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Indian Insurance Regime on Trading of Insurance Policies

SUNDAR KISHORE¹ AND P. HARIHARAN²

ABSTRACT

Trading of Life Insurance Policy is a relatively new kind of business which has entered India. This has tapped into the whole new market for insurance trading in the secondary in the market which was not present earlier in India and has generated a huge income and has made a substantial contribution to the growth of the economy. But the latest development in this sector has restricted the growth of the sector. This paper discusses about several aspects that revolve around the legality of trading of life insurance policy, in India. The very reason for regulating the insurance sector is to provide social security to the policyholders; however, the statute fails to consider other aspects, which are the financial security and development through the trading of such policy. This paper will discuss the historical background for the S. 38 of the Life Insurance Act of 1938, which allowed for the assignment of life insurance policies. However, this particular section has brought in many changes following the 2015 amendment, which has affected the whole sector of trading policies.

Restrictions have been imposed on the transfer or assignment of life insurance policies, which has affected the secondary market, which is essential for any country to develop its economy. India is by this step losing out on opportunities to improve the country's economy because when the value of the product in the secondary market rises, its value in the primary market rises as well.

This paper will look into the background of the application of section 38 of the Insurance act of 1938 and contentions opposing the validity of the provision. This paper will also discuss the reasons favouring the existence of such provision with help of decided case laws and other opinions from various scholars.

I. INTRODUCTION

Life Insurance has had a long journey, in different parts of the world, with respect to its evolution to the modern form of life insurance policy. It started out as a gambling business in the European countries, especially in England, and now serves as a social security to the people in dire need of help or assistance, in the time of emergency. These Life insurance policies act as a safety mechanism for the policy holders and their dependents, as they aid by providing

¹ Author is a Student at Alliance University, Bangalore, India.

² Author is a Student at Alliance University, Bangalore, India.

financial interest associated to the policy in case death of the policy holder by happening of an event covered under the policy. The policy, usually, is fixed for a particular term, until which the person is covered against any risk mentioned in the policy. So Basically, In the event of death of the Insured person or when the term of the policy is over i.e., matured, the company offering this policy must provide for the sum insured in the policy. By assuring the delivery of the sum assured in the policy, the life insurance policies guaranty's in reducing the risk associated with the event mentioned in the policy or contract. It also helps in the providing a sense of social security to the people buying the policy.

Owing to enormous number of business policies and plans enacted by the government, to expand the economy of the nation, many business units and activities have emerged all over the country; this has consequently increased the purchase of other types of insurances like fire insurance and marine insurance to protect the entities or subject matter from the risk of loss. However, Life insurance is still very much relevant and an example can be drawn out of the COVID-19 period, its effect around the world in such a short span, had many questioning the very existence of human life in future, people were not prepared for such events, the death of COVID victims had also invariably affected the dependents of the victims and there was not much that the government was able to do until the situation got a whole lot better. People are still in constant fear of risk by unforeseen events; hence life insurance policy is equally demanded compared to the other policies covering different subject matters.

Historically, Insurance regulation has seen a big change over the years. IRDA, Insurance Regulatory and Development Authority, came into existence when India witnessed an increasing foreign involvement in the Insurance sector as the insurance market was opened for private players. Regulatory system had gained a significant amount of power and duty, due to this foreign participation and thus Insurance act, 1938 was introduced. However, transfer and assignment of Life insurance was governed by the Transfer of property act, 1882, before the Introduction of the Insurance Act, 1938. Section 130,132 and 135 of Transfer of property act, 1882, dealt with transferable claims and assignment of policies. Transfer of property act treated the transfer of insurance policy like any other transfer of property, the transfer effected in the transfer of all the rights, duties and actionable claims of the transferor to the transferee. The very fact that TOPA, 1882 governed trading of insurance policy before the enactment of Insurance act,1938 clearly shows the intention of the statute to treat the life insurance policy as just another "PROPERTY". However, unlike transferability governed under the TOPA, where it was freely transferable rights given to other properties, after the enactment of Insurance act,

1938, life insurance policies have different rule when it comes to trading of such right by the owner.

For a long time, there has been a contention opposing the legality of trading life insurance policy and the validity of the provision allowing the same, especially after the judgement from Bombay high court in the case of *Insure Policy plus Services Pvt Ltd and Ors. v. LIC of India, 2007*. The court upheld the validity of Section 38 of Insurance act, 1938, which says that assignment of insurance policy can be done to a third party by policy holder from a consideration or a gift, by which the assignee will receive all the benefits of the policy which the, earlier, the policy holder was entitled to. However, 2015 amendment to section 38 has brought in certain changes to the provision, by also validating the same.

II. DIMENSIONS OF LIFE INSURANCE POLICIES

The purpose of taking a life insurance policy can be viewed to have two very different dimensions based on their purposes. The one long standing argument is that a Life Insurance Policy is a measure of Social Security undertaken by the subscriber of the policy himself. The purpose of a basic Whole Life insurance policy is to essentially protect the beneficiaries of the policy financially on the death of the assured or to create a financial security on the period of maturity upon the assured himself in any other kind of life insurance policy with a specified term of maturity. And this life insurance policy is usually taken by the assured in order to mitigate the risk of any illness that may affect him in a later stage of his life or any occupational hazard that may lead to the sudden demise of the assured. Thus, in this scenario the object for which the insurance policy subscriber goes for the subscription of a life insurance policy is that to mitigate the risk on his own life and creating a financial security over himself or his beneficiaries. Hence, it can be considered as a social security measure.

On the other hand, the life insurance policy can be viewed as an investment option. The Life Insurance Policy can be traded in the secondary market to gain a lot of profit. Here the life insurance policy is treated more as a commodity rather than a measure of social security. Here, the assignor, the original subscriber of the Insurance policy has an opportunity make investment and expect returns through assigning such policy to a third party and third party is benefited in this process as he is essentially subscribing to the policy at a very late stage and inheriting all the rights of a policy holder at a relatively low risk while gaining a considerable return on the policy. Thus, this position ethically justifies action of both the assignor and assignee as the assignor assigns the policy to an assignee at the time of his need and assignee has an opportunity to mitigate from the risk on his/her life. But this action interferes with the right of the insurance

company to do business and experience profit from such endeavour.

III. STANCE OF INDIAN LAW BEFORE 2015 AMENDMENT

Sections 38 of the Insurance Act of 1938, the Policy holder of any Insurance Policy have the right to assign any such policy in the name of any third party for any amount of consideration or even as a gift without any consideration. Through this transaction the assignee is now entitled to all the benefits of the insurance policy that normally would be enjoyed by the initial subscriber. The whole transaction imitates a transaction of a moveable property including a bond or a negotiable instrument. Thus, clearly the whole transaction of a trading of life insurance policy can be deemed to have the scope of policy to be treated as a commodity rather than a measure of financial security under the provision of Section 38 under the Insurance Act of 1938. This argument is only strengthened by the other practice that normally exists in the insurance regime where the insurance policy can be used as a means to recover debt from the assured person by a third party who has no insurable interest.

IV. INSURABLE INTEREST

The practice of assignment of Life Insurance Policy leads into the age-old problem of Insurable Interest. The general rule is that before the subscription of any insurance policy it is essential for the subscriber to have an insurable interest over the subject matter of the policy. But this also subject to an exception that a creditor in order to recover a debt amount from a debtor may subscribe for a life insurance policy in the name of the debtor without any insurable interest over the life of the debtor.³

The presence of insurable interest over the subject matter of the insurance contract gives meaning to any insurance policy and distinguishes it from a wagering contract. But in the case of Assignment of a Life Insurance Policy to an unrelated third party clearly lacks the insurable interest. Now this lack of insurable interest during the assignment of a life insurance policy to a third person has put the ethical integrity of such assignment of the life insurance policy in question. This issue was extensively discussed in the 2007 case of Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India⁴ which has turned out to be a landmark case in the Indian Insurance Law Regime which is elaborated below.

Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India⁵

In this case the questions arose before the High Court of Bombay whether life insurance

³Crotty vs Union Mutual Life Insurance, 144 U.S. 621, 623, 624 (1891)

⁴ Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India, 2007 (109) Bom L R 559.

⁵Id

policies are tradable commodity and whether the trading of the same by financial institutions was justified. The Insure Policy Plus and Services is a Private Limited Company which essentially acquired insurance policies from policy holders, in this instant case such policy is a life insurance policy assigned by the Life Insurance Corporation of India for a consideration less than the surrender value of the insurance policy and assign the same policy to a third party who are in immediate need of such policy with a higher rate making profits from the difference in the margins. This was later realized by LIC and denied to acknowledge such assignment stating that the assignment can only be made by them and the profits realized therein rightfully was theirs to be realized and assignment made by companies like IIPS will no longer be registered. The IIPS contended that the assignment made by them are valid and are in compliance with Section 38 of the Insurance Act of 1938. They also argued that the assignment of Life insurance Policy is the right of Policy Holder and the Insurer cannot interfere in that right of the assured unless if such assured has a malicious intent to defraud the insurer. Moreover, the LIC used their Life insurance policy as security in various banks and other financial institutions and thus, the use of the policies for similar purpose by other institutions is also justified argued the IIPS.

The main contention of the LIC is that the IIPS does not hold any insurable interest for the complete period for which the Life Insurance Policy is availed. And that any insurance contract without insurable interest is essentially a wagering contract and such contracts are void contracts under Section 30 of the Act. The LIC also argued that the revival of a lapsed policy should lie only in the hands of the insured person and not with any other third party. The LIC moreover, stated that the Life Insurance Policy measures in India are a measure of Social Security.

The High Court of Bombay opined in this case that the Insurance Policy has to be treated as an investment which is made by regular payment on a subject matter which is the payment of premium over the policy over a period of time which yields returns in the future which is the recovery of the sum insured on the end of the term of the policy. Thus, the High Court of Bombay decided that the Insurance Policy can be freely assigned to any person or a company even it is for the purpose of trading and it is under the complete discretion of the Assured person. This essentially meant that even if a third party does not hold any interest over the life of the assured person, he can make profits over the Life Insurance Policy availed by such assured person.

V. DEVELOPMENT IN LATER STAGES

In 2015, Section 38 of the Insurance Act of 1938 was amended to bring in certain changes with

regard to assignment of insurance policies. This essentially vested the Insurer to restrict assignment of the insurance policy in certain scenarios as mentioned below

- (i) If such assignment or transfer is done in bad faith
- (ii) If such assignment or transfer is made against the interest of the Policy Holder
- (iii) If such assignment or transfer is made against the public interest
- (iv) If such assignment of transfer is made only for the purpose of trading

This amendment was subjected to lot of controversies as it gave the insurance companies lot of power and previous liberal stance of the law on the matters of assignment of insurance policies was disturbed. This closed down the whole sector of trading of insurance policy was affected and entire businesses reliant on this one sector went bankrupt. With Reference to the above amendment, the Life Insurance Corporation of India went in for an appeal for the above-mentioned case.⁶ The Appeal was filed in the Supreme Court requesting the application this law brought in by the amendment of 2015 to Section 38 of the Insurance Act of 1938 to the earlier 2007 judgement of the Bombay High Court in the case of Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India.⁷

The Court was of the opinion that the Life Insurance Policy is not a commodity of trade and it is neither tradable in the primary market nor in the secondary market solely for the purpose of making profits. Thus, the LIC was power to restrict such trade of life insurance policy with respect to the powers provided by the amendment to Section 38 of the Insurance Act of 1938. But the language of the Amendment did not show any intention for a retrospective application of the amended law. The Supreme Court stated that the amendment was made view of prospective application and upheld the Bombay High Court decision and held the circular issued by LIC to IIPS invalid making the insurance policy subscribed before the amendment freely tradable and transferable. Thus, in the current case the LIC cannot enforce such power over the IIPS as the assignment of such policy was made before the amendment of 2015.

VI. ANALYSIS OF INSURANCE LAWS (AMENDMENT) ACT OF 2015

Insurance as a Measure of Social Security

The one major intent of the Insurance Laws (Amendment) Act of 2015 is to treat Insurance Policies as a measure of Social Security and not as a tradable commodity. It is true that the development of Insurance laws in the western countries including the US and the UK is

⁶LIC of India v. Insure Policy Plus Services Pvt Ltd and Ors ; C.A. No.-008542/2009; SC (2015)

⁷ 2007 (109) Bom L R 559

completely different from that of India where idea of trading of Life Insurance Policies is generally not welcomed either by the insurer or the lawmakers and the judiciary. But it is not completely true that the Insurance Policy is only a measure of Social Security. It is singularly visible in the idea of the allowing private players in insurance market by the Insurance Regulatory and Development authority of India (IRDAI) and allowing foreign investment in the insurance sector by the Reserve Bank of India (RBI).⁸ This shows that the intention of the law makers is not only to ensure social security through insurance but also to make profits and make such policies as a tradable commodity in India. This argument is also strengthened by the fact that the policy holders receive concessions in the areas of income tax and such exemption is even allowed for a private company. Thus, the Insurance Sector has to be treated as an opportunity of Investment in the Secondary Market complying with the changing trends and should not be viewed only as an instrument of Social Security.

Role of Insurable Interest

In the above case it is presented by LIC that the need for insurable interest is very important for a contract of Life insurance.⁹ But the Court decided on the basis of a counter argument that the presence of Insurable Interest on the Life insurance policy is limited the time of entering into the agreement.¹⁰ In a United States Judgement *Grigsby v Russel*¹¹ it was held that even though insurable interest is an indispensable essential to an Life Insurance Policy, the refusal of right to trade the policy significantly reduces the value of the policy and thus it must be recognised as a property or a commodity until to an extent until which it is safe. The same is true in the Indian Jurisprudence.

Trading of Insurance Policies in Secondary Market

The transactions in the secondary market with reference to Insurance Policy may be because of various reasons from Payment of Medical Bills to Repayment of Debt or even in the case where no beneficiaries remain surviving. The Trading of Insurance Policies in the Secondary Market can certainly be very beneficial to an economy like India where the Allowance of Private Players and the Foreign Investors is already in place. With some strong regulatory measures by the IRDAI it can really be proven to be all win situation to every single party involved in the transaction.

The Policy Holder can be highly benefited by the trading of Life Insurance Policy in the

⁸ Annexure II, Schedule I of Foreign Exchange Management Act of 2000

⁹Id at 2

¹⁰*Grigsby v. Russel*; 222 US 149

¹¹*Ibid*

Secondary Market. During the initial development of the Insurance Sector the LIC of India held the absolute power with regard to what happen in case of Lapse of a Life Insurance Policy. The Policy Holder when unable to pay the premium of the policy he has the option to either let the policy lapse or to pay an amount to the Insurance Companies for the repurchase of the Policy through which the insurance companies made of lot of benefit. But with the influx of the players from the secondary market this monopoly of the insurance company was set off and the policy holders were able to sell the policies to these players without incurring any major loss.

The Third-Party secondary market players are also benefitted in these transactions as make sizable profits out of the transactions and they also inherit all the rights of the assured while they also make a considerable return at a low risk. The insurer also benefits from such transactions over time as the value increase in the secondary market would eventually increase the rates in the primary market. The new investment opportunity created in the insurance industry will only increase the number of subscribers to the insurance policy expanding the business and yielding more returns to the insurer. Thus, the Trading of Life Insurance Policies creates a rewarding arrangement to all the parties involved.

VII. CONCLUSION

It is very evident that the Insurance Laws (Amendment) Act of 2015 has provided the insurer with lot of power which are overarching in nature which allowed them to act arbitrarily with the reason to protect the social security as the power of refusal of ay assignment done by the insured to a third party by the insurer is inherently wrong as according to the general principle insurer has no say during the assignment of insurance policy and the power exclusively lies in the hands of the assured. Although the Amendment Act of 2015 provides for restriction of trading of insurance policy, the intention of this statute does not match the intention of the other statutes. The idea of the allowing private players in insurance market by the Insurance Regulatory and Development authority of India (IRDAI) and allowing foreign investment in the insurance sector by the Reserve Bank of India shows that Insurance sector is not only for providing social security but also for profit making and acting as an investment opportunity. FEMA regulation allowing foreign investment in the insurance sector and tax exemptions provided also confirm the same.

This trading practice can be proven benefitting both the policy holder and the company, as the policy holder trade such policies in the secondary market is value will increase in the primary market, by this the insuring company can attract many people to buy policy from the company since it has great market value, apart from the social security aspect of it, it can also provide for

financial security. A viable opportunity such as this should be considered to improve the economy of the country. With private players and foreign investors coming in to the picture, the last thing we need is restrictions, which affects both parties involving in the trade and the economy.

Thus, instead of completely banning trading of life insurances, new regulatory framework for such trading in the secondary market should be introduced by the legislation to bring India in equal standing compared to the developed western regions like America and Europe. The secondary markets, in both western regions, are recognized, are institutionalized and constantly regulated due to which they are leading towards growth and success. Many high profile investors and large investing groups have invested in such life settlement policies and claim it as a matter of pride in being the front runner in identifying such investment opportunities. Hence the amendment should be considered for review and suitable actions should be made to secure the financial security of the policy holder and also keep in mind the investment opportunity provided by the secondary market.

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