

## **INSURABLE INTEREST AND LIFE INSURANCE**

Insurable interest<sup>20</sup> is the bedrock of all types of insurance contracts. As a general rule, all the insurance contracts are wagering contracts, as they deal with an uncertain event but the presence of insurable interest transforms these insurance contracts into valid subsisting enforceable and binding contracts.<sup>21</sup> Thus insurable interest is a basic requirement of any contract of insurance unless it can be, and is lawfully waived.

It simply means that the party to the insurance contract who is the insured or policyholder must have a particular relationship with the subject-matter of insurance whether that is a life or property or a liability to which he might be exposed. The absence of the required relationship will render the contract illegal, void or simply unenforceable depending on the type of insurance. The difference between

life and other insurances is very crucial as far as law regarding insurable interest is concerned. Every contract of insurance requires an insurable interest to support it; otherwise, it is invalid.<sup>22</sup> In certain kinds of insurance e.g. liability insurance and fidelity or solvency insurance, the very nature of the insurance implies

19 Supra n.3.

20 It is note worthy that neither the British Life Assurance Act, 1774 nor the Indian Insurance Act, 1938 defines the term “Insurable Interest”.

21 The term insurable interest is not defined in any British or Indian Statute in context with the life insurance contract, however, Section 7 of Marine Insurance Act defines insurable interest as, “every person has an insurable

interest who is interested in a marine adventure”.

22 Casford Union v. Poor Law and Local Government Officers Mutual Guarantee Association Ltd (1910) 103 LT 463.

the existence of an insurable interest.<sup>23</sup> Whilst other kinds e.g. personal accident insurance and burglary or livestock insurance are in practice effected by the assured for the most part in respect of one’s own person or property.

Occasionally, however, the assured may, for his own benefit, effect an insurance upon the person or property of another, and then the question of insurable interest becomes important. For example, a personal accident policy may be effected by the assured against the loss which he may suffer by reason of an accident of a third person.<sup>24</sup>

Without insurable interest, the 'life' of the insured itself would be in danger and if that aspect is not checked, the very purpose of life insurance business would be frustrated. The insurable interest alone gives rise to enforceable legal interest and at the same time, also offers a very fertile ground for insurers to refuse and dispute the claims so that they can retain their green pastures of resources intact.<sup>25</sup>

### **Definition and Nature of Insurable Interest**

Insurable interest in general sense means an interest in the safety and protection of subject matter of insurance. It exists when an insured person derives a financial or other benefit from the continuous existence of insured object.<sup>26</sup> In legal sense, it means a legal right to insure, a subject matter, arising out of a financial relationship recognized under law,

between the insured and the subject matter of insurance.<sup>27</sup>

Insurable interest is an interest which can be or is protected by a contract of insurance. This interest is considered as a form of property in the contemplation of law. It is assimilated to an actionable claim transferable to the same extent and within the same limitations.

But in case of fidelity insurance, where the same person is employed in two different capacities, a policy effected by one employer covering his acts in that employment does not entitle other employer to recover the amount of defalcations in other employment.

This type of personal accident policy protects the insured from liability to pay for a loss to a third party caused due to his negligence.

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[http://en.wikipedia.org/wiki/Insurable\\_interest](http://en.wikipedia.org/wiki/Insurable_interest). Accessed on 23/10/13 at 7:30 A.M.

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<http://bm.gdudf.edu.cn/kept/general%28insurance/baoxion/plan3.htm>. Accessed on 23/10/13 at 7:30 A.M.

The classical definition of insurable interest was given by Lawrence, J., in **Lucena v.**

**Craufurd**<sup>28</sup> which is as under:

“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, he may be said to be interested in the safety of the thing with respect to it as to have benefits from its existence

– prejudice from its destruction.”

To put it in short, in his Lordship’s words in the same case: „interest“ means „if the event happens, the party will gain advantage, if it is frustrated, he will suffer a loss“.29

In **Lucena v. Craufurd** it has been pointed out that the interest must be enforceable at law. Mere hope however strong it may be is not sufficient. Lord Eldon observed that expectation though founded on highest probabilities is not interest and it is equally not interest whatever might have been the chances in favor of expectation.30

A study of modern cases reveals that a vested or proprietary interest is not essential, but

such interest may be merely possessory, inchoate, contingent, defensible, equitable or expectant.<sup>31</sup>

The following points must be kept in consideration in this respect:-

(a) The interest should not be a mere sentimental right or interest, for example love and affection.

(b) It should be a right in property or a right arising out of a contract in relation to the property.

(c) The interest must be pecuniary, that is, capable of estimation in terms of money.



29 Supra n.3, p.61.

30 Supra n.28.

31 Supra n.3, p.62.

(d) The interest must be lawful, that is, it should not be illegal, unlawful, and immoral or opposed to public policy.

To sum up, insurable interest is a financial or other interest in preservation of the thing insured and continuance of the life which has been insured.

### **Necessity of Insurable Interest**

It is an undeniable truth that insurable interest is sine qua non of a contract of life insurance.<sup>32</sup> In order to affect a life insurance contract, it is necessary that the person who is

a party to the contract should have an insurable interest in the life of the person, for whom the policy is being bought. In **Warnock v. Davis**<sup>33</sup> it was clearly laid down that in all life insurance there must be a reasonable ground, founded on the reasonable relations of the parties to each other, either pecuniary or of blood or affinity, to expect some benefit or advantage from the continuance of the life of the assured or otherwise the contract is a mere wager, by which the party taking the policy is directly interested in the early death of the assured. Thus, it is a tool to avoid moral hazards.<sup>34</sup>

To put it more bluntly, if a person is allowed to insure the life of any other person there is a possibility that money in the form of life insurance policy may lead to inducement to commit murder. The tendency or temptation to kill the insured life will be removed if a person is not permitted to take insurance on

any one's life, less relationship by blood or by financial relationship, because one stands to gain more by the continuance rather than by death of the life insured.<sup>35</sup>

Moreover, if insurance is allowed without insurable interest, insurance could become insecurity. This aspect and significance of insurable interest was effectively demonstrated in

32 Supra n.3, p.60.

33 104 US 775; 779 (1881).

34 Peter Nash Swisher, "The Insurable Interest Requirement for Life Insurance; A Critical Reassessment",

The ICFAI Journal of Insurance Law, Vol.5, No.1, (2007), p.41.

35 Penal Sanction of Criminal Law and Section 27 of the Hindu Succession Act, 1956, which disqualify a person from inheritance if he kills to hasten succession of property will not encourage any inducement for crime.

the case of **Liberty National Life Insurance Company v. Weldon**<sup>36</sup>, wherein a nurse took three insurance policies on the life of her two year old niece without the knowledge of her parents before administering soft drink mixed with arsenic, killing the insured child within a few hours. The nurse was prosecuted for murder. In such cases a restriction in form of insurable interest will counter this murder inducement.<sup>37</sup> Therefore, it is a well settled principle of law that for the validity of an insurance contract the existence of an insurable interest is a mandatory precondition. Earlier, insurable interest was not essential in life insurance.<sup>38</sup> A contract of life insurance

was simply enforceable at common law despite the absence of any relationship between the insured and the life insured. The reason for this was that wagers in general were legally enforceable and thus courts had no option but to enforce wagers in the form of life insurance contracts. An increase in these practices which could serve as an inducement to murder, led to growing concern and ultimately, legislative action in form of the Life Assurance Act 1774 was taken.<sup>39</sup>

The English Life Assurance Act 1774 laid down three rules:-

(a) In every contract of insurance, the insured or the person for whose benefit the insurance was affected must have an interest in the subject matter.

(b) The person for whose benefit the policy was affected shall not recover more than the value of such insurable interest.

(c) Every policy shall have inserted in the policy, the name of the person interested or for whose benefit the policy was taken.

This Act for the first time required the insured to have an insurable interest in the life insured.<sup>40</sup> The other relevant provisions of the Act required the names of the persons

36 (1957) Alabama 100 S.C. 2D, 696.

37 Supra n.25, p.17.

38 Supra n.4, p.13.

39 Birds John, "Modern Insurance Law", (2003), p.36, Universal Law Publishing Co. Ltd., New Delhi.

40 The Life Assurance Act, 1774; Section 1.

interested to be inserted in the policy and declare that when the insured has an interest, he can recover no more than the amount of value of his interest.<sup>41</sup>

### **Insurable Interest and Life policies**

Insurable interest is the key element in the structure of a life insurance policy. It is fundamental to the policy's very existence. If there is no insurable interest there is no life insurance policy.<sup>42</sup> However, it is always difficult to define with precision what constitutes insurable interest in life policies; but one thing is settled, that for validity of a contract of life insurance, there must be an insurable interest.

The basic principle of the insurable interest in life insurance is the understanding that the beneficiary of the policy value is interested in

the continuance of the life insured far more than the money from the policy.

In life policies, the following persons have been recognized as having insurable interest and they may conveniently be considered under two main headings, namely:

(a) Blood Relationships.

(b) Contractual Relationship.

### (a) Blood Relationship:

This may be discussed under the following heads:-

#### (i) On one's Own Life

Every person is presumed to have an unlimited insurable interest in his own life because the



loss to the insured or his dependents cannot be measured in terms of money. Every person is entitled to recover the sum insured whether it is for full life or for any time short of it and if he dies his nominees or dependents are entitled to receive the amounts.<sup>43</sup>

41 The Life Assurance Act, 1774; Section 2 and 3.

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<http://www.pruadviser.co.uk/content/support/technical-centre/insurable-interest/>.

Accessed on 27/10/13 at 7:30 A.M.

43 Supra n.3, p.64.

Moreover, there is nothing to prevent a person bonafide insuring his own life as many times as he likes for his own benefit.<sup>44</sup>

## (ii) By Husband or Wife

Husband and wife are presumed to have an interest in each other's life.<sup>45</sup> No formal proof is required to establish the existence of such interest. In **Reed v. Royal Exchange Assurance Company**,<sup>46</sup> it has been established that no evidence is required in such cases because the husband is legally bound to support his wife and wife is dependent on her husband and hence has insurable interest in the life of her husband. Moreover, in this case extent of loss or gain cannot be measured and therefore, the insurable interest is unlimited. With due development of life insurance business, it is now well settled in England as well as India that a wife has an insurable interest in the life of the husband and vice-versa.

### (iii) Parent and Child

Presumably, the parent child relationship arising from the ties of blood is the strongest one of all. No relationship is more sacred and binding than that of parent and child. These ties uniting the parent and child are so strong that this type of relationship is enough to presume insurable interest in the life of each other.<sup>47</sup>

But in England, it has been laid down that a parent has no insurable interest in the life of the child because mere love and affection is not sufficient to constitute an insurable interest. However if the person has any pecuniary interest in life of the child, he can take out an insurance policy on the life of such child. On the other hand, a child is presumed to have an insurable interest in the life of the parent because it depends on the life of the parent for support. In USA and India, mere

sentimental interest is sufficient to raise presumption of existence of insurable interest.

44 Supra n.12, p.42.

45 The English Women's Property Act, 1882; section 2.

46 (1795) Peake 70.

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<http://www.fcsl.edu/sites/fcsl.edu/files/ART%203.pdf>. Accessed on 27/10/13 at 1:00 P.M.

(iv) Other Relations

The relationship by itself may not create an insurable interest. When one relation effects an insurance on the life of the other, there must be actual dependence on the person whose life is assured i.e. there must be reasonable expectation of benefit from the continued existence of such person and where he is so related to the other to have a claim for maintenance enforceable at law, in all such cases, there will be an insurable interest.<sup>48</sup>

### **(b) Contractual Relationship**

A wide variety of relations may acquire insurable interest by reason of contractual relationship. Some of them are noted hereunder.

#### **(i) Debtor and Creditor**

A creditor has an insurable interest in the life of the debtor.<sup>49</sup> The creditor's interest is limited to the extent of the value of the debt. It is immaterial whether the debt is secured or unsecured. The creditor has insurable interest in the life of the debtor because the chance of obtaining repayment materially depends upon the continuance of the life of the debtor.

## **(ii) Partner and Co-partner**

One partner has no insurable interest in another save where the latter is indebted to him personally or to the partnership, and to the extent only of such indebtedness.<sup>50</sup> A partner has insurable interest in the life of his co-partner to the extent of the amount of capital which the latter has contributed in the partnership.

Similarly, the following are said to have insurable interest:

(i) Principal and Agent

(ii) Master and Servant

(iii) Trustee and Co-trustee

48 *Atena Life Insurance Company v. France*  
(1876) 94, U.S. 561.

49 *Debtor v. Baldero* (1807) 9 East 72.

50 *Powell v. Dewy* (1898) 123 Log NC.