

## **Insurance Law Committee response to the Law Commission and Scottish Law Commission's consultation on the draft Insurable Interest Bill**

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The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of the Law Commission and Scottish Law Commission's consultation on the draft Insurable Interest Bill has been prepared by the CLLS Insurance Law Committee (the "Committee").

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The Law Commission and the Scottish Law Commission have published a draft Insurable Interest Bill (the "Bill") and notes to accompany the draft Bill, together with a list of questions for consultees.

The Committee's responses to the questions are set out below.

### **CLAUSE 1: DEFINITIONS**

*Q1. Do consultees agree that personal accident critical illness, disability and other insurances dependent on human life be subject to the same insurable interest rules as life insurance?*

The Committee has no comments on this question.

*Q2. Do consultees consider that the definition of “life-related insurance” works for insurance-linked investment products, and annuities?*

The Committee considers that the proposed definition of the “insured” is unnecessarily restrictive and might disqualify contracts taken out by a person on behalf of another, for example where pension fund trustees contract through a common investment fund or where there is a requirement for the insurance contract to be issued to a depositary. This concern could be addressed if the definition of “insured” were to be amended to read: “means the party to a contract of insurance who is the insured under the contract or the person for whose benefit the contract is made”.

## **CLAUSE 2: LIFE-RELATED INSURANCE**

*Q3. Do consultees consider that this non-exhaustive list is appropriately drawn to cover all the key situations in which an insured should be able take out insurance over another person?*

The Committee is in principle in favour of the non-exhaustive list, although it considers that the incorporation of the non-exhaustive list into the definition of insurable interest is problematic. Previously, the Law Commissions suggested that there would be a definition of “insurable interest”, followed by a separate non-exhaustive list.

The Committee considers that conflating the definition with a non-exhaustive list, and repealing all other relevant laws, will create a lacuna in the law. As currently drafted, it is unclear how the courts should establish the existence or otherwise of an insurable interest where none of clause 2(2)(a) to (f) of the draft Bill are satisfied. Accordingly, the Committee recommends that the Bill includes a general definition, in the terms of clause 2(2)(f), and a non-exhaustive list of circumstances where the insurable interest is assumed without having to satisfy the general definition.

The Committee also considers that the non-exhaustive list does not clearly cater for policies taken out by Local Government Pension Schemes (“LGPS”). The administrators of LGPSs are not trustees (although it is considered that they have certain trustee-like responsibilities) and so they would not fit within the test set out in clause 2(2)(d). It is considered by the Committee to be equally undesirable for there to be legal uncertainty over the status of insurance policies taken out by an LGPS, not least given that the relative investment regulations expressly permit an LGPS to invest in a Class III policy.

In addition, the Committee considers that the non-exhaustive list does not clearly cover all cases of group life insurance:

- a. This type of insurance does not always involve a trustee, so it would not necessarily fall within the scope of clause 2(2)(d) of the Bill.

- b. Employees may join a company after the group policy is taken out, meaning that at the time the policy is taken out, the policyholder lacks an insurable interest in respect of those future employees.

Accordingly, the Committee recommends that the Bill clarifies the position regarding such schemes and suggests that it may be appropriate to add additional examples to clause 2(2) for such schemes.

*Q4. Do consultees agree that the economic loss test is sufficient to ensure that families can ensure parents or grandparents in appropriate situations?*

The Committee has no comments on this question.

*Q5. Are there any negative consequences which this Bill could have on investment linked insurance products compared to the current law?*

The Committee has no comments on this question.

### **CLAUSE 3: NON-LIFE INSURANCE**

*Q6. Do consultees consider that there are any non-life insurance policies in which the requirement to have an insurable interest at the time of the insured event would be problematic? That is, are there any circumstances in which a non-life policy would, apart from this requirement, pay out in the absence of an insurable interest at the time of the insured event?*

The Committee does not consider that the existence of an insurable interest at the time of the insured event is problematic. However, the drafting of the Bill could result in an insured who fails the test in clause 3(1)(a) having a void contract, even where the insured has an insurable interest at the time of the insured event. This might arise, for example, in an open cargo cover, where the insured neither has nor has in contemplation at inception, an interest in the subject matter in relation to which it suffers the loss.

The Committee considers that a clause should be included in the draft Bill to the effect that if the insured actually has an insurable interest at the time of the insured event, this should be conclusive proof that they had a reasonable prospect of acquiring an interest at the time the contract was entered into. This is consistent with the Commissions' earlier proposals.

*Q7. Do consultees consider that this non-exhaustive list is appropriately drawn to cover all the key situations in which an insured should be able take out non-life insurance?*

In our response to the March 2015 Issues Paper, the Committee expressed its view that there was not a strong enough case to define insurable interest in the context of non-life insurance. We remain of this view.

However, if the Law Commissions do proceed with implementing a definition, we have the following comments:

(a) as with life insurance, the conflating of the general definition with a non-exhaustive list, together with the repeal of other relevant laws, creates a lacuna. Therefore, there should either be a general definition supplemented by non-exhaustive examples, or the definition of insurable interest should be left to the courts (including preserving earlier case law). A version of clause 3(3)(d) could form the general definition.

(b) the examples provided in clause 3(3) are insufficiently clearly drafted:

- i. it is unclear what 'a right' in the subject matter of the insurance means in clause 3(3)(a). It would be preferable to include more expansive wording to refer to a right or interest in the property which is the subject matter of the insurance (as per *Lucena v Craufurd*);
- ii. there is no reference to insurable interest where the insured event would give rise to a liability on the part of the insured;
- iii. it would be preferable for clause 3(3)(d) to refer to the insured having (i) an economic benefit from the preservation of the insured subject matter or (ii) an economic loss on its damage or destruction. We consider that (ii) would include a failure to make an economic gain which would have occurred had the insured event not taken place, and suggest that clause 3(3)(d) states this explicitly.

#### **CLAUSE 4: CONSEQUENCES OF THE CONTRACT BEING VOID**

*Q8. Should an exception to the retention of premiums be limited to consumer contracts only, or extended to all cases where it appears that it would be unfair to the insured for the insurer to retain them?*

The Committee has previously considered this issue in its response to the Law Commissions' Paper 10 – *Insurable interest: updated proposals*. The Committee's opinion has not changed from the response to Proposal 4 of this Paper.

The Committee's view is that the premium should not be returned, as the insurer is likely to have altered its position to its detriment in underwriting a risk, such as by holding capital and reserves against the risk and, potentially, having incurred or paid additional outwards reinsurance premium. In doing so, the capacity of the insurer to write other business is likely to have been reduced.

The Committee considers that the Financial Conduct Authority is best-placed to determine the consequences of a consumer making false statements.

#### **GENERAL**

*Q9. Do consultees foresee any significant difficulties in providing that contracts entered into under the old law are not void for lack of insurable interest if the insured would have an insurable interest under the provisions of the draft Bill?*

The Committee has no comments on this question.

*Q10. Do consultees agree that the question of severability is best left to the construction of the contract?*

The Committee has no comments on this question.

#### **THE COMMITTEE'S ADDITIONAL COMMENTS**

Clause 5 of the draft Bill proposes that the Bill will replace any other rule of law relating to the requirement of an insurable interest for the purposes of a contract of insurance. The Committee considers that it would be problematic to replace entirely the existing rules of law as regards the definition of an insurable interest, as doing so could introduce confusion into the scope of what is an insurance contract, particularly in the context of derivatives contracts, which are not currently regarded as insurance contracts but might be so regarded following enactment of the Bill. The draft clause 3 further confuses this issue by assuming that there will be contracts of insurance (albeit potentially void) which do not have an insurable interest.

It is important that the requirement to have an insurable interest remains a defining characteristic of an insurance contract. Accordingly, we consider that the Bill should make clear that it amends the law as it stands but does not replace it.

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