INSURANCE LAW

(1) CONTRACT OF INSURANCE

- A contract of insurance is a contract whereby one person (insurer) undertakes, in return for the agreed consideration (premium), to pay another person (insured/assured) a sum of money or its equivalent on the happening of a specified event.
- The aforesaid specified event must have some element of **uncertainty** as follows:
  (i) happening of the event depends on accidental causes and the event may therefore, never happen (e.g. fire insurance);
  (ii) although the event is bound to happen in the ordinary course of nature, the time of its happening is uncertain (e.g. life insurance/assurance).
- The specified event must be **adverse to the interest of the insured/assured** i.e. the accident must result in loss to the insured/assured.
- Every insurance contract would fall into either:
  (i) indemnity insurance – these types of insurance indemnify the insured against losses and therefore, the payment made by the insurer would depend on the **measure of loss** (e.g. fire insurance, motor insurance);
  (ii) contingency insurance – these types of insurance provide for **specific sums** to be paid on the happening of a contingent event (e.g. life insurance).
- The general principles of law of contract will apply to an insurance contract.

(2) CLASSIFICATION OF INSURANCE CONTRACTS

Insurance contracts can be classified in several ways as follows:

1. contracts of indemnity vs. contracts that are not of indemnity
2. depending on the type of risk covered:
   (i) Life insurance – insuring human lives. The payment is assured on death or on the happening of any contingency dependent on human life. The policy would state the amount for which he is covered, period of maturity etc.
   (ii) Fire insurance – effecting insurance against loss by or incidental to fire.
   (iii) Marine insurance – insuring vessels, cargo and freight for any transit.
   (iv) Motor vehicle insurance – insuring against loss of motor vehicles or damage arising out of or in connection with the use of motor vehicles including 3rd party risks.
   (v) Miscellaneous insurance – e.g. personal accident insurance, burglary insurance, professional indemnity insurance, employer's liability insurance.
3. (i) Personal insurance – specified event operates on the person (i.e. the body) of the assured or of a 3rd party.
   (ii) Property insurance – specified event operates on the property of the insured.
   (iii) Liability insurance – specified event imposes on the insured a liability towards a 3rd party.

(3) INSURANCE *VS.* ASSURANCE

- Insurance – the contract indemnifies the insured against unforeseeable damage which may or may not occur (e.g. fire/motor). The loss is not foreseeable and the loss may or may not occur.
- Assurance – the assured or his representative would receive a sum of money on the occurrence of an event which is bound to happen. The risk is foreseeable and definite. The assured would get the contracted sum of the claim at the end of the period assured (when the insurance matures); or if he dies within that period, his heirs will get that amount.

(4) INSURABLE INTEREST

- Every contract of insurance requires an insurable interest to support it; otherwise it is invalid.
- The insurable interest refers to the happening of an event against which the insured insures.

- The insurable interest would always be adverse to the assured, causing a loss or creating a liability.
- The owner of a property would have an insurable interest in such property and it is possible that persons in possession of a property even though not the owner (e.g. hirer of a vehicle) too may have an insurable interest.
- A person always has an insurable interest in his own life.
- One spouse has an insurable interest in the life of the other.
- A parent has no insurable interest in his child's life nor has the child in the life of the parent unless there is support (e.g. a parent has an insurable interest in his/her minor child).
- The insurable interest should have a pecuniary value.
- An insurable interest need not be of a permanent or continuing nature.
- Insurable interest must be a real interest and the mere expectation of acquiring an interest however probable does not give the right to insure the property out of which the expectation arises.

(5) *UBERIMAE FIDEI* / UTMOST GOOD FAITH & EFFECTS OF NON-DISCLOSURE

- A contract of insurance is one of utmost good faith and it is the duty of the proposed assured to make a full disclosure to the insurer without being asked of all material circumstances because the insurer knows nothing and the assured knows everything.
- Accordingly, the proposed insured/assured must disclose all **material facts** which are **within his actual or presumed knowledge**.
- Every contract of insurance proceeds on the basis that the duty of disclosure has been complied with by the insured and the failure to discharge this duty renders the contract voidable at the instance of the insurer.
- The duty of disclosure extends not only to matter which are actually known to the assured but also material facts which the assured ought to have known in the ordinary course of business.
- In *Lindenau vs. Desborough* (Irish case), it was held that the underwriter should be informed of every material circumstances within the knowledge of the assured. The proper question is whether any particular circumstance was in fact "material" and not whether the party believed it to be so.
- However, there is no duty to disclose facts which the assured did not know and which he could not reasonably have been expected to know. Nevertheless, if the fact could have been disclosed by the assured if he had made reasonable inquiries, he is guilty of breach of duty towards the insurer.

- The duty to disclose all material facts extends to the insurers and their agents as well and therefore, they too should disclose all material facts within their knowledge.
- In *Carter vs. Boehm* (English case) it was held that the insurance policy would be equally void against the underwriter, if he concealed information.

(6) WHAT IS "MATERIAL"?

(i) The test of the "**prudent insurer**" – under this test, every circumstance which would influence the judgment of a prudent insurer in fixing the premium or determining whether he will take the risk, is material. A prudent insurer would be measured by the degree of knowledge and foresight that would be possessed by experienced and intelligent insurers carrying on business in the market at that time.

(ii) The "**reasonable assured**" test – under this test, consideration is given to what a reasonable assured would have considered as material.

- It is irrelevant as to whether the non-disclosure would have influenced the particular insurer. If the facts are material, it must be disclosed.
- The assured's opinion as to whether the fact is material is irrelevant.
- Materiality is determined by reference to the date at which it should have been communicated to the insurers.
- The following facts are normally considered as material:
  (a) Where the subject matter of insurance is exposed to more than ordinary danger (e.g. persons engaged in dangerous sports, persons working in mines etc.).

(b) Special motives of the assured.
(c) That the liability of the insurers would be greater than normal.
(d) Moral hazard. E.g. previous claims, refusal by other insurers to effect insurance, similar insurance with other insurers.
Lambert vs. Co-operative Insurance Society Ltd – The insured's husband had previous convictions for retention of stolen property. This fact was held to be material in the case of an "all risks policy on jewellery".

- Following facts are generally not considered as material and need not be disclosed:
  (a) Those known or which should reasonably have been known by the insurers.
  (b) Those which could have been discovered by making inquiry.
  (c) Those which the insurer has waived.
  (d) Those which lessen the risk.
  (e) Those which need not be disclosed due to a condition of the contract.

(7) THE PROPOSAL

- The proposed insured/assured would fill up a proposal form and forward it to the insurer who would be entitled to accept or reject it.
- Either party is entitled to withdraw at any time before acceptance.
- The proposal form would have questions relating to the following:
  (i) Description of the proposed assured – name address, occupation etc.
  (ii) Description of the rights – this varies according to the nature of the insurance. E.g. if the proposed insurance is on property, full description of the property must be given.
  (iii) Description of the circumstances affecting the risk – this would relate to making a determination as to whether the risk is greater than usual. E.g. property insurance – description of nature and situation of any building containing the property proposed to be insured, measures taken to prevent to minimize losses.
  (iv) History of the proposed assured – experience of the proposed assured in making claims, relationship which the assured has with other insurers.

(8) COVER NOTE

- Since there is a time lag between the time the proposal is submitted and it is accepted by the insurer, it is the practice of insurance companies to give the proposed protection by the issue of a cover note.
- Cover notes are not issued in life insurance.
- The cover note is normally issued by the insurance agent for and on behalf of the insurer.
- Cover note would be valid until the proposal is accepted/rejected or until the date specified in the note, whichever is earlier.
- The cover note is not the contract of insurance itself. Therefore, if any loss occurs during the cover note period, it would be governed by the terms of the cover note and not the terms of the insurance policy itself, which may be issued later.

(9) THE CLAIM

- In order to make a claim, there should be a **loss caused by the peril insured against**.
- Loss should be caused when the peril operates on the subject matter of the contract of insurance.
- Recovery of the claim is subject to the **doctrine of proximate cause**. This means that the courts will look at which of the causes in the link is to be attributed within the intention of the policy. All causes preceding the proximate cause would be rejected as being too remote. This ensures that the policy would cover any loss which can be fairly attributed to the operation of the peril.
  In *Hamilton, Fraser & Co. vs. Pandorf & Co.* it was held that the damage caused to the cargo by sea water escaping through a hole made by rats was damage caused by "danger and accidents of the sea" and therefore, covered by the policy.

- There may be limitation on the amounts recoverable under the following:
  (a) Contribution clause – if there is any other insurance covering the property destroyed or damaged, the liability of the insurer upon the policy is limited to their rateable proportion of the destruction/damage.
  (b) Average clause – if at the time of the loss the sum insured is less than the value of what is insured for, the insured is to be considered as his own insurer for the difference and must bear a rateable proportion of the loss.
  (c) Excess clause – insured is expected to bear the loss up to a particular amount and it is only the excess which is insured for.
  (d) Clause specifying smaller payments in certain circumstances – in *Scragg s. United Kingdom and General Provident Institution*, the policy provided that the sum payable was limited if the insured died as a result of engaging in motor racing, motor rallies etc.
  (f) Limitation by statute.

(10) SUBROGATION

- Subrogation applies in all contracts of insurance involving an indemnity.
- This enables the insurers who have paid the loss to be placed in the position of the assured/insured and succeed to all his rights and remedies against 3rd parties in respect of the subject matter of insurance.
- This right does not arise until the insurers have admitted the assured's claim and have paid the sum payable under the policy.
- Rights must be enforced in the name of the assured. If the assured has made a formal assignment of his rights or if there is a statutory provision the insurer may be able to enforce the rights in its own name.
- The assured has a duty to give assistance to the insurer and not prejudice the insurer's position with respect to the exercise of the rights of subrogation.
- Insurers are under an obligation to account for any profits arising from subrogation to the assured.

  Yorkshire Insurance vs. Nisbet Shipping Co. Ltd. – This case involved a situation where a ship was insured for Pound Sterling 72,000/-. She became a total loss due to a collision with a Canadian Governmental Vessel and the insurers paid this sum and claimed damages from the Canadian Government. The action was successful and due to a devaluation in the Pound Sterling they recovered 127,000/-. It was held that the insurers were only entitled to the 72,000/- and the balance belonged to the insured.

(11) REGULATION OF INSURANCE INDUSTRY ACT, NO. 43 OF 2000 (AS AMENDED)

- This statute provides for the establishment and constitution of the Insurance Regulatory Commission of Sri Lanka which is responsible for the development, supervision and regulation of the insurance industry in Sri Lanka.
- It also provides for the registration of insurers, insurance agents, insurance brokers and their qualifications.
- In terms of this statute, no person in Sri Lanka can obtain foreign insurance. The only exceptions are reinsurance and health insurance through a broker registered in Sri Lanka.