legislation are typically self-serving. The RAO defines and specifies what constitutes a regulated activity for the purpose of financial services regulation. As such, the FCA states that "if the common law is unclear as to whether or not a particular contract is a contract of insurance, the FCA will interpret and apply the common law in the context of and in a way that is consistent with the purpose of the Act (i.e. the Financial Services and Markets Act 2000) as expressed in the FCA's statutory objectives.[77]

Functionally, contracts of insurance and guarantees are very similar. The effect of extending the common law definition of insurance to include "fidelity bonds, performance bonds, administration bonds, bail bonds, customs bonds or similar contracts of guarantee" is that insurers can issue such contracts without being in breach of PRA Rulebook 'Conditions Governing Business', rule 9.1 (commonly known as the "internal contagion" rule) which requires insurers to limit their activities to insurance business. Similarly, the express reference to annuities makes it clear that long-term insurers offering pension contracts which include an obligation to provide an annuity are, when doing so, carrying on insurance business. The other types of contract listed in Article 3(1) reflect the UK's previous implementation of various EU long-term insurance directives, now subsumed into Solvency II (2009/138/EC). However, it is questionable whether either tontines or capital redemption contracts are consistent with the requirement under English common law for there to be an insurable interest (see above). This emphasises the fact that the definition of a contract of insurance for the purposes of the Financial Services and Markets Act 2000 is not entirely identical with the definition under common law.

The FCA has produced guidance, which has been described as inconclusive,[78] that sets out principles and factors that it considers are relevant in deciding whether a contract is a contract of insurance. This guidance is in Chapter 6 of the Financial Conduct Authority's Perimeter Guidance manual ("PERG"). PERG 6.5.1 identifies that the starting position for identifying whether a contract is a contract of insurance is the case of *Prudential Insurance Co. v Commissioners of Inland Revenue*[79] and Channell J's definition (examined above). However, the FCA recognises that the common law definition is not exhaustive, but simply serves to provide general guidance.[80] In addition, the FCA's interpretation may not be shared by the courts (whether considering it in a regulatory context or more widely), although the experience (not just in the context of insurance) is that the FCA's guidance in PERG tends to carry significant weight, particularly where it clearly addresses a point being considered by the court.

The FCA will attach more weight to the substance of the contract, rather than the form of the contract and will examine whether a contract contains "an identifiable and distinct obligation that is, in substance, an insurance obligation".[81] MacGillivray concludes that the meaning of 'insurance obligation' is "shorthand for an assumption for valuable consideration of an obligation to pay money or to provide a benefit in response to an uncertain event

[77] ibid, 6.5.3 G
[78] Oskari Juurikkala, 'Credit Default Swaps and Insurance: Against the Potts Opinion' (2011) 26(3) JIBLR 128.
[79] [1904] 2 KB 658.
[80] Financial Conduct Authority's Perimeter Guidance manual, 6.3.3 G.
[81] ibid., 6.5.4 G, 6.6.7 G.

adverse to the interest of the recipient".[82] MacGillivray further concludes that the FCA's definition is wide and, as a result, the FCA will "find insurance in unlikely places".[83]

Within a regulatory context, even if a small element of a contract appears to meet the definition of a contract of insurance, the whole contract could be treated as though it is a contract of insurance. This is in direct contrast to the common law position: either a contract as a whole falls to be defined as a contract of insurance, or it is not – a contract as a whole will only fall to be a contract of insurance if the primary purpose of the contract is to insure.[84]

Lastly, the minutes of the Financial Markets Law Committee meeting which took place on 10 December 2020 noted that the definition of a 'contract of insurance', within the meaning of Article 3(1) of the RAO is broad and difficult to interpret.[85] In 2022, the Financial Markets Law Committee expressed particular concern around what is precisely meant by "similar contracts of guarantee" and made three recommendations to mitigate against the uncertainty it causes.[86]

In addition to the above, and through a slightly different regulatory perspective, regulation 5 of The Risk Transformation Regulations 2017 amends the Financial Services and Markets Act 2000 regime by introducing a new regulated activity: 'Transformer vehicles: insurance risk transformation'. A transformer vehicle is a special purpose vehicle that assumes insurance risks by way of an undertaking where the legal *or economic effect* is the transfer of an insurance risk to the transformer vehicle (which is subsequently transferred into the capital markets via non-insurance instruments).[87] Parametric products are not created by The Risk Transformation Regulations 2017. However, they can be used by transformer vehicles to transfer insurance risks into the capital markets: (1) at the insurance layer (i.e. the incoming risk), (2) the capital markets layer (i.e. the outgoing risk), (3) or both layers. Crucially, the regulatory distinction between the incoming insurance risk and the outgoing capital markets instrument means that parametric triggers can be used on the capital markets side without engaging insurance law concepts such as insurable interest or indemnity.

Under The Risk Transformation Regulations 2017, the incoming risk transferred to the transformer vehicle must be a risk assumed under a contract of insurance (i.e. the underlying contract must be a contract of insurance).

[82] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-009; see also PERG 6.3.4 G.
[83] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-009.
[84] *Fuji Finance Inc. v Aetna Life Insurance Co Ltd* [1994] 4 All ER 1025; Robert Potts QC, Erskine Chambers, prepared for the International Swaps and Derivatives Association (24 June 1997).
[85] Financial Markets Law Committee (2020), 'Item: Other – Section 3 of the RAO – Definition of contract of insurance (Chair: Peter Bloxham)', *Minutes of Financial Markets Law Committee meeting 10 December 2020*, London <http://fmlc.org/wp-content/uploads/2021/01/FMLC_UP_11710052_v_1_Minutes-FMLC-videoconference-10-December-2020.pdf> accessed 4 January 2026.
[86] Financial Markets Law Committee, 'The words "similar contracts of guarantee" in the definition of "a contract of insurance" in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001' (2022) < https://fmlc.org/wp-content/uploads/2022/08/FMLCRE1.pdf> accessed 4 January 2026.
[87] UK Government, 'Changes to the Risk Transformation Regulations: Consultation', <https://www.gov.uk/government/publications/changes-to-the-risk-transformation-regulations/changes-to-the-risk-transformation-regulations-consultation-accessible?utm_source=chatgpt.com#risk-transformation> accessed 4 January 2026; s.5 of The Risk Transformation Regulations 2017.

Accordingly, where the incoming risk is parametric, it must still satisfy the requirements of a contract of insurance, including insurable interest and (where applicable) indemnity. The transformer vehicle does not issue insurance contracts to investors; instead, it issues non-insurance instruments. For example, a transformer vehicle may assume a parametric insurance risk from an insurer, and then transfer the risk into the capital markets using non-insurance instruments whose payment mechanics reference the same or a related parametric trigger.

Therefore, a transformer vehicle does not convert a parametric insurance contract into a non-insurance contract, but rather that it enables a clean separation between: (i) the insurance contract at the incoming layer, which must satisfy insurance law requirements, and (ii) the outgoing non-insurance instrument, which may use parametric triggers without those constraints. The distinguishing features between the parametric insurance and parametric instrument may well be subtle, for example the inclusion or absence of an insurable interest, but as illustrated, it is an important question. Nonetheless, given that the underlying (incoming) risk transferred to the transformer vehicle must be risk assumed under a contract of insurance, the underlying contract must still be capable of being characterised as a contract of insurance.

Differentiating contracts of insurance from other speculative/aleatory contracts

Thus far, it is evident that the common law approach, and the regulatory approach to defining what constitutes a contract of insurance can be conflicting and complex. It is often necessary to consider closely contracts of insurance against other contracts of speculation in a bid to further draw out the distinctions. For example, if a parametric contract resembles a derivative more than an indemnity, then it may suggest that the parametric contract falls outside the definition of a contract of insurance.

2.4.1. Wagers

A wager, or wagering contract, is a speculative/aleatory contract in that the risk of loss is the wager/bet itself. As defined by Hawkins J in *Carlill v Carbolic Smoke Ball Co*:[88]

> "[A] wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent upon the determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, whether he will win or lose being dependant on the issue of the event, and therefore, remaining uncertain until the issues is known."

Therefore, there is no underlying risk of loss an insured possesses independently from the conclusion of the wagering contract.[89] This focusses the attention onto the subject matter of the contract – and the insured's

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[88] [1892] 2 QB 484.
[89] *Wilson v Jones* (1867) LR 2 Ex 139*; Carlill v Carbolic Smoke Ball Co* [1892] 2 QB 484; *Sharp v Sphere Drake Insurance Plc* [1992] 2 Lloyd's Rep 501; *The Maira (No. 2)* [1984] Lloyd's Rep 660.

relationship (or lack of relationship) with that subject matter – as a differentiator between wagering contract and contracts of insurance.[90]

2.4.2. Contracts of guarantee

A guarantee is a promise from a third party to ensure that a party to a contract fulfils their obligations under that contract. The case of *Seaton v Heath*[91] sets out a useful definition and differentiates a guarantee from a contract of insurance:

> "A guarantee is where, upon the negotiation for a contract, one of the parties requires, as a condition of his entering into the contract, that a third person shall enter into a collateral undertaking that the other party will perform the contract, and at the instance of the latter the third person enters into that collateral undertaking. In the case of a guarantee, the principal debtor gets credit on the faith of the guarantee, and the consideration for the guarantee is the entering into the contract, performance of which is guaranteed. Insurance, on the other hand, is where some risk incurred is insured against in consideration of a premium."

Therefore, it is necessary to closely examine the relationship between the parties to a contract and to consider the substance of each party's obligations to ascertain whether a contract is one of guarantee, or insurance.[92]

Having said that, Deane argues that it is possible for contracts of guarantee to equally fall within the definition of a contract of insurance with reference to the regulatory definition contained at Article 3(1) of the RAO which expressly includes guarantees within the definition of a contract of insurance in certain circumstances.[93]

2.4.3. Credit default swaps

The characteristics common to all types of derivative contracts are: (1) the contract is bilateral, (2) the contract is settled at a future date, and (3) the value of the contract derives from the value of the contract's underlying asset.[94]A credit default swap is a sub-class of derivative contract which allows a purchaser to offset its credit risk with another investor.[95] Economically, a credit default swap "functions like an insurance policy, with the swap buyer paying the swap seller a premium to protect against losses resulting from a defined credit event."[96] The

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[90] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-012.
[91] [1899] 1 QBD 782, 784; approved in *Re Denton's Estate* [1904] 2 Ch 178.
[92] Practical Law Financial Services, 'Contracts of insurance under FSMA?', (Practical Law UK, Practice Note 9-504-7521, 2021).
[93] ibid.
[94] Practical Law Financial Services, 'Derivatives: overview (UK)', (Practical Law UK, Practice Note 8-385-8330, 2021).
[95] Arthur Kimball-Stanley, 'Insurance and Credit Default Swaps: Should Like Things Be Treated Alike?' (2008) 15 Conn Ins LJ 241, 243.
[96] Erik Banks, Morton Glantz, and Paul Siegel, *Credit Derivatives: Techniques to Manage Credit Risk for Financial Professionals,* (McGraw-Hill Education, 2006), 33.

argument for treating a credit default swap as a contract of insurance centres around the fact that both contracts create similar moral hazards.[97]

Robert Potts QC prepared an Opinion for the International Swaps and Derivatives Association (known as the Potts Opinion), principally to advise upon whether a credit derivative could be characterised as a contract of insurance (amongst other concepts).[98] Potts concluded that the economic effect of credit derivatives can be similar to the economic effect of a contract of insurance[99] but that a credit default swap lacks the necessary requirement of an insurable interest and an indemnity requirement which is necessary for the definition of a contract of insurance to be met.

While it is widely accepted within the financial industry that a credit default swap falls outside the definition of a contract of insurance,[100] and specifically, the UK relies upon the Potts Opinion to reach such a conclusion,[101] it is challenging to reconcile. Juurikkala concludes that some scholars' interpretation of what constitutes the definition of a contract of insurance "clearly applies to some [credit default swaps]" and that, while the regulatory guidance does not make specific reference to credit default swaps, it includes "many points that challenge the Potts Opinion".[102] Indeed, Juurikkala specifically argues that the Potts Opinion is incorrectly applied because a contract of insurance does not necessarily require an insured to have suffered a loss.[103]

Kimball-Stanley concludes that lawyers, scholars, and regulators (in the USA and the UK) consider that, although there are similarities between credit default swaps and contracts of insurance, the difference in the objectives associated with each is sufficient to treat them differently.[104] The objective of insurance is to transfer risk, which provides financial security. Credit default swaps aims to transfer credit risk in financial markets; they can be used for hedging or they can be used for speculative investment by betting on or against the creditworthiness of an entity. The State of New York went a step further than the position in the UK and introduced legislation which excludes credit default swaps from the definition of a contracts of insurance[105] and any ambiguity as to how principles under a contract of insurance arose are to be settled in favour of the insured.

[97] Arthur Kimball-Stanley, 'Insurance and Credit Default Swaps: Should Like Things Be Treated Alike?' (2008) 15 Conn Ins LJ 241, 246; Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020), chapter 6.
[98] Robert Potts QC, Erskine Chambers, prepared for the International Swaps and Derivatives Association (24 June 1997).
[99] ibid.
[100] Oskari Juurikkala, 'Credit Default Swaps and Insurance: Against the Potts Opinion' (2011) 26(3) JIBLR 128.
[101] *Credit Suisse International v Stichting Vestia Group* [2014] EWCH 3103 (Comm).
[102] Oskari Juurikkala, 'Credit Default Swaps and Insurance: Against the Potts Opinion' (2011) 26(3) JIBLR 128.
[103] ibid.; Law Commission and Scottish Law Commission, *Issue Paper 4 – Insurable Interest* (January 2008).
[104] Arthur Kimball-Stanley, 'Insurance and Credit Default Swaps: Should Like Things Be Treated Alike?' (2008) 15 Conn Ins LJ 241, 247.
[105] New York Consolidated Laws, Insurance Law - ISC § 6901; Andrea Kramer, Alton Harris, and Robert Ansehl, 'The New York State Insurance Department and Credit Default Swaps: Good Intentions, Bad Idea' (2009) 22 JT Reg FInst 29; Franziska Arnold-Dwyer, *Insurable Interest and the Law* (1st edn., Routledge, 2020), chapter 6. Although the referenced regime is no longer the present situation.

2.5. Other jurisdictions

In Europe, a voluntary insurance contract law regime was drafted to harmonise the insurance law contract regime across European States. Article 1:201 of the Principles of European Insurance Contract Law defines an insurance contract as, "*a contract under which one party, the insurer, promises another party, the policyholder, cover against a specified risk in exchange for a premium*". This definition is evidently narrower than that of Channell J.

In the United States of America, a key defining characteristic of a contract of insurance is the risk transfer mechanism from an insured to an insurer, and the pooling and distribution of losses among a wider community.[106] Similarly to the UK, in Australia, the Full Federal Court of Australia in the case of *Todd v Alterra at Lloyd's Ltd (on behalf of the underwriting members of Syndicate 1400),*[107] held that in defining a contract of insurance, the starting position is the definition provided for by Channell J, though the Australian courts may then go on to consider the nature of the contract and how it came into existence, whether the aim is to transfer risk, and how the contract is performed to reach a definitive conclusion.

2.6. Conclusion on definition of 'contract of insurance'

It remains the case that defining a contract of insurance is challenging. It is further complicated by the fact that the common law and the regulatory definitions diverge to some degree, creating the possibility of certain contracts falling to be defined as a contract of insurance in the regulatory context, but not in respect of the common law approach – for example, fidelity bonds, annuities, and guarantees. Indeed, the common law approach, and in particular Channell J's definition, prescribes certain aspects that must be present for a contract to be defined as a contract of insurance. As this paper has demonstrated, the requirements are no longer as rigid as, probably, initially contemplated by Channell J. It is clear that the distinction needs to be drawn to understand the applicability of various obligations that arise from a contract of insurance, such as regulatory, tax, risk presentation, and criminal liability. Some jurisdictions, such as the USA, focus upon the objective of a contract of insurance; i.e. the presence of risk transference and pooling and distribution of losses among a wider community. Perhaps further legislative involvement is needed to narrow and refine the definition of a contract of insurance because, as demonstrated, it is not easy to pin-point a consistent definition of a contract of insurance, still less a comprehensive one.

[106] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-011; *Group Life & Health Insurance Co v Royal Drug Co* 440 US 205 (1979); *Union Labor Life Insurance Co v Pireno* 458 US 119 (1982); John Pruitt, 'Insurance and reinsurance in the United States: overview', (Practical Law UK, 2021).
[107] [2016] FCAFC 15.

3. Defining 'Parametric Insurance'

3.1. Overview and definition of parametric insurance

There is no definition of parametric insurance, legal or otherwise. The Law Commissions suggest that in its simplest form, a parametric insurance product provides for a fixed sum to be paid upon the occurrence of an event, without the insured having to demonstrate *the extent* of loss (emphasis added).[108]

The Law Commissions illustrate the operation of a parametric insurance product with the following example:

> "An insurer seeks to cover its exposure to hurricane losses in Florida. It buys [a parametric product] which, in order to prompt a pay-out, requires a "triple trigger":
>
> (1) Florida must be exposed to a hurricane classified as at least Category 4 on the Saffir-Simpson scale;
> (2) the total industry insured loss from the hurricane must be above $10 billion; and
> (3) the relevant insurer does receive some hurricane-related claims."[109]

The Law Commissions identify that industry members are keen to be able to structure parametric products so as to fall within the definition of either a contract of insurance or, alternatively, a derivative contract.[110] This causes some difficulty. In enabling industry members such flexibility, the determining factor appears to be the *extent* of a loss an insured experiences.

3.2. Application to traditional definitions of contract of insurance

By applying the Law Commissions' simple definition, and the characteristics of a parametric insurance product to Channell J's definition, little difficulty can be found in applying the requirements of: (1) consideration/premium, and (2) uncertain event. However, some difficulty arises when considering the requirements of: (3) benefit/indemnity, and (4) insurable interest.

3.2.1. Benefit/indemnity

Upon the pre-determined triggers being met, an insurer is compelled to make a payment under a parametric insurance product. Therefore, the rule established in *Medical Defence Union v Department of Trade*[111] does not apply to parametric insurance products. Furthermore, it is now accepted, as previously highlighted, that the presence of the indemnity principle is not a prerequisite to a contract falling within the definition of a contract of

[108] Law Commission and Scottish Law Commission, *Insurable interest and parametric policies* (April 2016), 1.1.
[109] ibid., 1.7.
[110] ibid., 20.
[111] [1979] 1 ALL ER 421.

insurance.[112] The difficulty arises because a parametric insurance product, at first blush, falls within the definition of a contingency contract of insurance. The Law Commissions state that the wordings of parametric insurance products that they have seen require the insured to demonstrate at least a nominal element of loss, adding an element of indemnity, which in turn distinguishes it from a contingency contract of insurance, which is not dependent on actual loss being suffered as long as the defined event occurs.[113] This is a marginal distinction and the 'insurer' is free to pivot its product between that of a derivative contract, and that of a contract of insurance, with a very subtle change to the contract drafting. By drafting the contract to include a (small) indemnity trigger, it would comfortably fall within the established common law definition of a contract of insurance. This approach shares similarity with valued policies where the insurer and the insured agree in advance the value of property during the pre-contracting stage. If a total loss occurs, the insurer pays to the insured the pre-agreed value. This type of policy is traditionally used where, for example, it is difficult to determine the exact market value of the insured property due to its uniqueness. For payment to be made under the policy, the insured has to prove that they have suffered the relevant loss, but not the value of the loss.[114]

Despite the subtle difference, industry members were keen to emphasise to the Law Commission that there must be a distinction between derivative contracts and contracts of insurance.[115]

3.2.2. Insurable interest

As previously demonstrated, the Law Commissions describe the presence of insurable interest as a "hallmark" of insurance.[116] Both the insurance industry and the derivatives industry heavily rely upon the Potts Opinion which concluded that derivatives were not contracts of insurance because there is no requirement to demonstrate an insurable interest.[117] The position is presently unclear in terms of parametric insurance. But applying that logic, if a contract is structured in such a way that mandates the presence of an insurable interest, by connecting the objective trigger(s) to the potential loss of the insured (in other words, the insured must stand to lose financially if the event that triggers cover occurs, such as damage to property and/or a reduction in revenue), the contract would more likely be classified as a contract of insurance.

[112] Robert Merkin, *Colinvaux's Law of Insurance* (14th edn., Sweet & Maxwell, 2025), 1-016; Law Commission and Scottish Law Commission, *Issue Paper 4 – Insurable Interest* (January 2008).
[113] Law Commission and Scottish Law Commission, *Insurable interest and parametric policies* (April 2016), 1.22.
[114] See s.27(3) of the Marine Insurance Act 1906.
[115] Law Commission and Scottish Law Commission, *Insurable interest and parametric policies* (April 2016), 1.18.
[116] Law Commission and Scottish Law Commission, '*Insurance Contract Law: Post Contract Duties and other Issues'* (Law Com CP No 201, December 2011), 12.6; Law Commission and Scottish Law Commission, '*Issue Paper 10 – Insurable Interest: Updated Proposals'* (March 2015), 2.3.
[117] Law Commission and Scottish Law Commission, *Insurable interest and parametric policies* (April 2016), 1.18.

3.3. Application to regulatory definition

Since the FCA will examine whether a contract contains *"an identifiable and distinct obligation that is, in substance, an insurance obligation*",[118] which is wide in its application,[119] the FCA may well find that parametric insurance products fall within the regulatory definition of a "contract of insurance". However, there is no specific FCA guidance published in respect of parametric insurance.

4. Conclusion

This paper has already detailed the consequences that stem from a contract falling within the definition of a contract of insurance. Seemingly, a parametric insurance product can be structured as a derivative contract or as a contract of insurance depending on the wording of the contract. If there is a requirement for there to be an insurable interest and the insured is required to demonstrate at least a nominal element of loss as a condition of payment under the contract, the contract more likely to classified as a contract of insurance. If those elements are not present, then it is likely that the contract will be a derivative. The Law Commissions stressed that industry members were extremely keen to preserve the ability to structure a parametric contract as a derivative or as a contract of insurance. The difference appears marginal in terms of economic effect, and not immune to criticisms similar to that of the Potts Opinion. The clear difference between the substance of the Potts Opinion, however, is that it produced an affirmative conclusion that derivatives contracts were not contracts of insurance, even if their commercial effect may be very similar. Parametric insurance products are less delineated and can be structured in more than one way. Although this gives parties maximum flexibility, this could catch parties out when it comes to enforcing certain requirements or remedies, as previously described.

[118] Financial Conduct Authority's Perimeter Guidance manual, 6.6.7.
[119] Ben Lynch KC, Franziska Arnold-Dwyer, John Birds, and Simon Paul, *MacGillivray on Insurance Law* (16th edn., Sweet & Maxwell, 2025), 1-009.