

CHAPTER TEN

PRINCIPLES OF INSURANCE: PART TWO

10.1 Principle of Insurable Interest

One of the essential ingredients of an Insurance contract is that the insured must have an insurable interest in the subject matter of the contract. Insurance without insurable interest would be a mere wager and as such unenforceable in the eyes of law.

The subject matter of the Insurance contract may be a property, or an event that may create a liability but it is not the property or the potential liability which is insured but it is the pecuniary interest of the insured in that property or liability which is insured.

The concept is the basis of the doctrine of insurable interest and was cleared in the case of *Castellain v/s Priston* in 1883 as follows.

“What is it that is insured in a fire policy? Not the bricks and materials used in building the house but the interest of the Insured in the subject matter of Insurance.”

The subject matter of the contract is the name given to the financial interest, which a person has in the subject matter and it is this interest, which is insured.

Insurable Interest is defined as “The legal right to insure arising out of a financial relationship recognized under the law between the insured and the subject matter of Insurance”.

10.2 Components of Insurable Interest

There are four essential components of Insurable Interests

- 1)** There must be some property, right, interest, life, limb or potential liability capable of being insured.
- 2)** Any of these above i.e. property, right, interest etc. must be the subject matter of Insurance.
- 3)** The insured must stand in a formal or legal relationship with the subject matter of the Insurance. Whereby he benefits from its safety, well-being or freedom from liability and would be adversely affected by its loss, damage existence of liability.
- 4)** The relationship between the insured and the subject matter must be recognized by law.

10.3 How Is Insurable Interest Arises

There are a number of ways by which Insurable Interest arises or is restricted.

1. **By Common Law:** Cases where the essential elements are automatically present can be described as Insurable Interest having arisen by common law. Ownership of a building, car etc, gives the owner the right to insure the property.
2. **By Contract:** In some cases, a person will agree to be liable for something which he would not be ordinarily for. A lease deed for a house for example may make the tenant responsible for the repair and maintenance of the building. Such a contract places the tenant in a legally recognized relationship with the house or the potential liability and this gives him the insurable interest.
3. **By Statute:** Sometimes an Act of the Parliament may create an insurable interest by granting some benefit or imposing a duty and at times removing a liability may restrict the Insurable Interest.

Insurable Interest is applicable in the Insurance of property, life and liability.

In case of property Insurance, insurable interest arises out of ownership where the owner is the insured but it can arise due to other situations & financial interests which gives a person who is not an owner, insurable interest in the property and some of the situations are listed below:

4. Mortgagee and Mortgagers:

The practice of Mortgage is common in the area of house & vehicle purchase. The mortgagee is the lender normally a bank or a financial institution, and the mortgager is the purchaser. Both have an insurable interest; the mortgager because he is the owner and the mortgagee as a creditor with insurable interest limited to the extent of the loan.

5. Bailee:

Bailee is person legally holding the goods of another, may be for payment or other reason. Motors garages and watch repairers have a responsibility to take care of the items in their custody and this gives them an insurable interest even though he is not owner.

6. Trustees:

They are legally responsible for the property under their charge and it is this responsibility which gives rise to insurable interest.

7. Part Ownership:

Even though a person may have only part interest in a property he can insure the entire property. He shall be treated as a trustee or the co-owners; and in the event of a claim he will hold the money received by him in excess of his financial interest in trust for the others.

8. Agents: When the principal has an insurable interest then his agent can insure the property.

9. Husband & Wife:

Each has unlimited interest in each other's life and hence they have an insurable interest in each other's property. These parties can insure each other's lives as they stand to lose in the event of death of any of them.

10. Creditor:

Similarly, a creditor may lose financially if a debtor dies before paying the loan so the creditor gets an Insurable Interest in the life of the debtor to the extent of the loan amount.

11. Liability

In Liability Insurance a person has insurable interest to the extent of any potential liability which may be incurred due to damages and other costs. It is not possible to foretell how much liability or how often a person may incur liability and in what form or shape it arises. In this way Insurable Interest in Liability Insurance is different than Insurable Interest in life & property - where it is possible to predetermine the extent of Insurable Interest.

10.4 When Should Insurable Interest Exist

(i) In Life Insurance Insurable Interest must exist at the time of inception of Insurance and it is not required at the time of claim

(ii) In Marine Insurance Insurable Interest must exist at the time of loss / claim and it is not required at the time of inception.

(iii) In Property and other Insurance Insurable Interest must exist at the time of inception as well as at the time of loss/ claims.

10.4.1 Other Salient Features of Insurable Interest

(i) *Insurable Interest of Insurers.* Once the Insurers have accepted the liability they derive an insurable interest, which arises from that liability thus they are free to insure a part or whole of the risk with another insurer. This is done by reinsurance.

(ii) *Legally Enforceable.* The Insurable Interest must be legally enforceable. The mere expectation that one may acquire insurable interest in the future is not sufficient to create insurable interest.

(iii) *Possession* Lawful possession of property together with its responsibility creates an insurable interest

(iv) *Criminal Acts.* A person cannot avail benefits from Insurance to cover penalties because of a criminal act but insurance to take care of civil consequences arising out of his criminal act can be done. This is applicable in the case of motor Insurance where a driver found guilty of an offence which is involved in an accident receives the claim for damage to his own car and also liability incurred due to damage to another's property but he shall not be insured for the amount of penalty that was imposed for his offense.

(v) *Financial Value.* Insurable interest must be capable of financial evaluation. In the case of property and liability incurred it is easily evaluated but in life it is difficult to put a value on the life of a person or his spouse and this depends on the amount of premium the individual can bear. However, in cases where lives of others is involved a value on life can be placed i.e. creditor can put a value on the life of debtor restricted to the extent of the loan.

Employers have an insurable interest in the lives of their employees because if the employee dies there will be cost on training of the replacement and in the case of death of a key employee there may be loss of income as well. The amount of insurable interest cannot be exactly determined but it should be reasonable and proportionally related with salary of an employee; contribution level of a key personal or equity contribution in case of partners.

Assignment of policies is possible but normally not without the permission of the Insurer because it can mean a change in the underwriting consideration as the new policyholder may not have the same insurable interest.

Fire and other Misc. policies are not freely assignable as the Insurer at the time of underwriting has satisfied himself about the Insureds attitude or treatment of the subject matter and its loss causing capability. This would however change in the case of an assignee and it is reasonable to give the insurer a chance to consider the credentials of the new proposer. When the Insurer gives his consent to the assignment of the policy a new contract is in fact being entered into and this is called NOVATION.

Marine cargo policies are however freely assignable without the knowledge or the consent of the Insurer the reason being that the ownership of the goods insured frequently change when the goods are still in

transit and it is necessary that the benefit of the policy passes to the new owner.

In some cases, only the proceeds of the policy are assigned. There is normally no objection to such assignments as the assured is still a party to the contract with the insurer and he has to continue to comply with all the terms and conditions of the policy with the only difference being that in event of a claim the insurer is directed to pay the amount to the Assignee.

Insurers protect themselves by taking a receipt from the person receiving the amount discharging the Insurer from any further liability. This condition arises often in motor claims when bills of repair are directly paid to the garage and not the owner of the vehicle. In these cases, the garage owners obtain a letter of satisfaction from the owner and submit his bills to the Insurer directly for payment.