INSURABLE INTEREST IN LIFE: SECTION 40 OF THE INSURANCE ACT, 1963 (ACT 89)

Introduction

The Insurance Act 1963 (Act 89), the main insurance legislation in Malaysia, was intended primarily to be a regulatory piece of legislation rather than a code on the substantive aspects of insurance law. There are, however, some provisions therein which deal with substantive law. Of these, one of the most significant is perhaps section 40 which radically alters certain aspects of the common law relating to insurable interest in life insurance.

The most important provisions in section 40 are sub-sections (1) and (2). They read:

> (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 null and 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 the insurable interest at that time.
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> (2) The lives excepted from sub-section (1) 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 either wholly or partly dependent.

Neither the origin[1] of, nor the justification[2] for, the introduction of section 40 can be clearly determined.

[1]Section 40 was in the original Bill as tabled in Parliament but was not in the draft proposal of the Act in the *Report Upon Insurance Legislation for the Federation of Malaya, 1960*, as was submitted by SW Caffin. Caffin was a former Insurance Commissioner of Australia who was appointed by the government of the Federation to prepare the said Report and to draft a comprehensive insurance legislation.

[2]The Minister of Finance when tabling the Bill justified the inclusion of section 40 by referring to the then common practice whereby members of the public were insuring the lives of strangers with the hope that the lives insured would die early.

The Effects of Section 40

Under the common law there are two basic rules governing insurable interest in life insurance. First, for there to be an insurable interest, there must generally be pecuniary interest of some kind. Second, insurable interest is presumed to exist in two instances: when a person insures his own life or that of his spouse.

Section 40 of the Insurance Act 1963 seems to have left the first basic principle untouched but has enlarged the second. Insurable interest is presumed to exist (and hence need not be shown) not only when a person insures his own life or that of his spouse, but also when he insures the life of his child or ward who is below the age of majority at the time the insurance is effected and also when he insures the life of anyone upon whom he is at that time wholly or partly dependent.

(i) *Insurable interest in one's own life*

The Life Insurance Act 1774 (UK) makes no exceptions to the requirement of insurable interest in life insurance. The common law however has long since recognised that insurable interest need not be proven when a person insures his own life.[3] Such a requirement could not have been justified either by the aim of avoiding wagers or preventing destruction, for a man would not commit suicide to get insurance moneys not for himself but for his estate.[4]

With respect this justification was not valid even at that time. Even prior to 1963, the Life Insurance Act 1774 (UK) which was then, and still is, applicable here by virtue of section 5 of the Civil Law Act 1956, clearly provides that no insurance shall be made where the persons to whom the policies are issued have no interest. There were also then already in existence the Contracts Act 1950 and the Civil Law Act 1956, both of which have provisions declaring contracts by way of wagers void. (See sections 31(3) and 26 respectively).

[3]In *M'Farlane* v *The Royal London Friendly Society* (1886) 2 TLR 755 at p. 756, Pollock B. said that there was nothing to prevent any person from insuring his own life a hundred times.

[4]The insurance by a man on his own life is not within the mischief of the 1774 Act as a man does not gamble his own life to gain a Pyrrhic victory by his own death: *Griffiths* v *Fleming* [1909] 1 KB 805 at p. 821, per Kennedy LJ. See however, *Beresford* v *Royal Insurance Co.* [1938] AC 586, where the unfortunate Major Rawlinson committed suicide to benefit his creditors.

In Malaysia this basic common law principle is given statutory recognition by section 40 of the Insurance Act. While sub-section (1) refers to a policy insuring the life of anyone 'other than the person effecting insurance', sub-section (2) lists the lives excepted from the requirement of insurable interest 'besides that of the person effecting insurance'.

(ii) *Insurable interest in the life of one's spouse*

The common law presumes the existence of insurable interest when a person insures the life of his/her spouse irrespective of any evidence of pecuniary interest.[5]

While the provision in section 40(2) does not seem to materially differ from the common law, the application of this provision amongst Muslims can bring about interesting practical differences. As a Muslim man in Malaysia is allowed to have up to four wives at the same time, a man who in fact has four wives is presumed to have insurable interests in the lives of all the four. As the law requires interest to be shown only at the inception of the policy[6], even if he divorces all four of them and marries another set of four, he would be able to retain his policies on his four ex-wives and yet insure the lives of all his new wives.

(iii) *Insurable interest in the lives of one's minor children or wards*

Under the common law, in the absence of evidence of pecuniary interest, a parent does not have an insurable interest in the life of his minor child.[7] Neither does a guardian in the life of his ward.

In what seems to be an interesting departure from the common law, section 40(2) exempts from the requirement of insurable interest, a policy taken out by a person in the life

[5] *Griffiths* v *Fleming*, *ibid*, and *Reed* v *Royal Exchange Assurance Co.* 170 ER 198.
[6] See *infra*, pp. 166-167.
[7] *Halford* v *Kymer* 109 ER 619.

of his minor child or ward, who is below the age of majority[8] at the time the policy is effected.

As the origin and rationale of this particular clause in section 40(2) has never been explained, it remains unclear what could have motivated the legislature to radically change the common law. Interestingly though, the Life Insurance Act 1945 of Australia has a similar though not identical provision.[9]

In all other relationships where insurable interest is presumed to exist under section 40, there runs a common connecting thread, i.e., there is some form of dependence by the person insuring upon the life to be insured. Such a dependence cannot be said to be present in a parent - minor child or guardian - ward relationship. If the term 'dependence' in this context is to be taken to include the vague notion of 'expected dependence', i.e., that the parents or guardians having taken care of the minors are entitled to expect future pecuniary returns from them, then this clause should not be restricted to minor children only. After all most parents and guardians continue to 'invest' in their children long after the children have reached the age of majority.

If such a clause is intended to enable parents or guardians to give to their children or ward some property to dispose of in the future, then there are already in existence other more effective means of doing so. The parent or guardian can in fact take out life policies on the children's lives, not for their (the parent's/guardian's) benefit but for the benefit of the said children.[10] Section 41 of the Insurance Act allows a child above ten years of age to enter into a contract of insurance provided that if the child is below sixteen years of age, he must have the written consent of his parent or guardian.

[8]A child attains the age of majority on his 18th birthday; Age of Majority Act 1971, section 2.

[9]Section 86(1) of the Australian Act provides that a parent of a child under 21 years of age or a person *in loco parentis* with such a child has an insurable interest in the life of that child.

[10]This was suggested by Bayley J in *Halford* v *Kymer*, *op. cit.* footnote 7, at p. 621, as a means of avoiding the common law requirement that insurable interest be shown when a parent takes out a policy on the life of his child.

A parent can also provide for the future security of his children by means of insurance by taking out a policy on his life but expressing it to be for the benefit of the child. This automatically creates a trust policy under section 23 of the Civil Law Act 1956.[11] In such a situation, so long as the object of the trust remains unperformed, the moneys payable under such a policy will not form part of the estate of the deceased or be the subject of his debts.

A parent or a guardian is also free to assign a policy on his life to his child or ward once the child or ward has reached the age of majority as the law does not require an assignee of such a policy to have any insurable interest in the life of the assignor.

In the light of all the above, there seems to be no valid justification for doing away with the requirement of insurable interest when a parent or guardian insures the life of his minor child or ward. Such a provision in fact defeats one of the main reasons for the requirement of insurable interest in life insurance, viz. the removal of the temptation on the policy-holder's part to destroy the life insured.[12] A clause doing away with insurable interest in such a relationship, like that in section 40(2), may in fact encourage child neglect and abuse as there is little to prevent a parent or guardian who has insured the life of his minor child or ward to neglect or abuse the said child or even to use other subtle means to hasten the child's death.

(iv) *Insurable interest in the life of a person on whom one is wholly or partly dependent*

Lastly, insurable interest is deemed to exist under section 40(2) when a person takes out a policy on the life of another on whom he is either 'wholly or partly dependent'.

[11]This provision basically follows section 11 of the Married Women's Property Act 1882 of the U.K. (45 and 46 Vict. c. 75). For a good account of this so-called 'Section 23 Policies' see Balan, P. and Joned, A., 'Amanah Yang Berbangkit di bawah Seksyen 23 Akta Undang-undang Sivil 1956', [1983] JMCL 201.

[12]The preamble to the Life Insurance Act 1774 (UK) mentions the need to prevent 'a mischievous kind of gaming' in an obvious reference to similar practices.

Because of its extreme generality and because this clause, like all the other clauses in the sub-section, has yet to be tested in a court of law, the precise scope of this provision remains a matter for speculation. Persons on whom one 'is either wholly or partly dependent' is so broad in its scope and so vague in its meaning that it is difficult to determine which relationships are within its purview. Neither the nature nor the degree of the required dependence is reflected in the clause. While 'wholly dependent' may be clear in its meaning, 'partly dependent' can range from minimal to almost total dependence. It is also not stated whether the dependence must be exclusively pecuniary in nature or whether emotional or physical dependence would suffice. There is also the further question of whether the dependence, whatever its nature, must be based on a legally recognised relationship or whether mere factual dependence is enough. Perhaps, all the uncertainties in this clause can be paraphrased by posing the question: Will a paraplegic who depends upon the generosity of his neighbour to cook his evening meals for him, be presumed to have an insurable interest in the life of that neighbour, by virtue of this clause in section 40(2)?

Inspite of the multitude of uncertainties as to its precise scope, certain types of relationships where insurable interest must traditionally be shown under the common law, will clearly come within the purview of this provision. A child who is dependent upon an adult (whether his parents or other relatives) for support and education, can by virtue of this clause, insure the life of that adult without the need to prove the existence of insurable interest. Conversely, parents too are deemed to have insurable interests in the lives of their children who support them. Outside the sphere of traditional family ties, a common law wife can be deemed by virtue of this clause, to have an insurable interest in the life of the man who maintains and supports her. The absence of any reference to either 'financial' or 'pecuniary' dependence can also be taken to mean that homosexual couples too may be able to insure the lives of their partners without the need to prove the existence of pecuniary interest in the strict and orthodox sense.

Furthermore, as by virtue of the Interpretation Act 1967[13], 'person' includes a body of persons, corporate or unincorporated, companies and other corporate entities can be presumed to have an insurable interest in the lives of their employees provided they can show that they are either totally or partly dependent upon such employees. Such companies would thus not have to prove pecuniary interest not only in their key employees but also in other personnel whose lives they wished to insure.

Section 86(1) of the Life Insurance Act 1945 of Australia has a clause similar to the one considered above. The Australian provision is however narrower in its scope and thus clearer in its meaning. A person is deemed to have an insurable interest in the life of another upon whom he is either wholly or partly dependant *for support or for education.*[14] In stipulating the nature of the required dependence, the Australian provision is much clearer though more restrictive in its meaning.

(v) *Insurable interest in the lives of others*

Section 40 has not altered the common law as regards insurable interest in the lives of persons other than those considered earlier. In all other circumstances therefore, whether a person has an insurable interest in the life of another depends on whether he has a pecuniary interest in that person's life. Presumably particular situations where insurable interest has been held to exist under the common law will also be so held in Malaysia. A creditor, for instance, has an insurable interest in the life of his debtor.[15] Where there is a contract of employment, an employee has an insurable interest in the life of his employer to the extent of the contract,[16] and so does the employer in the life of the employee.[17] The sole determinant in all these situations is whether there exists a pecuniary interest which is based on a legally enforceable relationship.

[13]Act No 23 of 1967, section 3.
[14]Emphasis added.
[15]*Godsall* v *Boldero* 103 ER 500.
[16]*Hebdon* v *West* 122 ER 218.
[17]*Green* v *Russell* [1959] 2 All ER 525.

(vi) *Time at which insurable interest must exist*

The Life Insurance Act 1774 (UK) does not stipulate the time at which insurable interest must exist. The courts however have, in *Dalby* v *The India and London Life Assurance Co.*[18] by overulling the earlier decision in *Godsall* v *Boldero,*[19] made it clear that insurable interest must be shown to exist at the inception of the policy. This is also the position under the Insurance Act as section 40(1) provides that insurable interest must exist 'at the time the insurance is effected'.

By apparently endorsing the decision in *Dalby* and incorporating it into a statutory provision in Malaysia, the question as to when insurable interest must be shown to exist has been made 'judge-proof'. The wisdom and utility of converting a case law into a statutory provision is dubious. Case law can react more quickly to changes in the commercial world as judges are known to have reinterpreted, overruled and widened the scope of existing decisions.

Even in the absence of any statutory provision incorporating it, the decision in *Dalby* would have been the law in Malaysia anyway. By having a crude provision requiring insurable interest to exist at the time the insurance is effected, the legislature has overlooked much of the subtlety of the decision in *Dalby*. It has been said that in *Dalby* there was not merely an insurable interest at the time the policy was effected but there was also then an expectation that the interest would subsist throughout the duration of the policy, i.e. until the occurrence of the insured event.[20] Hence when the policy was effected there was not merely an insurable interest in existence but there was also a reasonable expectation that such interest would continue to exist. The expectation of the continued existence of the insurable interest up to the time of loss is extremely important as it effectively replaces the indemnity principle in ensuring that life policies are not used for wagering. It serves as a sieve to separate the

[18]139 ER 465.
[19]*Op. cit*, footnote 15.
[20]MacGillivray, EJ, *MacGillivray and Parkington on Insurance Law*, 7th Edition, Sweet & Maxwell, London 1981, p. 15.

gamblers from those with a genuine interest in the life insured. Thus by requiring insurable interest to exist only at the time the policy is effected, section 40(1) as it stands has not only failed to effectively reflect the common law but has also brought the law in Malaysia in this respect to a standstill while the common law remains open to continued interpretation. However, the courts can, and it is hoped that they will, preserve the spirit of the decision in *Dalby*, by introducing an additional requirement that that there must be a reasonable expectation that the insurable interest which exists at the time the insurance is effected, will continue to exist throughout the duration of the policy.

(vii) *Insurable interest and the amount recoverable under a life policy*

Section 40(1) provides that the policy moneys paid under a life policy shall not exceed the amount of the interest at the time the policy was effected. The Life Insurance Act 1774 (UK) on the contrary does not specify the time at which the value of the interest is to be determined; it merely provides that the amount recoverable from the insurer shall not be greater than the value of the insured's interest.[21] As according to *Dalby* as long as insurable interest exists at the inception of the policy, the full policy moneys are payable on the occurrence of the insured event, the effect of the two provisions seem to be the same. Both underline the fact that a contract of life insurance is not one of indemnity.

(viii) *Effect of the absence of insurable interest on a life policy*

Inspite of the fact that the expressed purpose behind the introduction of section 40 was to prevent gambling on people's lives by means of insurance policies, the Insurance Act 1963 imposes no penalty for the contravention of section 40. Section 40 merely declares a contract made in contravention

[21]Section 3.

of the provisions therein to be void but if the insurer agrees to honour such a contract, there is in fact no way for the state to effectively check such practices.

It is regrettable that the Insurance Act which is almost two centuries younger than the Life Insurance Act 1774 (UK), chooses to repeat the omission of the 1774 Act in not including a penalty for persons entering into a contract of life insurance where there is no insurable interest. Long before the Insurance Act 1963 was passed it was already clear that the primary defect of the 1774 Act was its failure to impose such a penalty.

Conclusion

While some of the changes introduced by section 40 of the Insurance Act are most welcome, the multitude of possible problems that may arise in determining its scope and application clearly indicate that radical changes to the substantive law of insurance cannot be effectively introduced in this country by merely having a few such provisions scattered in a piece of legislation which is basically regulatory in nature. The common law has evolved over such a long period of time and has been tried and tested in the courts of law over the same period, that its principles cannot be effectively and easily negated by a single, or even several, statutory provisions.

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