Chapter 6

Guidance on the Identification of Contracts of Insurance

6.6 The factors

6.6.1 G Contracts under which the provider has an absolute discretion as to whether any benefit is provided on the occurrence of the uncertain event, are not *contracts of insurance*. This may be the case even if, in practice, the provider has never exercised its discretion so as to deny a benefit: Medical Defence Union v. Department of Trade and Industry [1979] 2 W.L.R. 686. The degree of discretion required and the matters to which it must relate are illustrated in ■ PERG 6.7.1 G (Example 1: discretionary medical schemes).

6.6.2 G The 'assumption of risk' by the provider is an important descriptive feature of all *contracts of insurance*. The 'assumption of risk' has the meaning in (1) and (3), derived from the case law in (2) and (4) below. The application of the 'assumption of risk' concept is illustrated in ■ PERG 6.7.2 G (Example 2: disaster recovery business).

(1) Case law establishes that the provider's obligation under a *contract of insurance* is an enforceable obligation to respond (usually, by providing some benefit in the form of money or services) to the occurrence of the uncertain event. This *guidance* describes the assumption of that obligation as the 'assumption' by the provider of (all or part of) the insured risk. 'Transfer of risk' has the same meaning in this *guidance*.

(2) The case law referred to in (1) is Prudential v. Commissioners of Inland Revenue [1904] 2 KB 658, read with Hampton v. Toxteth Co-operative Provident Society Ltd [1915] 1 Ch. 721 (C.A.), Department of Trade and Industry v. St Christopher Motorists Assoc. Ltd [1974] 1 All E.R. 395, Medical Defence Union v. Department of Trade and Industry [1979] 2 W.L.R. 686 and Wooding v. Monmouthshire and South Wales Mutual Indemnity Soc. Ltd [1939] 4 All E.R. 570 (H.L.).

(3) The *FCA* recognises that there is a line of case law in relation to *long-term insurance business* that establishes that a contract may be a *contract of insurance* even if, having effected that contract, the provider 'trades without any risk'. The *FCA* accepts that the insurer's risk of profit or loss from insurance business is not a relevant descriptive feature of a *contract of insurance*. But in the *FCA's* view that is distinct from and does not undermine the different proposition in (1).

(4) The case law referred to in (3) is Flood v. Irish Provident Assurance Co. Ltd [1912] 2 Ch. 597 (C.A.), Fuji Finance Inc. v. Aetna Life Insurance Co. Ltd [1995] Ch. 122, Re Barrett; Ex parte Young v. NM Superannuation Pty Ltd, (1992) 106 A.L.R. 549, Fuji Finance Inc. v. Aetna Life Insurance Co. Ltd [1997] Ch. 173 (C.A.).

6.6.3 G Contracts, under which the amount and timing of the payments made by the recipient make it reasonable to conclude that there is a genuine pre-payment for services to be rendered in response to a future contingency, are unlikely to be regarded as insurance. In general, the *FCA* expects that this requirement will be satisfied where there is a commercially reasonable and objectively justifiable relationship between the amount of the payment and the cost of providing the contract benefit.

6.6.4 G Contracts under which the provider undertakes to provide periodic maintenance of goods or facilities, whether or not any uncertain or adverse event (in the form of, for example, a breakdown or failure) has occurred, are unlikely to be *contracts of insurance*.

6.6.5 G Contracts under which, in consideration for an initial payment, the provider stands ready to provide services on the occurrence of a future contingency, on condition that the services actually provided are paid for by the recipient at a commercial rate, are unlikely to be regarded as insurance. Contrast ■ PERG 6.7.21 G (Example 7: solicitors' retainers) with ■ PERG 6.7.22 G (Example 8: time and distance cover).

6.6.6 G The recipient's payment for a *contract of insurance* need not take the form of a discrete or distinct premium. Consideration may be part of some other payment, for example the purchase price of goods (Nelson v. Board of Trade (1901) 17 T.L.R. 456). Consideration may also be provided in a non-monetary form, for example as part of the service that an employee is contractually required to provide under a contract of employment (Australian Health Insurance Assoc. Ltd v. Esso Australia Pty Ltd (1993) 116 A.L.R. 253).

6.6.7 G Under most commercial contracts with a *customer*, a provider will assume more than one obligation. Some of these may be insurance obligations, others may not. The *FCA* will apply the principles in ■ PERG 6.5.4 G, in the way described in (1) to (3) to determine whether the contract is a *contract of insurance*.

(1) If a provider undertakes an identifiable and distinct obligation that is, in substance an insurance obligation as described in ■ PERG 6.5.4 G, then, other things being equal, the *FCA* is likely to find that by undertaking that obligation the provider has effected a *contract of insurance*.

(2) The presence of an insurance obligation will mean that the contract is a *contract of insurance*, whether or not that obligation is 'substantial' in comparison with the other obligations in the contract.

(3) The presence of an insurance obligation will mean that the contract is a *contract of insurance*, whether or not entering into that obligation forms a significant part of the provider's business. The *FCA* generally regards a provider as undertaking an obligation 'by way of business' if he takes on an obligation in connection with or for the purposes of his core business, to realise a commercial advantage or benefit.

6.6.8 G The following factors are also relevant.

(1) A contract is more likely to be regarded as a *contract of insurance* if the amount payable by the recipient under the contract is calculated by reference to either or both of the probability of occurrence or likely severity of the uncertain event.

(2) A contract is less likely to be regarded as a *contract of insurance* if it requires the provider to assume a speculative risk (ie a risk carrying the possibility of either profit or loss) rather than a pure risk (ie a risk of loss only).

(3) A contract is more likely to be regarded as a *contract of insurance* if the contract is described as insurance and contains terms that are consistent with its classification as a *contract of insurance*, for example, obligations of the utmost good faith.

(4) A contract that contains terms that are inconsistent with obligations of good faith may, therefore, be less likely to be classified as a *contract of insurance*; however, since it is the substance of the provider's rights and obligations under the contract that is more significant, a contract does not cease to be a *contract of insurance* simply because the terms included are not usual insurance terms.