



Applicability of insurable interest and science of life insurance in India

¹ Dr. Aman Vashisht, ² Dr. KC Dabas

¹ Prof. & Dean Student Welfare, BMU, Asthal Bohar, Rohtak, Harayana, India

² Prof. & Head, Dept. Lib. & Inf. Sc. BMU, Asthal Bohar, Rohtak, Harayana, India

Abstract

The whole idea of insurance has developed on the fact that human life is full of uncertainties and the life of a person itself is very uncertain. Paper tells that eventualities do cast their shadows, and therefore one has to equip oneself with possible means so as to face the unforeseen. The science of life insurance revolves around the principle of providing some financial relief to the loved ones of a person in case of his sudden death. It points out that the mortality, the interest and the expenses are the three main factors which are taken into account for ascertaining the contribution of each policy-holder. Article helps in understanding the concept of life insurance by discussing its nature and scope in a very scientific way. Besides throwing light on the concept of life insurance in India it also discusses in detail the concept of insurable interest and its importance in the context of life insurance. Also, it compares that in USA and India, mere sentimental interest is sufficient to raise presumption of existence of insurable interest, but in England, a parent has no insurable interest in the life of the child simply because of mere love and affection. Paper highlights that insurable interest is the bed rock of all types of insurance contracts and without an insurable interest all contracts of insurance are invalid. Insurable interest is an interest which can be or is protected by a contract of insurance.

Keywords: risk, uncertainties, science of life insurance, insurable interest, contract, indemnity, IRDA, awareness, assured, contractual, relationship, grievance, consideration

1. Introduction

“If a child, a spouse, a life partner, or a parent depends on you and your income, you need life insurance.”

Suze Orman



Fig 1

It is well said that “Life is full of risks. For property, there are fire risks, for shipment of goods, there are perils of sea, for human life, there is the risk of death or disability and so on and so forth” [1]. Life insurance is a husband’s privilege, a wife’s right and a child’s claim [2]. The scheme of life insurance provides an assurance that if such an event happens, the person or his dependents would get financial assistance to bear the loss. Life insurance offers the safest and surest means of establishing a socialistic pattern, perhaps not without a lot

of sweat but certainly without blood and tears. It stabilizes the economic security of the policy holder and at the same time contributes its might to promotion of industry by providing the necessary capital and supports various social security measures [3].

1.1 Scope and Objectives of the Study

- To define and understand the concept of life insurance and science of life insurance in India.
- To discuss the concept of insurable interest and its importance in context of life insurance.
- To enhance awareness and knowledge about the existing framework of the Life Insurance in India and
- To provide valuable suggestions for better regulation of life insurance in the interest of all.

2. Methodology of the Study

This study has been designed keeping in view the objectives and scope of the study. The study is doctrinal in nature and doctrinal research is the most common methodology employed by those undertaking research in law. This is so because, legal rules possess the quality of being doctrinal. Doctrinal meant to be the rules that apply consistently and which tend to evolve slowly with case laws. Doctrinal research is a research into the law and legal concepts and this method has main influence in the last two centuries on the views of legal experts and jurists and still it tends to dictate legal research designs. It includes legal concepts and principles of all types, such as cases, statutes and rules. It can be defined as a synthesis of rules, principles, norms,

interpretive guidelines and values. It explains and justifies through systematic consistency, a segment of law as part of a larger system of law. Doctrines can be abstract, binding and non-binding.

2.1 Understanding the Meaning of Life Insurance

Insurance is a co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to insure themselves against the risk^[4]. The aim of all types of insurance is to make provision against such risks. In other words, it is a provision which a prudent man makes against inevitable contingencies, loss or misfortune^[5]. In this way, life insurance is a social device to share the risk of loss of life.

In simple words, it means an agreement in which one party agrees to pay a given sum of money upon the happening of a particular event contingent upon duration of human life in exchange of the payment of a consideration. The person who guarantees the payment is called *Insurer*, the amount given is called *Policy Amount*, the person on whose life the payment is guaranteed is called *Insured* or *Assured*. The particular event on which the payment is guaranteed to be given may be *Death* or *Life*. The consideration is called the *Premium*. The document evidencing the contract is called *Policy*^[6].

There is no statutory definition of life insurance, but it may be defined as a contract in which the insurer, in consideration of a certain premium, either in lump sum or in form of any other periodical payments, in return agrees to pay to the assured, or to the person for whose benefit the policy is taken, a stated sum of money on the happening of a particular event contingent on the duration of human life^[7].

2.2 Definitions of Life Insurance Which Need To Be Considered

“Life insurance contract is a contract whereby a person (insurer) agrees for a consideration (that is payment of a sum of money) or a periodical payment, called the premium to pay to another (insured or his estates) a stated sum of money on happening of an event dependent on human life^[8].”

“Life insurance is a contract to pay a certain sum of money on the death of a person in consideration of the due payment of a certain annuity for his life calculated according to the probable duration of life^[9].”

“Life insurance is a contract in which one party agrees to pay a given sum of money upon the happening of a particular event contingent upon the duration of human life in consideration of immediate payment of a smaller sum or other equivalent periodical payments by the other^[10].”

“A life insurance policy promises that the insurer will pay to the policy holder a certain sum of money if the person insured dies or any other specified contingency happens^[11].”

2.3 Case Laws to Define Life Insurance

The best explanation of the definition and nature of life insurance contract undoubtedly occurs in the case titled *Dalby v. India and London Life Assurance Company*. The basic fact about life insurance recognized in this case is that a contract of life insurance is not a contract of indemnity. One of the effects of life insurance not being a contract of indemnity is that on happening of the event insured against the insurer should pay

the agreed amount irrespective of whether the assured suffers any loss or not^[12].

Therefore, Life insurance is in the nature of a contingency insurance. It does not provide an indemnity but only provides for a payment on a contingent event. Moreover, the sum is not measured in terms of a loss as the policy states the amount payable; and the sum undertaken to be paid becomes payable irrespective of the value of life or limb lost^[13].

The Supreme Court explained this concept in a case^[14] in which the subject matter of the contract was insurance on the life of the assessee. The contract on behalf of the assessee was entered into between his father and LIC as the assessee was then a minor. The contract of insurance provided that the assessee was not entitled to the policy till he adopted the contract on the date of his attaining majority. The apex court held that “reading the contract as a whole it appears in substance to be a contract of life insurance with regards to the life of assessee. The important point to notice is that if the assessee adopts the policy upon attaining majority the corporation becomes liable to pay the sum assured to the assessee on the stipulated date of majority, if the assessee was alive. The LIC was also liable to pay the amount assured if the assessee was to die before the stipulated date of majority but on or after the deferred date. The insurance on the life of the assessee was the main intention of the contract and the other clauses relied are merely ancillary to the main purpose. Life insurance in a broader sense comprises any contract in which one party agrees to pay a given sum upon happening of a particular event contingent upon the duration of human life, in consideration of the immediate payment of a smaller sum or certain equivalent periodical payments by another party^[15].”

In light of the above definitions the essential features of life insurance^[16] can be summed up as under: i) Life insurance is a contract relating to human life; ii) There need not be an express provision that the payment is due on the death of the person; iii) The contract provides for payment of lump sum money; and iv) The amount is paid at the expiration of certain period or on death of the person.

2.4 Science of Life Insurance

Life insurance is a business proposition resting on the combined operation of law of mortality and interest. We all know that time of our death is uncertain and in case of untimely death of a person his family could be put into great financial hardship. The science of life insurance revolves around the principle of providing some financial relief to the loved ones of a person in case of his sudden death^[17].

The first essential for working of life insurance is calculation of risk to fix the amount of contribution (premium) to be made by each policy-holder according to his age, medical history, habits, occupation, etc. so that the fund should be adequate to meet the whole claims^[18]. The probability of death or the law of mortality is used for this purpose.

Secondly, the funds acquired from each policy holder must be carefully invested to safeguard the interest of the policy-holders. The insurance company should take care that adequate funds are available at all times to meet the claims of the policy-holders.

Thirdly, the policy-holders are required to pay not only the timely premium but also the costs for meeting the expenses of

organization. The expenses of organization are also included in the regular premium fixed at the time of taking policy. Thus, the mortality, the interest and the expenses are the three main factors which are taken into account for ascertaining the contribution of each policy-holder^[19].

2.5 Insurable Interest and Life Insurance

Insurable interest^[20] 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^[21]. 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 (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/she 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^[22]. In certain kinds of insurance e.g. liability insurance and fidelity or solvency insurance, the very nature of the insurance implies the existence of an insurable interest^[23]. 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, the assured may, for his own benefit, affect 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 affected by the assured against the loss which he may suffer by reason of an accident of a third person^[24].

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^[25].

2.6 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^[26]. 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^[27].

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.

The classical definition of insurable interest was given by Lawrence, J., in *Lucena v. Craufurd*^[28] which is as under:

“The having some relation to, or concern in, the subject of the insurance (life of a person), insurable interest is a financial or other interest in preservation of the thing insured and continuance of the life which has been insured”.

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 favour 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^[31].

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.
- 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.

2.7 Necessity of Insurable Interest

It is patent truth that insurable interest is sine qua non of a contract of life insurance^[32]. 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*^[33] 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 gamble, 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^[34].

To put it more frankly, 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^[35].

Moreover, if insurance is allowed without insurable interest, insurance could become insecurity. This aspect and significance of insurable interest was effectively demonstrated in the case of *Liberty National Life Insurance Company v. Weldon*^[36], 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 [37]. 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 [38]. 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 bets in general were legally enforceable and thus courts had no option but to enforce gambles 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 [39].

The English Life Assurance Act 1774 laid down three rules: 1) 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; 2) the person for whose benefit the policy was affected shall not recover more than the value of such insurable interest; 3) every policy shall have inserted in the policy, the name of the person interested or for whose benefit the policy was taken.

This Act required the insured to have an insurable interest in the life insured [40]. The other relevant provisions of the Act required the names of the persons 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 [41].

2.8 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 [42]. 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; and b) Contractual Relationship.

2.9 (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 [43]. Moreover, there is nothing to prevent a person bonafide

insuring his own life as many times as he likes for his own benefit [44].

(ii) By Husband or Wife

Husband and wife are presumed to have an interest in each other's life.⁴⁵ No formal proof is required to establish the existence of such interest. In *Reed v. Royal Exchange Assurance Company* [46], 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 [47].

In USA and India, mere sentimental interest is sufficient to raise presumption of existence of insurable interest. 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.

(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 [48].

2.10 (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 [49]. The creditor's interest is limited to the extent of the values 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 [50]. 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.

3. Conclusion

In modern times, various new forms of insurance have been developed but, undoubtedly, the most popular form of insurance remains to be life insurance. There is no statutory definition of life insurance, but it has been defined as a contract of insurance whereby the insured agrees to pay a certain sum called premium, at specified time, and in consideration thereof the insurer agreed to pay certain sums of money on certain condition and in specified way upon happening of a particular event contingent upon the duration of human life.

Insurable interest is one of the strange concepts of life insurance. Insurable interest is the interest in the safety and protection of subject matter of insurance. It arises out of the economic relationship that exists between the policy holder and the life assured so that the policy holder stands to lose by death of the assured or continues to gain by his continued existence. In family relationships like parent and child and husband and wife insurable interest is presumed to exist whereas in business or contractual relationship like creditor and debtor and between partners, insurable interest arises due to financial relationship between proposer and the life assured. But in England, mere love and affection of a parent towards the life of the child is not sufficient insurable interest without any economic interest. In absence of insurable interest the contract of life insurance is void. Regarding consumer awareness, campaigns should be encouraged by the Insurance Regulatory and Development Authority (IRDA) and Law Commission of India have to improve financial literacy/ insurance literacy levels by conducting workshops, distributing leaflets, distributing literature in both rural and urban area.

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