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# Trading of Life Insurance Policy in Indian Insurance Market: Legal Implications

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## ABSTRACT

*In this paper several aspects revolving around the legality of trading of life insurance policies have been considered with respect to Indian scenario. India though wanting to protect the social security of the policy holders fails to equally consider their financial security and development. India may not have a social security program in place however making this an excuse to restrict itself from playing at par with the global market seems like a heavy price to pay in the long term. S. 38 of the Life Insurance Act of 1938 allowed for the free and unrestricted transfer or assignment of life insurance policies. However, this is no longer permitted following the 2015 amendment. Due to it being a personal contract, restrictions have been imposed on the transfer or assignment of life insurance policies, with covered rights being non-transferable in nature with respect to trading purposes. India is currently in a particularly fortunate position, since most international businesses view it as the most trustworthy emerging market and it must take advantage of this opportunity. When investment insights are applied to life insurance, it benefits both the insured and the insurer because when the product price in the secondary market rises, its value in the primary market rises as well. Western secondary markets have been legalized and are regularly codified, leading in significant development and profitability. Customers benefit through establishment of a vibrant secondary market, but so do a variety of insurance providers and organizations. If deliberate action and legislative steps are adopted, India can achieve great feats in life insurance sector through developing secondary markets.*

## I. INTRODUCTION

Starting as a gambling business in England<sup>2</sup> to now being the most significant and demanded contract policy recognized by special laws, life insurance has had a long evolving journey. Life insurance plans are often thought of as safety nets for the insured and their dependents, protecting their financial interests in the case of death attributable to a protected occurrence. In event of, such death of the insured or maturity of the policy, the insurer is liable to pay the

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<sup>2</sup> K C Mishra, *Life Insurance "Principles and Practice"*; (2009).

assured sum as per the insurance policy. The main purpose that life insurance policies seek to achieve is the reduction of risk and increasing security for the buyers by promising delivery of the assured sum at pre-estimated date. The notable probability of a contingent event like death is not lost on the general public and hence, life insurance policy if not more, is equally demanded when compared to other types of property. However, unlike the freely transferable rights given to other properties, life insurance policies have different rule when it comes to trading of such right by the owner. This journey of life insurance continues, as various amendments and changes having been made with regards to laws governing life insurance policies especially the recent amendment of 2015 to S. 38 of the Insurance Act, 1938 (Hereinafter, the Act) which governs the process of transfer of life insurance policies.<sup>3</sup>

In the current paper, I would be explaining the legality of transfer or trading of life insurance policies in the context of 2015 amendment along with the landmark case of LIC of *India v. Insure Policy Plus Services Pvt Ltd and Ors* and the impact they made on the current scenario of life insurance segment. I will be further discussing the benefits of the secondary market in life insurance, steps to be taken, as how the Indian commerce scenario is becoming more dynamic and needs a change of perspective in order to make best of its unprecedented opportunities.

## II. BACKGROUND

As India witnessed foreign involvement in the Insurance sector when the insurance market was opened for private players, the creation of an autonomous Insurance Regulatory and Development Authority, (IRDA) came into being. Regulatory oversight has gained critical significance as foreign participation has recently begun in the Indian insurance field with decisions being made in light of the Indian context in terms of the scope of regulation.<sup>4</sup> However, before the introduction of the Insurance Act, 1938 the laws with regards to insurance policies and their assignment and their transfer were governed by the Transfer of Property Act, (TOPA) 1882, namely S. 130,132 and 135 which deal with transferable claims and assignment rights of policy.<sup>5</sup> These provisions of the TOPA treated the transfer of insurance policy as transfer of all the rights and actionable claims of the transferor to the transferee. Herein, a notice of such transfer was not essential as long as the transfer was made in accordance to the provisions under TOPA. However, when the Insurance Act came into place, insurance policies

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<sup>3</sup> The Insurance Laws (Amendment) Act, 2015, § 38.

<sup>4</sup> Akansha Joshi and Siddharth Walalkar, “*Life insurance Policy Uses Restricted by recent change*”; INDIA BUSINESS LAW JOURNAL, (2016).

<sup>5</sup> *Id* at 3.

were specifically excluded from the purview of TOPA via S. 130 of the Insurance Act.

S. 38 of the Act, now governs the transfer and assignment of life insurance policies providing that such policy can be transferred partly or in whole and such transfer/assignment only comes into effect by endorsement of the policy or via a separate instrument for which notice has to be given to the insurer. Such notice must indicate the reasons of transfer along with its facts and terms on which it was made. Such assignment becomes operative only when it is made in writing and copy of the endorsement or instrument is delivered to the insurer. The recent amendment of 2015 gives the insurer right to decline such assignment subject to certain conditions which is highlighted upon further in the upcoming parts.

### **III. RIGHT TO ASSIGNMENT OF LIFE INSURANCE POLICIES**

The Insurance Act, 1938 is the governing law for the insurance sector and its operations throughout India. Life Insurance Policies constitute to a major segment of the insurance sector being in popular demand due to the financial security that it provides to the buyer's family members in times of need. The insurer herein has an important role to play as the insurance company is liable to pay the assured sum contracted upon the death of the insured or upon maturity period for which the insured pays a premium at a regular interval. The insured upon complying with the terms and conditions of the insurance contract is entitled to receive the assured sum at a future date which is already pre-determined.<sup>6</sup> The fact that it was formerly governed by TOPA makes the intention of law quite clear with insurance policies to be treated as 'property'.

Upon the death of the insured, the dependents or family members of the insured can recover the assured sum like a debt due to the insured and the same policy can also be attached by creditors just as other properties of insured. Therefore, the policy holder has a right to assign the policy as clearly provided by S. 38 of the Act and that such assignment of policy can be done in name of a third party by the policy holder by means of consideration or a gift (without consideration) wherein the assignee is entitled to all the benefits of the policy after its matured as he is the one who pays the premium. This whole transaction is very similar to the transaction of movable properties like bonds, actionable claims and other negotiable instruments with one major difference being that herein the assignee will only be entitled to those rights available with the assignor and none more.

The law regarding the same was extensively debated after the 2007 judgement of *Insure Policy*

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<sup>6</sup> The Insurance Laws (Amendment) Act, 2015, § 38.

*Plus Services Pvt Ltd and Ors. v. LIC of India*<sup>7</sup> wherein the Bombay High Court laid down that life insurance policies are deemed as tradable and thus, can be used by financial institutions for trading. This meant that a third-party who has no insurable stake in the covered policyholder's life would now be able to profit from the life insurance policy's benefits. This judgement got a huge reaction as many raised concern at the implications and feasibility of the same in the Indian market scenario.

#### **IV. INSURE POLICY PLUS SERVICES PVT LTD AND ORS. V. LIC OF INDIA (BOMBAY HC) 2007**

S. 38 of the Act, exclusively governs the assignment of life insurance policies, the implication of it being that once the insured assigns his rights as the policyholder to the assignee, no longer can he avail benefit of the policy as he has handed over all his rights of the policy to the assignee with now assignee being the owner of the policy. Such assignment cannot be cancelled once validly made; furthermore, re-assignment of such assignment is also permitted under law.<sup>8</sup> The assignee also derives right to sue in cases of assignment and under all circumstances the assignment made by default cancels out the nomination. In cases of conditional assignment, upon the death of the condition assignee the policy benefits goes back to the insured person if alive. Whereas in an absolute assignment, when the assignee dies, the assignee's legitimate beneficiaries are entitled to the policy's privileges. This assignment of life insurance policies was not only done on individual basis but was also made a business in itself by companies who were involved in trading such policies from the insured to third party in case of insured's incapacity to pay the premiums.

In the case of, *Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India*<sup>9</sup>, the validity of such trading by companies with regards to life insurance policies was challenged by LIC. In the instant matter Insure Policy Plus Services (IPPS) was one such company conducting its business in assigning of life insurance policy wherein it paid a higher amount of consideration than the surrender value offered by LIC to the policyholders and later assigned such policies to the third parties thus earning from the differences in the margins. LIC acknowledging these transactions later released a circular stating that trading of life insurance policies should not be allowed and companies such as IPPS should no longer be assigned the policies hence, it refused to register such assignments as required under S. 38.

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<sup>7</sup> *Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India*, 2007 (109) Bom L R 559.

<sup>8</sup> The Insurance Laws (Amendment) Act, 2015, § 38.

<sup>9</sup> *Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India*; 2007 (109) Bom L R 559.

IPPS stated that LIC has no right to refuse such assignments as they follow the procedure laid down under S. 38 of the Act and thus, are legally valid. It furthered that assignment to third party is permitted under law and hence, the policy holder has the right to do whatever he deems fit with the policy and that the insurable interest is only required at the time of purchasing the policy and not later. It also argued that the stance of LIC seemed hypocritical in nature as LIC itself furthered life insurance policies as security to various financial institutions and banks hence; there is no reason as to why the same should not be extended to trading purposes.

The LIC on the other hand contended that insurable interest cannot be a matter of debate and that it must be present throughout the period of insurance contract as it the sole objective behind the contract. Insurable interest serves the purpose of the contracting insured to gain pecuniary benefits arising out of the policy during his life term or by his dependents after his death. Without such interest, insurance goes back to gambling business it was when it started, a wagering contract, which is deemed to be against public policy. Thus, such contracts fall under S. 30 of the Indian Contract Act, 1872 and should be declared void moreover, the court opined that Indian insurance industry cannot be compared to that of developed countries of Europe and America as India doesn't have a defined system of social security making life insurance the primary source of social security unlike in USA and UK. LIC argued that revival of relapsed policy should be only in the hands of insured and that the circulars issued were in favor of the interest of social security of policy holders and in furtherance of public policy.

The Bombay High Court however decided that life insurance policy is a property of the insured and he can assign it to anyone as he sees fit. The reason reflected by the court was that the premium paid by the insured is to be looked as an investment which assures a sum recoverable at the end of the term specified. Thus, the insured can assign the insurance policy freely to companies even if it is for the purpose of trading.

## **V. LIC OF INDIA V INSURE POLICY PLUS SERVICES PVT LTD AND ORS (SC) 2015<sup>10</sup>**

### **(A) Amendment to S.38**

S. 38 of the Act, as amended by the Insurance Laws (Amendment) Act, 2015, which now allows an insurer to refuse assignment or transfer of a policy in case: “(i) It was made in bad faith; (ii) is contrary to the policyholder's interest; (iii) is against public interest; (iv) or was made solely for the purpose of trading the policy.” This amendment marked a huge change for the Insurance Industry due to its new stance on the previously liberal one allowing the trading

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<sup>10</sup> LIC of India v. Insure Policy Plus Services Pvt Ltd and Ors ; C.A. No.-008542/2009; SC (2015).

of life insurance policies. Now, the assignment and transfer of life insurance policies is no longer free but restricted to the above mentioned causes.

### **(B) Prospective effect of Amended Law**

In the case of *LIC of India v Insure Policy Plus Services Pvt Ltd and Ors.*<sup>11</sup>, an appeal from the Bombay HC judgement of 2007, the Supreme Court though not overruling the judgement of Bombay High Court, held that the life insurance policies issued after the amendment cannot be assigned or transfer for the objective of trading. It upheld the decision of Bombay HC only in the context that the amendment of 2015 did not apply retrospectively, thus, making the insurance policies issued before such amendment freely transferable and assignable without application of amended S. 38.

The Supreme Court derived the intention of the amendment with regards to S. 38 to be of prospective nature by inspecting the language of the Act which nowhere claimed retrospective application. Therefore, it was held by the court that S. 38 before amendment remains enforceable and substantive in nature thus, making life insurance policies freely transferable for trading, issued before 2015 but not after such amendment. Thus, the circular issued by LIC was held to be invalid and ultra vires however, looking at the current status of law it seems that the contentions of LIC were taken into consideration by the 2015 amendment.

## **VI. CRITICAL ANALYSIS: INSURANCE LAWS (AMENDMENT) ACT, 2015**

### **(A) Life insurance: a matter of social security?**

Though the amendment of 2015 and Supreme Court upheld that life insurance should not be used solely for the purpose of trading, the reason behind the same remains unsatisfactory when deliberated upon. In the Indian scenario, a freely transferable right of life insurance policies is frowned and considered pre-mature as Indian Insurance industry unlike when compared to US and UK are formed for the objective of social security rather than investment. It has been pointed out that developed countries have a default social security package for their citizens; this is not the case in India. However, there still remains the fact that IRDAI ceased the singular role of LIC in insurance policies by allowing private players to enter the industry.<sup>12</sup> Private companies are profit motivated which cannot guarantee that their priority is the security of the policy holder. Moreover, social benefits like income tax and other such exemptions by private companies also indicate that considering social security to be the sole objective behind

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<sup>11</sup> *Id* at 9.

<sup>12</sup> Debosmita Nandy and Avisha Gupta; “*Insure Policy Plus Services (P) Ltd. V. Life Insurance Corporation Of India: Can Life Insurance Policies Be Traded?*”; (2007).

purchase of life insurance might be incorrect. If India was truly driven by the perspective of social security when it came to life insurance then LIC would still have monopoly over the sector and private players would not have been so warmly welcomed. Instead, India as one of the largest newly emerging economy in the world must compete with the changing trends and widen its horizon by not limiting itself to a single ideology disregarding the obvious opportunity that a secondary market can provide.

### **(B) Need for Insurable interest**

It was contended by the LIC that insurable interest must be present with the insured for the whole life term of the contract or after the death of the insured to his family otherwise the contract would be rendered to that of a wagering contract.<sup>13</sup> In most of the Indian jurisprudence relating to wagering contracts nowhere is a contract declared illegal merely because of wager as the difference between void and illegal is significant.<sup>14</sup> Moreover, the settled principle of UK courts is that insurable interest is only required at the time of purchasing life insurance as outlined in the landmark judgement of *Grigsby v. Russel*<sup>15</sup> wherein it was held that life insurance has now been widely acknowledge with the characteristic of investment and should also be recognized as a property till the extent to which it is safe. The court reasoned that denying the right to sell to those who do not have such an interest reduces the value of the agreement for the policy holder and that though there is a need of an insurable interest; no provision explicitly states the requirement of the same until the end of policy.<sup>16</sup> The same reasoning can also be said to apply to the Indian life insurance segment as in India too there is no specific provision which provides for mandatory insurable interest throughout the term of life insurance policy.

### **(C) Secondary market for trading**

Trading of life insurance policies have always been in practice ever since the early periods of 1990s starting with the patients of chronic illnesses selling of their life policies to other parties for the purpose of generating income for payment of various medical bills and treatments.<sup>17</sup> The realization of investment playing a role in life insurance only grew from here expanding the definition of life insurance. However, due to the secondary market not being unregulated, fraudulent activities increased in numbers<sup>18</sup>, the need for better settlement markets emerged,

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<sup>13</sup> Insure Policy Plus Services Pvt Ltd and Ors. v. LIC of India; *Supra* note 8.

<sup>14</sup> Gherulal Parekh v. Mahadeodas Maiya; AIR 1959 SC 78.

<sup>15</sup> *Grigsby v. Russel*; 222 US 149.

<sup>16</sup> The Insurance Laws (Amendment) Act, 2015, § 38.

<sup>17</sup> Michael Cavendish, "Policing Terminal Illness Investing: How Florida Regulates Viatical Settlement Contracts", (2000).

<sup>18</sup> *Id* at 16.



life insurance being one of them. The secondary market is the market in which the life insurance policy is transferred or traded by the insured to a third party having no insurable interest in the same but allowing him to benefit the profits of such policy. In earlier times when the insured was rendered incapable to pay for the policy premium, his options were limited to either letting the policy lapse or accept the surrender value offer by the insurer, which is usually a minimal amount. With the shift in market and due to liberalization and entry of private players, now there emerged a whole new secondary market where the insured can sell his policy to the party offering him the best price. The policy holder can choose the offer he deems to be the best and be relieved of his liabilities towards the contract with his consent, reducing the burden upon the insured as well as helping him out financially.

The perspective of investment when added to life insurance not only benefits the insured but also the insurer because it is a settled principle of economics that with the improvement of secondary market of a commodity, the value of it in the primary market also increases, they are directly proportional. Thus, with the possibility of assignment and selling of life insurance policy to third parties, the demand of the same will also increase in the primary market paving a more profitable way for the insurance companies. Life insurance policies make the perfect durable product that the buyers would like to purchase as it would give them value for the duration they invest in it and can be easily traded for fair sum if it becomes a burden to maintain.<sup>19</sup>

It will be even further financially feasible for the policy holders as early premium rates on a whole-life policy are higher than sufficient to cover for the low chance of mortality in the early years, making such policies accumulate a profit that can be used to subsidize additional rates.<sup>20</sup> The trading of life insurance policy is most beneficial to the policy holder because we look at the scenario before existence of secondary market; the insured was forced to sell the policy to the insurance company itself, marking a clear monopoly of the insurance companies over this business. The insurance companies used to buy such policies at a minimal price and made huge profits over such re-purchases. Having a secondary market in life insurance ensures that the policy holder is not forced to sell the policy at unfair price and is left in a beneficial position after paying for such policy.<sup>21</sup> Trading enables a competitive market instead of monopoly established by insurance companies, making such market fair with added advantage of not being governed by market conditions in other investments such as interest rates, fluctuation in

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<sup>19</sup> Dennis Carlton and Jeffrey Perloff, *“Modern Industrial Organization”*; Pg 482 (2000).

<sup>20</sup> Neil Doherty and Hal Singer; *“Benefits of Secondary Market for Life Insurance Policies”*; (2009).

<sup>21</sup> *Id* at 19.

inflation, etc. The secondary market for life insurance policy is guaranteed as people trade life insurance for various reasons from repayment of debt to having no remaining beneficiaries.<sup>22</sup> Thus, the third party also benefits from such purchase by inheriting all the rights of the insured and getting considerable return at a low risk. Economy and market of a country like India can benefit a lot as it has already allowed participation of private players and permitting a secondary market for life insurance will only lead to a win-win-win situation thus, removing the last obstacle faced by the policy holders.

#### **(D) Regulatory Requirements**

In my opinion, the restrictions on trade of insurance policies by India by stating reason of inadequate system, pre-mature market and unfeasibility is misconstrued, not due to the fact that it is incorrect however due to the fact that the situation can be rectified with some regulatory reforms along with legislative initiatives. The life insurance policies before amendment of 2015 still remain transferable for trading purposes, this indicates that India has already been successful in this segment and that market is not pre-mature for trading of life insurance. Instead of banning trading of life insurances, new regulatory framework for secondary market should have been introduced by the government to bring India at par with western continents like America and Europe. In both of these regions secondary markets have been legally recognized and are being constantly institutionalized leading to their speedy growth and success. Many famous investors and large investing groups have invested in such life settlement policies and claim it as a matter of pride. Seeing the widespread interest of investors in this sector, the regulatory authorities have taken up the task of forming better accountability framework for the same.

### **VII. CONCLUSION**

The current time is the most advantageous for India as most of the world players are looking at it as the most reliable emerging market. With foreign investors and players coming in, the last of things we need are restrictions that curtail opportunity for the economy as well as our people due to lack of adequate framework. The economic factors of demand and supply in secondary markets are already in favor of our economy, introducing a competitive secondary market does not limit the benefits only to consumers but also to various insurance companies and agencies. Across the world, the life settlement industry though in its early stages is rapidly growing with insurance finding an attractive place among the investors. Soon the demand of third party buyers will pave the way to inevitable secondary markets with policy holders in

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<sup>22</sup> William Baumol and Alan Blinder, *“Economic Principles and Policy”*; Pg. 271 (1994).

favor of such market as it improves the consumer welfare in general by providing them with multiple options and financial security. The argument that trading of life insurance policies creates hindrance for policy holders in exercise of their legal rights is ill-founded as adequate regulatory framework will be accompanying such markets. The psyche of Indian consumer market with regards to this issue must be modified because by not allowing a place for secondary market in life insurance segment we are not protecting the social security of the consumers but merely giving a head start to other countries to develop their economy and markets. In today's global world specifically with regards to trade and commerce, it is impossible for a practiced established by the majority of developed countries not to be extended to other countries to certain extent. India can change these practices to suit it needs but cannot completely deny the inevitable market growth; rather we must start working at this issue along with others so that we remain globally competitive. A viable opportunity such as this must be considered by experts and proper infrastructure for the same should be provided in order to ensure efficiency and effectiveness of the economy and business sector. If proper attention and legislative steps are taken, India can achieve great lengths through the establishment of secondary markets especially with the life insurance industry of today.

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