INSURABLE INTEREST IN LIFE POLICIES

Insurable interest refers to the relationship, usually pecuniary, which must exist between the insured and the subject matter of insurance in order that the contract of insurance be enforceable. It is a device intended to check the abuse of the insurance process which has seen more than its fair share of scandals and frauds. Whether it is a successful device is, of course, debatable. After all, only recently, Lloyd's has had to ban the effecting of 'tonner policies' under which underwriters could reap huge profits from aerial or maritime disasters even though they themselves have no insurable interest as they have assumed no liability for the losses.[1] Considering that 'policy proof of interest' policies have been outlawed so very long ago,[2] this practice at Lloyd's may prove shocking but then, the insurance market has grown accustomed to a world of non-existent cargo, ridiculously over-insured goods, deliberately scuttled ships and criminal destruction of life and property. Even so, as there is a real need to avoid the overcrowding of Davy Jones's locker and the premature destruction of life and property, the requirement of insurable interest makes good sense. However, the rules which have evolved in regard to insurable interest have not always been consistent and, at times, in the interest of 'good commercial sense', insurance practice has been at variance with the law. This article will look into some of the rules relating to insurable interest in life policies, the *reason d'etre* for such rules, the inconsistencies in the rules and some proposals for change.

As local law on insurable interest has its roots in English law, it is necessary to look at the history of the common law to determine its *raison d'etre.* Insurable interest is not a creature of the common law. In early days, although English judges loathed wagers, people were free to idle themselves by gossiping about the health of prominent persons and speculating, through insurance policies, on their lives. Needless to say, some of such prominent persons' deaths must have been hastened by discouraging reports on the latest odds on their chances of survival. What was equally distressing was that no one knew for certain how many people had been killed or maimed as a result of a desire to collect insurance proceeds at an earlier date. Obviously, a nation of shopkeepers could not afford to be debilitated by social ills associated with wagering, which in one writer's terms,[3] included the encouragement of idleness, vice, a parasitic way of life, an increase in impoverishment, misery and crime and the discouragement of useful business and activity. There could be little doubt that the twin evils of wagering and temptation to commit crime had to be combated. In 1746, Parliament intervened but only in regard to marine insurance

1 See *The Straits Times,* 15 June 1981, *Times Business* IV.
2 Marine Insurance Act 1906, s. 4.
3 Patterson, *"Insurable Interest in Life"* 18 Columbia L.R. (1918) 381.

contracts for which insurable interest was made a statutory requirement. This was a curious move for although it was imperative that the law had to put an end to 'pernicuous practices whereby great numbers of ships with their cargo have either been fraudulently lost and destroyed or taken by the enemy in time of war',[4] surely the abuses in the other branches of insurance law merited equal attention. It was not until the Life Assurance Act[5] was passed in 1774 that insurable interest became a statutory requirement for life insurance contracts. The principles contained in this Act were incorporated together with some amendments into the Malaysian Insurance Act[6] which applied until it was replaced by Singapore's own Insurance Act[7] which, for the purposes of insurable interest, is *in pari materia* with the Malaysian Act.

The Insurance Act and its predecessors are not and could never have been altogether effective in eliminating the twin evils of wagering and temptation to commit crime. From the very start, the public policy considerations in regard to the requirement of insurable interest conflicted with the important principle of freedom to contract. The statutes allowed for such conflicts because they were defective in many ways. Firstly, as none of the statutes governing life insurance defined the meaning of insurable interest,[8] judges, who were left to circumscribe its limits, leaned, wherever possible, towards upholding contracts. This approach was, of course, encouraged by the attitude of insurers who sought to evade their contractual responsibilities when they knew that they ought not to have entered into the disputed contracts in the first place. Such insurers were lambasted by Brett M.R. in *Stock* v. *Inglis*[9] when he said:

> 'After the underwriters have received the premium, the objection that there was no insurable interest is often, as nearly as possible, a technical objection, and one which has no merit, certainly not as between the assured and the insurer. Of course we must not assume facts which do not exist nor stretch the law beyond its proper limits but we ought, I think, to consider the question with a mind, if the facts and the law will allow it, to find in favour of an insurable interest'.

This approach is not indefensible in view of the harsh rule that a life insurer who has been paid premiums under a void contract could keep the premiums. However, it did contribute towards the haphazard development of the rules relating to insurable interest.

[4] Preamble to the Marine Insurance Act 1746 which has since been repealed by the Marine Insurance Act 1906.

[5] 14 Geo. 3 c. 48. The title is an odd one since the Act applies to certain types of property insurance as well.

[6] No. 1/63.

[7] Cap. 193 of 1970, Rev. Ed. Also s. 7 of the Civil Law Act (Cap. 30 of 1970, Rev. Ed.) which reproduces the relevant sections of the English Gambling Act of 1845 (8 & 9 Vict. c. 109).

[8] In contrast, s. 5 of the Marine Insurance Act 1906 defines insurable interest in the following terms:

5. — (1) Subject to the provisions of this Act, every person has an insurable interest who is interested in a marine adventure.

(2) In particular a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

[9] (1884) 12 Q.B.D. 564, 571.

The second weakness of the insurance statutes is that they never made it an offence for a person without insurable interest in another person's life to effect an insurance policy on that person's life. Lack of insurable interest is a mere inconvenience, although a grave one. Although it renders a contract void, insurers are free to honour their contractual obligations if they choose to do so. Lack of insurable interest therefore becomes relevant only if an insurer refuses to honour the bargain in which case, a court which is deciding the case is obliged to take note of its absence[10] even if the insurer, who is the only person entitled to plead the defect, does not do so. Not only is an insurer allowed to honour a policy without insurable interest, the law aids such an insured by providing that if he has been paid the insurance proceeds, he is entitled, as against all other claimants, to retain the money. That such is the position is evident from *Worthington* v. *Curtis,*[11] where Mellish L.J. explained the rationale for the rule in the following terms:

> 'First because the statute is a defence for the insurance company only if they choose to avail themselves of it. If they do not, the question who is entitled to the money must be determined as if the statute did not exist. The contract is only made void as between the (insured) and the insurer. And secondly, if that is not so, and if the effect of the statute is that the court will give no relief to any party because of the illegality of the transaction, in that case the maxim *'melior est conditio possidentis'* must prevail and the party who has the money must keep it'.

The above rule can only counter the avowed aim of stamping out insurance policies without insurable interest. If insurers are at liberty to accept and honour such policies and if beneficiaries who have been paid are so well protected by the law against claims by others, there will be some who will be willing to take a chance that the insurers of their choice will be honourable enough to live up to their contractual obligations under wagering policies. Clearly then, existing laws are not entirely consistent with public considerations in requiring the presence of insurable interest.

Turning to the local position, any discussion must begin with section 40 of the Insurance Act, the relevant portions of which read as follows:

> S. 40(1) A life policy insuring the life of anyone other than the person effecting the insurance or a person connected with him as mentioned in sub-section (2) shall be void unless the person effecting the insurance has an insurable interest in that life at the time the insurance is effected; and the policy moneys paid under such a policy shall not exceed the amount of that insurable interest at that time.
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> (2) The lives excepted from sub-section (1) of this section besides that of the person effecting the insurance, are those of that person's wife or husband, of that person's child or ward being under the age of majority at the time the insurance is effected and of anyone on whom that person is at that time wholly or partly dependent.

As the Insurance Act does not define the term 'insurable interest', one has to look towards the common law for some guidance as to its meaning. The common law has two basic rules. Firstly, in order to have an insurable interest, one must have a pecuniary interest

[10] *Gedge* v. *Royal Exchange* [1900] 2 Q.B. 214.
[11] (1875) 1 Ch. D. 419.

capable of valuation in monetary terms and of a category recognised by the law. Secondly, in limited instances, namely insurance on one's own life and that of one's spouse, insurable interest is presumed to exist or, as some would prefer to phrase it, the question of insurable interest does not arise.[12] Section 40(1) incorporates the first of these rules whereas section 40(2) includes the second rule and enlarges the category of persons for whom insurable interest is presumed to exist. As is the case under English law, insurable interest need only be present at the time a life policy is effected.[13]

Insurance on one's own life and that of one's spouse

There is no divergence between section 40(2) of the Insurance Act and English law as far as insurance on one's own life and that of one's spouse is concerned. That a man has an insurable interest on his own life is beyond doubt for as Kennedy L.J. rightly put it in *Griffiths v. Fleming,* 'A man does not gamble on his own life to gain a Pyrrhic victory by his own death'.[14] Similarly, the law freely allows insurance on the life of one's spouse because spouses are not expected to have sinister counter interests against the continued good health of their life partners. Most life policies are 'own life' policies. People are encouraged to effect such policies because these are advertised as one of the better forms of self-enforced saving and investment. The law also lends a helping hand to spouses in regard to avoidance of estate duty on life policies through section 73 of the Conveyancing and Law of Property Act.[15]

The law is understandably concerned that a person who insures his own life does not do so in order to assist another person in getting around the rules on insurable interest. An 'own life' policy is only valid if it is a *bona fide* policy on the insured's life and for his own benefit. Thus, if X effects a policy on his own life, at Y's instigation and for the purpose of earning some money from Y, the policy would be void and Y cannot take advantage of the policy because it was not intended, *ah initio,* to benefit X. This rule is easy to state but difficult to apply. There is nothing to prevent X from effecting a valid policy even though he has every intention of assigning it to a third party when he effected the policy so long as he is not party to a scheme to evade the rules on insurable interest. As the devil himself knows not the thought of man,[16] it must take a very competent sleuth or extremely suspicious circumstances to have the veil on a life policy lifted and the hidden third party's rights defeated.

The full effect of the law's policing action is felt only when a policy is effected. After a *bona fide* policy has been effected, it may be assigned to a third party.[17] As life policies have grown to become

[12] See, *inter alia, Griffiths v. Fleming* (1909) 100 L.T. 765 C.A. and *Reed* v. *Royal Exchange Assurance Co.* (1895) Peak Add. Cas. 70.

[13] *Dalby* v. *India and London Life Ass. Co.* (1854) 15 C.B. 365. S. 40(2) of the Insurance Act refers to insurable interest "at the time the insurance is effected."

[14] (1909) 100 L.T. 765 C.A.

[15] Cap. 268 of 1970, Rev. Ed. This is the local equivalent to s. 11 of the English Married Women's Property Act 1882 (45 & 46 Vict. c.75).

[16] *Per* Brian C.J., Anon (1477) Y.B. Pasch. 17 Edw. IV, f. 1, pl. 2.

[17] See Policies of Assurance Act 1867 (30 & 31 Vict. s. 144) and s. 4 of the Civil Law Act (Cap. 30 of 1970 Rev. Ed.).

part of the way of life, it is not undesirable that they should have some characteristics of property so that they can be freely negotiable. However, while opting for free negotiability of life policies, the law has failed to come to terms with the fact that such free negotiability runs counter to the public policy considerations which called for the introduction of the requirement of insurable interest. Judges have attempted to paper over the difficulties caused by the law's inconsistent positions on effecting and assigning of policies by assuming that 'cases in which a person having an interest lends himself to one without any as a cloak to what is in its inception a wager have no similarity to those where an honest contract is sold in good faith'. They further assume, that there is less likelihood of temptation to crime since the holder of a valid policy of insurance on his own life ought to know better than to transfer the policy to someone whom he is afraid to trust. These presumptions are not irrebutable. A person who buys a policy from another person on whose life that policy is based is neither better nor worse than a person who tries to insure the life of another person in whom he has no insurable interest. As for sinister counter interests against the continued existence of the person whose life has been insured, the question of choice of buyer becomes irrelevant when the policy is re-sold for the second and subsequent times. Ethical questions may also be raised. For instance, surely a surgeon who is about to perform a dangerous operation on a patient ought not to be allowed to purchase life policies on that patient's life.

It would be unrealistic to expect the law to decree that life policies can only be transferred to those who have an insurable interest in the person whose life is the subject of insurance. Such a move would naturally reduce the value of the policy in the seller's hands. What has not been sufficiently considered and which could be a better way of assisting policy holders who are in need of money is to have them look towards their insurers for the required funds. Among other things, present cash-surrender-value provisions should be studied to determine whether they are attractive enough to tempt policy holders into exploring this avenue of raising funds. If they are found wanting, the law should, after taking into account the interest of insurers, take steps to ensure the improvement of such provisions.

Insurance on the lives of children and wards

Insurance law relating to minors, whether it be on the right of parents and guardians to insure the lives of their children or wards or *vice versa,* like the law on infant contracts, has proved quite troublesome. Parents and guardians have claimed to have an insurable interest in the lives of their children and wards on various grounds including liability for funeral expenses, expenditure on maintenance and education, rendering of domestic services by the child or ward without which money would have had to be expended on hired hands, contribution by the child or ward to a common fund to support the family and the child or ward's obligation to provide for the parent or guardian in the event of illness, poverty and old age.[18]

As a general rule, such claims by parents or guardians have failed to impress the courts although the decision in *Barnes* v. *London,*

[18] MacGillivray, *Insurance Law,* (Sixth Ed. 1979).

Edinburgh and Glasgow Life Insurance Co.[19] is indeed an anomaly. In *Barnes' Case,* a lady who had promised her step-sister to look after the latter's child was allowed to succeed in her claim to insurance proceeds on the child's life on the dubious ground that she undertook to pay for the child's education and maintenance even though she was not legally obliged to do so. This decision runs counter to the main stream of decisions and must be regarded as having been wrongly decided. The generally accepted rule under English law is that a parent or guardian cannot insure his child or ward unless he can prove that some form of pecuniary interest exists. Mere expenditure on a child with the expectation of future reimbursement will not do. That such is the effect of the Life Assurance Act was put beyond doubt by Bayley J. in *Halford* v. *Kymer.*[20]

The Insurance Act alters the above position. Section 40(2) provides that a person may insure the life of his child or ward provided the child or ward is below the age of majority at the time the insurance is effected. The wisdom of this rule is, with respect, questionable. The English position of disallowing such insurance is not without its merits. Even if one were to disregard the question of wagering, the law ought not to allow perverse parents or guardians, who have vast sums to gain from policies on the lives of their children or wards, to be tempted into not taking necessary steps to ensure that their children or wards are in the best of health. In any case, little social purpose can be served by allowing such insurance. After all, if a parent or guardian wants financial benefits for himself, there are ample types of policies on his own life which can benefit him while he is still alive. On the other hand, if the aim is to benefit the child or ward, policies on the parent's or guardian's life will do just as well. Parents and guardians should also note that the Insurance Act has amended the common law rules on contractual capacity of minors insofar as insurance contracts are concerned.[21] Minors who have attained the age of ten may enter into their own insurance contracts although a minor who has not attained the age of sixteen can only do so with the written consent of his parent or guardian. Parents and guardians should consider having their children or wards enter into their own contracts. That contracts under which minors insure their own lives for their own benefit are preferable to those effected by adults on the lives of minors was stressed by Bayley J. in *Halford* v. *Kymer*[22] when he said:

> 'It has been said that there are numerous instances in which a father has effected an insurance on the life of his son. If a father, wishing to give some property to dispose of make an insurance on his son's life in his (the son's) name, not for his (the father's) own benefit, but for the benefit of his son, there is no law to prevent his doing so: but that is a transaction quite different from the present; and if a notion prevails that such an insurance is valid, the sooner it is corrected the better'.

An additional safeguard against mischief against the interest of minors when they enter into their own insurance contracts is that adults are not allowed to influence them into assigning the benefits

[19] [1892] 1 Q.B. 864.
[20] (1830) 10 B. & C. 724.
[21] S.41.
[22] (1830) 10 B. & C. 724.

of the policy to third parties. This is because the common law rules protecting a rash or unduly influenced minor from parting with his property apply in full force as the Insurance Act, in altering the contractual capacity of minors, only deals with their right to *enter* into insurance contracts and makes no reference to the question of assignment.

Before leaving the subject of insurance on the lives of minor children and wards, it might be added that if such insurance is to be allowed, safeguards ought to be present to prevent abuse by parents and guardians. For instance, in South Africa, where insurance on the lives of children is allowed, financial limits are set for such policies. These limits vary according to age of the minor and are lowest for minors below the age of six. Similar provisions are to be found in the insurance law of New York.

Insurance by dependents

The last category of persons for whom, as a result of section 40(2), the question of insurable interest need not arise concerns those who, at the time of effecting the insurance policy, are wholly or partly dependent on the person whose life is the subject of insurance. This is an unusually vague category, the outer limits of which have yet to be charted. Admittedly, the hitherto inflexible attitude of English law in regard to the categories of persons for whom insurable interest is presumed to exist needed changing as it created unnecessary hardship for some persons. However, providing for such deserving cases through the wide statutory formula of 'dependents' is hardly the right answer to such problems since this benefits too wide a class of persons.

For a start, section 40(2) is to be welcomed insofar as it benefits young children and wards who ought to have an insurable interest in the lives of their parents or guardians. This is an improvement on the English position under which, as is evident from *Howard* v. *Refuge Friendly Society*[23] and *Elson* v. *Crookes,*[24] children and wards have no such insurable interest. Children and wards do suffer a pecuniary loss upon the demise of their parents or guardians. If this were not so, the life insurance industry would have floundered since its development rests on the desire of people to provide for spouses and children. Young children and wards should be allowed to ensure that their opportunities for a good education and standard of living do not rest solely on the foresight and inclination of their parents or guardians to provide for them. However, section 40(2) is too widely worded in that it allows adults who are partly or wholly dependent on their parents or former guardians to insure their lives. This should not have been allowed as adults who wish to secure their own future should do so by other means.

The wide wording of section 40(2) also allows parents to insure the lives of their adult children if they are wholly or partly dependent on them. Similarly, an old uncle or aunt may be able to insure the

[23] (1866) 54 L.T. 644.

[24] (1911) 106 L.T. 462. Also see *Greenslade* v. *London and Manchester Industrial Insurance Co., Ltd.* 1913 48 L. Jo. 330. This case concerns insurance on the life of a step-parent by a step-child.

life of a nephew or niece if they are being supported, in whole or in part, by that nephew or niece. These are clearly not allowed under English law. While these situations may seem socially acceptable, one might well ask whether an old man who is being given some money every month by his neighbour ought to have an insurable interest in that neighbour's life. To go further, it surely does not seem proper that a young female university graduate, who has her own career, should be able to insure the life of her married lover whose monthly allowance allows her to live beyond her own means. Clearly, the last limb of section 40(2) ought to have been more precise about the meaning of the term 'wholly or partly dependent'. The law could well nurture unhealthy counter interests against the persons whose lives are insured if this phrase is given too wide a meaning. Much can be said for amending this limb so as to allow only near relatives to effect insurance policies under it. After all, as Holmes J. so aptly put it long ago in *Grigsby* v. *Russel*:[25]

> 'The very meaning of insurable interest is an interest in having the life continue and so one that is opposed to crime. And what, perhaps is more important, the existence of such an interest makes a roughly selected class of persons who, by their general relations with the person whose life is insured ,are less likely than criminals at large to attempt to compass his death.'

There will be a period of uncertainty until the courts have had the opportunity to chart the outer limits of this very unsatisfactory limb of section 40(2). Until this has been done, one can only hope that insurers will have good sense to help regulate the position even though the law reports abound with instances of lack of fairplay on the part of many insurers as far as insurable interest is concerned.

Insurance by creditors on the lives of debtors

Under common law as well as under section 40(1) of the Insurance Act, creditors may insure the lives of their debtors.[26] While such policies must be extremely rare today, they are interesting enough, from the academic point of view, to merit discussion as they illustrate how unrealistic and inconsistent the law has been.

To begin with, the rationale for allowing such insurance is questionable. While it would, no doubt, be more convenient, for the purposes of debt collection if the debtor were to remain alive, all is not lost if the debtor dies since it is clear that upon the death of a party to a contract which is not one for personal services, his liabilities under the contract are assumed by his personal representatives. There is thus no room for the application of the maxim *actio personalis moritur cum persona.* Convenience of collection alone should not be a ground for giving rise to insurance rights. As creditors can secure their loans through other practical methods, some of which include mortgaging of property and furnishing of guarantees by third parties, there is no economic or social justification whatsoever for the law to allow insurance on a debtor's life. In view of this, the law ought not to court the danger, however slight, that some creditor might consider

[25] 222 U.S. 149, 32 S. Ct. 58, 56 L. Ed. 133 (1911).
[26] See, for instance, *Dolby* v. *India and London Life Ass. Co.* (1854) 15 C.B. 365.

terminating his debtor's life in order to solve his immediate cash flow problems.

In any case, the sum for which insurance may be effected on a debtor's life is not a realistic one. Presently, as section 40(1) refers to insurable interest at the time the insurance is effected, the amount of insurance which may be effected with any insurer is limited to the debt owed plus interest up to the date of the policy plus the first premium. Such a basis of calculation does not take into account interest rates as well as inflation rates, both of which are very high. A creditor who has waited a long time to receive the insurance proceeds will finally have in his hands a sum which is but a pale shadow of its original purchasing power. If insurance on a debtor's life is to make any sense, then factors such as interest and inflation must be taken into account. These figures should, of course, be linked to the expected life expectancy of the debtor based on present life expectancy tables of insurers. In the United States, the general practice is that any sum can be insured for so long as the difference between the insured sum and the debt is not so great as to suggest a wager. It is suggested that this approach ought not to be adopted as it does not give a clear picture in regard to the sum for which insurance may be effected and there would always remain a risk that the insurance policy may be void because it is considered a wagering contract.

Another unsatisfactory rule in this branch of insurance law is that a creditor whose loan has been affected by the Limitation Act or some other technical defence, such as lack of form, is said to have no insurable interest. As business is not infrequently conducted on the basis of a man's word, it is not unlikely that a creditor may finally recover his loan even though his debtor is aware that technical defences may be pleaded. In view of this, the law ought to ensure that an insurer, who is fully aware of the circumstances of the case and who has seen it fit to issue a policy and receive premiums, should not be allowed to deny his contractual liabilities.

Insurance on an employee's life

The local position, as well as that under English law, is that an employer has an insurable interest in his employee's life but only to the extent of the employee's future earnings for the unexpired portion of the employee's contract of service.[27] The law does not take into account the pivotal role an employee may play in an organisation and the economic damage that would be caused to an employer should his key personnel die. 'Key-man' insurance, which takes into account such factors, is allowed in the United States and, despite the lack of sanction by the law, is not unavailable in Singapore. Realisation of insurance proceeds will therefore be dependent on the integrity of the insurer.

Whether 'key-man' insurance should be sanctioned by the law or not is a controversial issue. It may be argued that here is one instance

[27] An employee, who is under a contract of service, is also entitled to insure his employer's life for a sum not exceeding the amount of future salary which may be earned for the unexpired portion of the contract of service. See *Hebdon* v. *West* (1863) 3 B. & S. 579.

that the law ought not to be at variance with insurance practice. After all, only very top executives whose abilities and contacts are the key to the success of the employer may be the subject of such insurance. However, on balance, if the law is to be consistent, such insurance ought not to be allowed. It cannot be denied that there is a risk, however slight, that counter interests against the lives of insured employees may be created by such insurance, especially when such key employees leave their employers on their own accord. If such policies are legal, they remain valid even though such employees have resigned since life policies are not contracts of indemnity. An employer whose business interests are severely damaged by such resignation may well be tempted to harm the former employee for immediate financial gain. That the law disallows such insurance does not mean that it is failing to match the dynamism of modem business operations. There are more healthy ways for an employer to ensure that his future is a secure one.

CONCLUSION

Local law on insurable interest has not been free from the tussles under English law between the desire to encourage freedom to contract and public policy considerations. It is hardly surprising that the rules resulting from the tussle reveal how unruly a horse public policy can be. If one were to examine the two main considerations for requiring insurable interest today, one must conclude that in modern Singapore, the threat of excessive wagering through insurance contracts cannot be great as local gamblers would definitely find the more conventional forms of legalised betting far more attractive propositions than the cold actuarial precision of premiums. However, the other consideration, namely avoidance of crime, remains a very relevant consideration. The role of the law must be to ensure that legal rules adapt to modern economic and social needs without sacrificing relevant public policy considerations. This is no mean task.

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