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WAGERING ON THE LIVES OF STRANGERS: THE INSURABLE INTEREST REQUIREMENT IN THE LIFE INSURANCE SECONDARY MARKET

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Predictably, every stranger-owned life insurance scheme must confront the insurable interest requirement. In life insurance as in all other lines of insurance, an insurable interest requirement is fundamental to the insurance contract. Additionally, stranger-owned life insurance plans must tiptoe through the related area of policy assignments. There are often very fine lines between legitimate life settlements and invalid wagering arrangements.[1]

INTRODUCTION

Over three-quarters of American families own some form of life insurance, bringing total life insurance coverage in the United States to more than $18 trillion.[2] Yet, until very recently, persons who held unneeded, unaffordable, or unwanted life insurance policies due to altered life circumstances had only two limited options: (1) they could either allow their life insurance policies to lapse, in which case the policyholders lost all their investment; or (2) they could "surrender" their policy to the life insurance company for a predetermined "cash surrender value," which

1. Douglas R. Richmond, *Investing in the Grim Reaper: Insurable Interest and Assignment in Life Insurance*, 47 Tort Trial & Ins. Prac. L.J. 657, 691 (2012).
2. American Council of Life Insurers, 2010 Life Insurance Fact Book 63 (2010).

typically amounts to only 3 percent to 5 percent of the policy's face value and sometimes zero percent.[3]

The emergence of a third option—a robust secondary market for life insurance—is a relatively recent phenomenon. The fundamental aspect of a life settlement transaction, whether characterized as a life insurance viatical, a life settlement, or a stranger-originated life insurance (STOLI) scheme, is fairly simple: A terminally ill policyholder (for viaticals) or an elderly policyholder, frequently with impaired health (for life settlements and STOLI), sells his or her life insurance policy to a third party life settlement provider and investors for an amount that is lower than the policy's death benefit but higher than the policy's cash surrender value.[4]

One influential study conducted at the Wharton Business School estimates that more than 20 percent of policyholders over the age of sixty-five hold life insurance policies that exceed their cash surrender value; this means that the potential market for life settlements is close to $100 billion.[5] Not surprisingly, a number of traditional life insurance companies have been trying to block the growth of the life settlement industry and limit what they perceive is competition for policy surrender options. In the most extreme cases, traditional life insurance companies have prohibited their agents from advising clients of the availability of life settlement options, even when a life settlement may be the most suitable financial choice for a particular client. Indeed, some insurance agents and brokers have been disciplined or even terminated from employment for discussing life settlement options with their clients.[6] Nevertheless, a substantial majority of trade publications and commentators have endorsed and supported these newly emerging life settlement options and a secondary market for life insurance,[7] although legal commentators

3. Life Insurance Settlement Association (LISA) White Paper, *Cashing in on Unneeded Life Insurance Policies: How Seniors Are Benefiting From Life Settlements*, at 5 (Aug. 22, 2006), http://www.lisassociation.org/files/LISA_whitepaper.pdf; *see also* Sachin Kohli, *Pricing Death: Analyzing the Secondary Market for Life Insurance Policies and Its Regulatory Environment*, 54 BUFF. L. REV. 279, 280 (2006). Life insurance companies "traditionally held monopsony power over policyholders because they were the only re-purchasers of in-force life insurance policies." *Id.*

4. *See, e.g.*, Life Partners Inc. v. Morrison, 484 F.3d 284 (4th Cir. 2007) (applying Va. law) (involving a disputed viatical life settlement); Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882 (D. N.J. 2009) (applying N.J. and Cal. Law) (involving a disputed STOLI life settlement).

5. Neil A. Doherty & Hal J. Singer, *The Benefits of a Secondary Market for Life Insurance Policies*, 38 REAL PROP. PROB. & TR. J. 449, 452–53 (2003–2004).

6. Brian Brooks & Elizabeth Baird, *Clients May Hold Millions in Untapped Insurance Wealth, Study Finds*, ON WALL ST., at 2 (Nov. 2002); *see also* Doherty & Singer, *supra* note 5, at 474–75.

7. *See, e.g.*, Doherty & Singer, *supra* note 5; Harold G. Ingraham Jr. & Sergio S. Salani, *Life Settlements as a Viable Option*, J. OF FIN. SERV. PROFS. 72–76 (Sept. 2004); Eileen Shovlin, *Clearing Up Common Misconceptions About Life Settlements*, NAT'L UNDERWRITER LIFE & HEALTH MAG., Dec. 10, 2001; Robin S. Weinberger & Peter N. Katz, *Business Changes*

have taken a more nuanced and critical approach, especially regarding STOLI settlements.[8]

The elephant in the room, however, for the life settlement industry is the crucial concept that viatical settlements, life settlements, and STOLI settlements all constitute stranger-owned life insurance and therefore may, or may not, constitute a void ab initio insurance contract, based upon the lack of a bona fide insurable interest in the life of another person.[9]

The purpose of this article is to explore and analyze the crucial interrelationship and the present tension existing between various life settlement alternatives and the insurable interest requirement for life insurance. Does the 240-year-old insurable interest doctrine adequately meet the needs of a modern society in recognizing a secondary market for life insurance? If so, what additional remedies, if any, are available to both the insured and the insurer to legally protect the contractual rights and reasonable expectations of the parties?

Part I of this article presents a comprehensive discussion of the insurable interest requirement for life insurance, including the origin and purpose for the insurable interest doctrine; the incorporation of this doctrine into American judicial and statutory law; the necessary parameters of the insurable interest requirement for life insurance; and, most importantly for life settlement purposes, the assignment of life insurance policies to one who lacks an insurable interest in the life of another. Part II discusses the evolution, regulation, viability, and legality of viaticals and life settlements in the secondary insurance market today and argues that preexisting unneeded or unwanted life insurance policies should be freely assign-

Can Mean Life Settlement Opportunities, LIFEHEALTHPRO (Feb. 28, 2012), *available at* www.lifehealthpro.co/2012/02/28; Constance M. Buerger, *The Secondary Market for Life Insurance Is Poised to Go Mainstream—Are You Ready?* CAL. BROKER 20–22 (Feb. 2004); Life Insurance Settlement Association (LISA) White Paper, *supra* note 2; Robert Buechner, *Stranger-Owned Life Insurance: The Good, the Bad, and the Ugly*, 19 OHIO PROB. L.J. 7 (2008); M. Bryan Freeman, *Life Settlements Enter the Mainstream*, NAT'L UNDERWRITER LIFE & HEALTH MAG., Sept. 19, 2005, at 20; Tom Lauricella, *The Cost of Cashing Out Life Insurance*, WALL ST. J., June 30, 2013, at 2; Alan Jensen & Stephan R. Leimberg, *Stranger Owned Life Insurance: A Point/Counterpoint Discussion*, 33 ACTEC J. 110 (Fall 2007) (presenting both sides of the life settlement debate); *see also* GLORIA WOLK, VIATICALS AND LIFE SETTLEMENTS: AN INVESTOR'S GUIDE (2005). *But see contra* Deloitte Consulting LLP & Univ. of Conn., *The Life Settlement Market: An Actuarial Perspective on Consumer Economic Value* (2005) (concluding that "for the majority of policyholders with impaired health, the greatest economic value results from retaining the [life insurance] contract until death").

8. *See, e.g.*, Kohli, *supra* note 3; Eryn Mathews, *STOLI on the Rocks: Why States Should Eliminate the Abusive Practice of Stranger-Owned Life Insurance*, 14 CONN. INS. L.J. 521 (2008); Susan Lorde Martin, *Betting on the Lives of Strangers: Life Settlements, STOLI, and Securitization*, 13 U. PA. J. BUS. L. 173 (2010).

9. *See generally* Peter Nash Swisher, *The Insurable Interest Requirement for Life Insurance: A Critical Reassessment*, 53 DRAKE L. REV. 477 (2005), *reprinted in* 55 DEFENSE L. J. 527 (2006) *abridged and reprinted in* 5 ICFAI J. INS. L. 41 (2007) (Institute of Chartered Financial Analysts of India); *see also infra* Part I.

able to viatical and life settlement providers and investors who do not have an insurable interest in the life of the insured. Part III analyzes and criticizes controversial STOLI schemes that lack an insurable interest requirement in the life of another but do not fall under the assignability exception that viaticals and life settlements arguably do. Part IV of this article concludes that, although further state regulation in the secondary life insurance market may be desirable, existing legal precedent presently is sufficient in most states to legally validate viaticals and life settlements, while at the same time declaring most STOLI schemes to be fraudulent, deceitful, and void ab initio contracts based upon the lack of a bona fide insurable interest in the life of another.

I. THE INSURABLE INTEREST REQUIREMENT FOR LIFE INSURANCE

Life insurance generally includes all policies of insurance in which the insurer's payment is contingent on the death of a specified individual.[10] Historically, life insurance has long been validated by most American courts from a legal, economic, and social perspective as a well-recognized investment device to shift and distribute the risk of loss from an untimely or premature death.[11] However, in order to secure insurance on the life of another, an insurable interest in that life is required in order to prevent wagering contracts and the unwelcome possibility of homicide.[12] Accordingly, almost all American jurisdictions today, by judicial case law, legislative statute, or both, now require that a bona fide insurable interest exist for life insurance, or the life insurance policy in question will be declared null and void based upon very strong public policy grounds.[13] This insurable

10. *See, e.g.*, Bowles v. Mut. Benefit Health & Accident Ass'n, 99 F.2d 44, 48 (4th Cir. 1938) (quoting Mut. Reserve Life Ins. Co. v. Dobler, 137 F. 550, 553 (9th Cir. 1905)).

11. *See, e.g.*, Helverig v. Le Gierse, 312 U.S. 531, 539 (1941).

12. *See, e.g.*, Hopkins v. Hopkins, 614 A. 2d 96, 98 (Md. 1992) (holding that the primary purpose of the prohibition of insuring another person's life without a bona fide insurable interest "is to prevent wagering on the life of another, although . . . prevention of murder is another rationale"); Rubenstein v. Mut. Life Ins. Co. of N.Y., 584 F. Supp. 272, 279 (E.D. La. 1984) (noting similar purposes); *see also* Ferdinand S. Tinio, Annotation, *Killing of Insured by Beneficiary as Affecting Life Insurance or Its Proceeds*, 27 A.L.R.3d 794 (1969 and Supp. 2014); *see generally* Swisher, *supra* note 9, at 478–80. For a fascinating discussion of earlier notorious miscreants and murderers, *see* ALEXANDER C. CAMPBELL, INSURANCE AND CRIME (1902).

13. *See generally* FRANKLIN L. BEST, JR., LIFE & HEALTH INSURANCE LAW Ch. 4:1–4:6 (2012); ROBERT H. JERRY II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW § 43 (5th ed. 2012); ROBERT E. KEETON & ALAN J. WIDISS, INSURANCE LAW § 3.5 (1988); JEFFREY W. STEMPEL, STEMPEL ON INSURANCE CONTRACT DISPUTES § 1.05 (3d ed. & 2014 Cum. Supp.); LEE R. RUSS & THOMAS SEGALLA, COUCH ON INSURANCE §§ 36:77–36:92, 41:17–41:24, 43:1–43:29 (3d ed. 1997); EDWIN PATTERSON, ESSENTIALS OF INSURANCE LAW 162–66 (2d ed. 1957); WILLIAM R. VANCE & BUIST M. ANDERSON, HANDBOOK OF THE LAW OF INSURANCE §§ 31–34 (3d ed. 1951); GEORGE RICHARDS, RICHARDS ON THE LAW OF INSURANCE §§ 34–37 (4th ed. 1932); *see also* 44 AM. JUR. 2D *Insurance* §§ 978–1003 (2003). *But see contra*

interest requirement also applies to viatical settlements, life settlements, and STOLI settlements as well,[14] as will be further discussed below.

A. *Origin and Purpose for The Insurable Interest Doctrine in Life Insurance*

Prior to the end of the eighteenth century, English courts permitted and enforced various gaming and wagering contracts made by persons who had absolutely no insurable interest in the life of another person. Gambling on the lives of others was a relatively common practice in eighteenth century England, where the institution resembled modern day sports betting. Popular accounts of that period describe the practice of purchasing life insurance on individuals tried for capital crimes and betting on whether the individual would be convicted and executed or exonerated. Another practice was insuring the lives of famous, elderly persons, who may have suffered from a recent illness affecting their life expectancy. A duel with an insured over a perceived slight of honor might also hasten his or her untimely death.[15]

By the middle of the eighteenth century, however, such wagering activities on the lives of others began to attract significant public hostility.[16] Consequently, the British Parliament in 1774 passed a statute holding that any life insurance contract without a bona fide insurable interest in the life of another would henceforth be null and void.[17] Unfortunately,

Jacob Loshin, Note: *Insurance Law's Hapless Busybody: A Case Against the Insurable Interest Requirement*, 117 YALE L.J. 474 (2007–2008) (arguing that the insurable interest doctrine "invites unfairness and inefficiency in the insurance market").

14. *See, e.g.*, BEST, *supra* note 13, Ch. 4:4; LEO MARTINEZ ET AL., NEW APPLEMEN INSURANCE LAW PRACTICE GUIDE § 34.09[3][e] (2013 ed.); *see also* Douglas R. Richmond, *Investing with the Grim Reaper: Insurable Interest and Assignment in Life Insurance*, 47 TORT TRIAL & INS. PRAC. L.J. 657 (2012); Robert S. Bloink, *Catalysts for Clarification: Modern Twists on the Insurable Interest Requirement for Life Insurance*, 17 CONN. INS. L.J. 55 (2010); Martin, *supra* note 8; Eryn Matthews, *STOLI on the Rocks: Why States Should Eliminate the Abusive Practice of Stranger-Owned Life Insurance*, 14 CONN. INS. L. J. 521 (2008).

15. *See, e.g.*, JERRY & RICHMOND, *supra* note 13, at 255–258: Bloink, *supra* note 14, at 61–63; *see generally* GEOFFREY W. CLARK, BETTING ON LIVES: THE CULTURE OF LIFE INSURANCE IN ENGLAND 1695–1775 (1999).

16. CLARK, *supra* note 15, at 52–53.

17. *See* Life Assurance Act, 1774, 14 Geo. III, c. 48, sec.1 (Eng.). The Act provided in relevant part:

> Whereas it hath be found by Experience, that the making Insurances on Lives, or other Events, wherein the Assured shall have no Interest, hath introduced a mischievous Kind of Gaming: For Remedy whereof, be it enacted by the King's most Excellent Majesty, by and with the Advice and Consent of the Lords Spiritual and Temporal, and Commons, and by the Authority of the same, That from and after the passing of this Act, no Insurance shall be made by any Person or Persons, Bodies Politick or Corporate, on the Life or Lives of any Person or Persons . . . wherein the Person or Persons for whose Use, Benefit, or on whose Account such Policy or Policies shall be made, shall have no Interest, or by way of Gaming or Wagering; and that every Assurance made, contrary to the true Intent and Meaning hereof, shall be null and void, to all Intents and Purposes whatsoever.

Id.

Parliament left to the courts the daunting task of how to interpret and enforce this poorly drafted act.[18]

The underlying purpose of an insurable interest requirement in life insurance, as originally enacted in England in 1774, and as later adopted by most American courts and state legislatures, was two-fold: (1) to discourage the practice of using life insurance as a gambling or wagering device and (2) to remove the incentive for the procurer of life insurance to commit homicide.[19]

B. *Incorporation of The Insurable Interest Doctrine into American Case Law and Statutory Law*

During the nineteenth century and the early twentieth century, most American courts recognized the insurable interest requirement for life insurance policies, based upon earlier English precedent.[20] For example, in the 1876 case of *Connecticut Mutual Life Insurance Co. v. Schaefer*,[21] Justice Bradley declared:

> It is generally agreed that mere wager policies—that is, policies in which the insured party has no interest whatever in the matter insured, but only an interest in its loss of destruction—are void as against public policy . . . [citing to an English statute regarding marine risks, and "with regard to lives" the statute of 14 Geo. III, c. 48]. . . . In this country, statutes to the same effect have been passed in some of the States; but where they have not been, in most cases either the English statutes have been considered as operative, or the older common law has been followed.[22]

In the United States, the insurable interest doctrine for life insurance was adopted by a vast majority of state courts[23] and subsequently ratified and confirmed by a vast majority of state legislatures, where the insurable interest statutes for life insurance were enacted within comprehensive

18. *See generally* Robert Merkin, *Gambling by Insurance: A Study of the Life Assurance Act of 1774*, 9 ANGLO-AMERICAN L. REV. 331 (1980).

19. *See supra* note 12 and accompanying text; *see also* JERRY & RICHMOND, *supra* note 13, at 258; Swisher, *supra* note 9, at 481–82; Richmond, *supra* note 14, at 669.

20. BEST, *supra* note 13, Ch. 4:1; VANCE & ANDERSON, *supra* note 13, § 31.

21. Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457 (1876).

22. *Id.* at 460.

23. *See, e.g*, Commonwealth Life Ins. Co. v. George, 28 So. 2d 910, 912 (Ala. 1947); Home Ins. Co. of N.Y. v. Masterson, 21 S.W.2d 414, 416 (Ark. 1929); Boyer v. U.S. Fid. & Guar. Co., 274 P. 57, 60 (Cal. 1929); Knott v. State *ex rel.* Guar. Income Life Ins. Co., 186 So. 788, 789–90 (Fla. 1939); Colgrove v. Lowe, 175 N.E. 569, 571 (Ill. 1931); Newton v. Hicks' Adm'r, 138 S.W.2d 329, 331 (Ky. Ct. App. 1940); Katona v. Colonial Life Ins. Co. of Am., 173 A. 99, 100 (N.J.C.P. 1934); Werenzinski v. Prudential Life Ins. Co. of Am., 14 A.2d 279, 280–81 (Pa. 1940); Washington v. Atl. Life Ins. Co., 136 S.W.2d 493, 494 (Tenn. 1940); Green v. Sw. Voluntary Ass'n., 20 S.E. 2d 694, 696 (Va. 1942).

state insurance codes.[24] Thus, today—by case law, statutory law, or both—an insurable interest at the inception of a life insurance contract appears to be required in every state,[25] and the burden of proof to demonstrate such an insurable interest is on the claimant who has procured insurance on the life of another.[26]

Although the language in numerous judicial opinions and state statutes as to what constitutes a valid bona fide insurable interest in the life of another varies from state to state, there is a general consensus that an insurable interest in a life may be founded on one of two broad categories: (1) a "love and affection" insurable interest for persons closely related by blood or affinity; and (2) for all other persons, "a lawful and substantial economic interest in the continued life, health, and bodily safety of the person insured."[27] These insurable interest categories are discussed in more detail below.

C. *Necessary Parameters of The Insurable Interest Doctrine in Life Insurance Contract Disputes*

The insurable interest in life insurance is often interpreted by dividing life insurance transactions into two general groups based upon "whether (1) the policy is taken out by an insured on his or her own life or (2) the policy is purchased by someone on the life of another person."[28]

1. Insurable Interest in One's Own Life

It has often been stated that every person has an unlimited insurable interest in his or her own life and may make payment to anyone he or she pleases, whether the beneficiary has an insurable interest in that

24. *See, e.g.*, Ala. Code § 27-14-3 (2008); Alaska Stat. § 21-42-020 (2002); Ariz. Rev. Stat. Ann. § 20-1104 (1989); Ark. Code Ann. § 23-79-103 (2003); Cal. Ins. Code § 10110.1 (2010); Colo. Rev. Stat. § 10-7-701 (2011); Del. Code Ann. tit. 18 § 2704 (2010); Fla. Stat. § 627.404 (2008); Ga. Code Ann. § 33-24-3 (2006); Haw. Rev. Stat. § 33-59-2 (2010); Idaho Code Ann. § 41-1804 (2010); Ky. Rev. Stat. Ann. § 304.15-010 (2010); La. Rev. Stat. Ann. § 22:853 (2011); Me. Rev. Stat. Ann. tit. 24-A, § 2404 (2009); Md. Code Ann. Ins. § 12-201 (2010); Minn. Stat. § 60A.078 (2009); Miss. Code Ann. § 83-5-251 (2009); Mont. Code Ann. § 33-15-201 (2009); N.Y. Ins. Law § 3205(a)(1) (2010); N.D. Cent. Code § 26.1-29-09.1(3) (2009); Okla. Stat. tit. 36 § 3604(C) (2010); 40 Pa. Cons. Stat. Ann. § 512 (2010); R.I. Gen. Laws § 27-4-27(c)(2009); S.D. Codified Laws § 58-10-4 (2009); Va. Code Ann. § 38.2-301 (B) (2009); Wash. Rev. Code § 48.18.030(3) (2010); W.Va. Code § 33-6-2(c) (2010); Wyo. Stat. Ann. § 26-15-102(c) (2009).

25. Best, *supra* note 13, Ch. 4:1, 80–81.

26. *Id.*; *see, e.g.*, Kentucky Cent. Life Ins. Co. v. McNabb, 825 F. Supp. 269 (D. Kan. 1993); Rubenstein v. Mut. Life Ins. Co. of N.Y, 584 F. Supp. 272 (D. La. 1984); Foster v. United Ins. Co. of Am., 158 S.E.2d 201 (S.C. 1967).

27. *See* Swisher, *supra* note 9, at 483–84; Martin, *supra* note 8, at 177–78. *See, e.g.*, N.Y. Ins. Law §§ 3205(a)(1)(A), (B) (2010).

28. Keeton & Widiss, *supra* note 13, § 3.5(a) at 179; Swisher, *supra* note 9, at 484–85.

person's life.[29] The rationale for this general rule seems to be that the insured normally wishes that his or her life will continue and is not inclined to self-destruct for the sole purpose of bestowing a financial benefit on others.[30]

Likewise, it is assumed that the insured would not designate a person as his or her beneficiary who is likely to murder the insured for the life insurance proceeds.[31] But, unfortunately, this does happen, and murder committed by a life insurance beneficiary, sadly, is not uncommon.[32] In such a situation, it is generally held that a beneficiary who intentionally kills the insured cannot, and should not, recover the life insurance benefits, and the proceeds should be paid instead to the innocent contingent beneficiary or to the estate of the insured, based on the underlying rationale that it is contrary to state public policy, either under the common law[33] or under a particular state's "slayer statute,"[34] to permit a person

29. *See generally* BEST, *supra* note 13, Ch. 4:3, 83–85; VANCE & ANDERSON, *supra* note 13, § 31 at 188; Swisher, *supra* note 9, at 48–97; *see, e.g.*, Mutual Sav. Life Ins. Co. v. Noah, 282 So. 2d 271, 273 (Ala. 1973) (noting that "a person has an unlimited insurable interest in his own life"); Pittsburgh Underwriters v. Mut. Life Ins. Co. of N.Y., 27 A.2d 278, 280 (Pa. Super Ct. 1942) ("It is elementary that everyone has an unlimited insurable interest in his own life); Hoffman v. Fed. Reserve Life Ins. Co., 255 P. 980, 981 (Kan. 1927) (stating that an "insured has an unlimited insurable interest in his own life"); Am. Cas. Co. v. Rose, 340 F.2d 469, 471 (10th Cir. 1964) (applying Ohio law) (holding that the plaintiff had an insurable interest in his own life and was free to "name anyone he saw fit as beneficiary, regardless of whether the beneficiary had an insurable interest in the insured"); Roundtree v. Frazee, 209 So. 2d 424, 436 (Ala. 1968) ((holding that an insurable interest is not necessary to be an eligible beneficiary); Dodson v. Dodson, 825 S.W.608, 611 (Ark. Ct. App. 1992) (similar holding); Smith v. Coleman, 35 S.E.2d 107, 111 (Va. 1945) (similar holding).

30. *See, e.g.*, ROBERT H. JERRY II, UNDERSTANDING INSURANCE LAW § 43, at 311 (3rd ed. 2002). There also is a suicide exclusion in most life insurance policies during the two-year contestability period after the insured obtains his or her policy; *see* JEFFREY STEMPEL, PETER SWISHER, & ERIK KNUTSEN, PRINCIPLES OF INSURANCE LAW, App. A at 1214 (4th ed. 2011).

31. *See generally* Swisher, *supra* note 9, at 487–97.

32. *See, e.g.*, Wilson v. Wilson, 144 Cal. Rptr. 180, 181 (Cal. Ct. App. 1978); Ford v. Ford, 512 A.2d 389, 390 (Md. 1986); *In re* Barrett, 637 N.Y.S.2d 751, 752 (N.Y. App. Div. 1996); Dill v. Farm Bureau Life Ins. Co., 797 So. 2d 858, 859 (Miss. 2001); Wunsch v. Sun Life Assurance Co. of Can., 92 S.W.3d 146, 155 (Mo. Ct. App. 2002). *See generally* F.S. Tinio, Annotation, *Killing of Insured by Beneficiary as Affecting Life Insurance or Its Proceeds*, 27 A.L.R. 3d 794 (1969 & Cum. Supp. 2014).

33. *See, e.g.*, Aetna Life Ins. Co. v. Primofiore, 145 Cal. Rptr. 922, 926 (Cal. Ct. App. 1978) (stating that public policy requires that an individual not benefit from the unlawful killing of another); State Farm Life Ins. Co. v. Smith, 363 N.E.2d 785, 786 (Ill. 1977) (same rationale); Harper v. Prudential Life Ins. Co. of Am., 662 P.2d 1264, 1269 (Kan. 1983) (same rationale).

34. *See, e.g.*, Lunsford v. W. States Life Ins., 908 P.2d 79, 83 (Colo. 1995) (en banc) (analyzing Colorado's "slayer statute," which precludes a beneficiary of an insurance policy from collecting the proceeds when the beneficiary kills the insured); Bennett v. Allstate Ins. Co., 722 A.2d 115, 117 (N.J. Super. Ct. App. Div. 1998) (discussing New Jersey "slayer" law); Wunsch v. Sun Life Assurance Co. of Can., 92 S.W.3d 146, 154 (Mo. Ct. App. 2002) (discussing and applying the Missouri "slayer statute").

who has unlawfully killed another to benefit from his or her wrongdoing. This rule applies to assignees of life insurance policies[35] as well as to beneficiaries.

In a life settlement context, the rule that every person has an unlimited insurable interest in his or her own life is illustrated in the case of *First Penn-Pacific Life Insurance Company v. Evans*.[36] In this case, Moore, an Arizona resident, "commenced a fraudulent scheme" by buying seven life insurance policies on his own life with a total face value of $8.5 million. Within months he then sold these life insurance policies to a viatical settlement broker after falsely claiming to be terminally ill.[37] The insurance company tried to have one of the policies declared void ab initio by claiming that Moore did not have a bona fide insurable interest because he intended to sell the policies to strangers at the time he applied for them.[38] The court held, however, that Moore did have an insurable interest in his own life when he obtained the policies and because "[n]o third party participated in the procurement of Moore's policy, and therefore no one was 'wagering' on Moore's life in violation of public policy."[39]

Professor Susan Lorde Martin has strongly criticized the holding of *Evans*, writing: "[t]he [*Evans*] court rather outrageously refused to consider [the insured's] subjective intent in evaluating insurable interest because doing so 'would inject uncertainty into the secondary market for insurance.' "[40] "It is difficult to understand why the court assumed responsibility to protect the life settlement industry. In doing so, the court is encouraging life insurance scams."[41] I believe that Professor Martin makes a valid point, since a number of earlier and later cases have looked to the intent of the parties as the basic test for determining the validity of a life insurance assignment.[42] However, if there is no mutual intent of the parties at the

35. *See, e.g.*, Equitable Life Ins. Soc'y v. Wightman, 160 P. 629, 632 (Okla. 1916) (finding it "unquestionably the law that the assignee takes no greater interest than the assignor has"); Johnson v. Metro. Life Ins. Co., 100 S.E. 865, 866 (W.Va. 1919) (stating that the assignees of a beneficiary cannot "stand on any higher ground than the beneficiary herself."); *see generally infra* Part I.D.

36. First Penn-Pac. Life Ins. Co. v. Evans (4th Cir. 2009) (applying Ariz. law).

37. *Id.* at 634–35.

38. *Id.* at 635. The insurer's argument was largely based on the earlier precedential authority of *Warnock v. Davis*, 104 U.S. 775, 781 (1881) and *Grigsby v. Russell*, 222 U.S. 149, 156 (1911), both holding that a preconceived intent to assign a life insurance policy to one without an insurable interest, who thereafter pays the premiums, may be open to question as a wagering contract. *See generally infra* an extended discussion under Part I.D.

39. *Evans*, 313 F. App'x at 636; *see also* Sun Life Assur. Co. of Canada v. Paulson, 2008 WL 5112 0953 (D. Minn. 2008) (similar holding).

40. *Id.* at 636.

41. Martin, *supra* note 8, at 205–16, 211.

42. *See, e.g.*, Fitzgerald v. Rawlings, 79 A. 915, 916–17 (Md. 1911); Volunteer Life Ins. Co. v. Buchanan, 73 S.E. 602, 604 (Ga. Ct. App. 1912); Oleska v. Kotur, 48 N.E.2d 88, 94–95 (Ind. Ct. App. 1943); *see generally* C.T. Dreschler, Annotation, *Validity of Assignment*

time the policy is procured to circumvent the insurable interest requirement, the insurance company may raise alternate defenses of breach of contract, fraud, and tortious misrepresentation.[43]

Another notorious life settlement case where the insured apparently had an "unlimited insurable interest" in his own life is *Kramer v. Phoenix Life Insurance Company*.[44] In *Kramer*, the insured Arthur Kramer, a prominent New York attorney, purchased several life insurance policies on his own life, allegedly with the intent of immediately assigning the beneficial interests to investors who lacked an insurable interest in his life.[45] These life insurance policies collectively provided $56,200,000 in coverage.[46] When Kramer died, his widow, as personal representative of her deceased husband's estate, brought an action against the various life insurance companies, trustees, insurance brokers, and "stranger" life settlement investors, seeking to have the policy proceeds paid to her instead, as Kramer's beneficiary.[47]

The New York Court of Appeals stressed the distinction of when one insures his or her own life, compared to when a third party insures the life of another:

> When one insures his or her *own* life, the wagering aspect is overridden by the recognized social utility of the contract as an investment to benefit others. When a third party insurers *another's* life, however, the contract does not have the same manifest utility and assumes more speculative characteristics which may subject it to the same general condemnation as wagers.[48]

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of Life Insurance Policy to One Who Has No Insurable Interest in Insured, 30 A.L.R.2d 1310, § 30 (1953 & Cum. Supp. 2013); *see also* AXA Equitable Life Ins. Co. v. Infinity Fin. Grp. LLC, 608 F. Supp. 2d 1349 (S.D. Fla. 2009) (applying Fla. law) (holding *contra* to the *Evans* case regarding the intention of the parties in a life settlement contract dispute); PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust, 28 A.3d 1059 (Del. 2011) (holding that an insured's right to take out a life insurance policy with the intent to immediately transfer that policy is not unqualified, and that right is limited to a bona fide sale of a life insurance policy taken out in good faith).

43. *See generally infra* Part III.C.2. *But see also* Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882, 890 (D.N.J. 2009) (finding that a *unilateral fraudulent intent of the insured* was sufficient in alleging an insurable interest challenge) (emphasis added).

44. Kramer v. Phoenix Life Ins. Co., 914 N.Y.S.2d 709 (N.Y. 2010).

45. N.Y. IN. LAW § 3205(b)(1) addresses individuals obtaining life insurance on their own lives: "Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association, or corporation. Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effectuated" *Id.* at 713.

46. This is not a typo or a misprint. We are talking about insurance policies on Kramer's life totaling $56 million.

47. *Id.* at 712. In most jurisdictions, however, the rights of an assignee are superior to the rights of a beneficiary. *See, e.g.*, JERRY & RICHMOND, *supra* note 13, § 52B(d)(1) at 342 ("Most courts treat the assignee's rights as superior to those of the beneficiary").

48. *Id.* at 713–14 (*citing with approval* New England Mut. Life Ins. Co. v. Caruso, 538 N.Y.S.2d 217 (1989) (emphasis added).

The *Kramer* majority concluded that

> New York law permits a person to procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest in that life, even where the policy was obtained for just such a purpose. . . . We recognize the importance of the insurable interest doctrine in differentiating between insurance policies and mere wagers [citation omitted] and there is some tension between the law's distaste for wager policies and its sanctioning an insured's procurement of a policy on his or her own life for the purpose of selling it. It is not our role, however, to engraft an intent or good faith requirement.[49]

One commentator, Douglas Richmond, asks

> [w]hy should it matter whether the insured acquired the policy in good faith adherence to the insurable interest requirement rather than as an attempt to circumvent it as in *Kramer*? For that matter, so long as Kramer did not misrepresent his intentions on the policy applications, arguably he was not attempting to circumvent the insurable interest requirement. To the contrary, he passed the insurable interest test but simply deployed his policies in a fashion the insurers disliked.[50]

With all due respect, I strongly disagree. First, I question whether Kramer "did not misrepresent his intentions on the policy applications." I think he probably did.[51] And second, I agree with the dissenting judge in *Kramer* that the strong common law public policy rationale preventing wagering contracts in life insurance policies has become so firmly established in American life insurance jurisprudence, that it has not been

49. *Id.* at 710–11.

50. Richmond, *supra* note 14, at 684.

51. Life insurance applications frequently ask questions regarding the applicant's intent in taking out the policy. For example, the following questions are excerpted from a John Hancock life insurance application:

> 4(a) Is there, or will there be an understanding or agreement providing for a party, other than the Owner designated in the Application, to obtain any right, title, or other legal or beneficial interest in any policy issued on the life of the Proposed Life Insured as a result of the application? . . . (c) will the premiums, now or in the future, be funded by a loan or other means from someone other than the Insured or the Insured's employer?

Most life insurance companies have incorporated similar questions in their policy applications in an effort to avoid STOLI policies. *See, e.g.*, Buechner, *supra* note 7, at 8 n.26. If an applicant answered these questions incorrectly, this would constitute fraud and material misrepresentation on the part of the applicant that would render the policy void ab initio; *see also* Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, 2011 WL 759554, at * 1 (C.D. Cal. 2011) ("Hartford, in an effort to avoid STOLI policies, includes certain questions on its life insurance application related to 'whether the insured or proposed owner has discussed selling the policy or an interest in the policy, whether the premium payments are being financed either directly or indirectly [by a third party], and whether financial incentives have been offered to the insured or proposed owner of the policy.' Each of the questions in the Barnes' application were answered in the negative.").

"displaced" by New York Insurance Law Section 3205(b),[52] as I will discuss more fully below.[53] The *Kramer* case became moot, however, in May 2010 when the New York state legislature passed new statutes further regulating life settlements in New York.[54]

2. Insurable Interest Requirement in the Life of Another

Although the language found in state judicial opinions and state statutes as to what constitutes a valid insurable interest in the life of another varies from state to state, there is nevertheless a general consensus that an insurable interest in the life of another may be founded on one of two broad categories: (1) a family "love and affection" insurable interest for persons closely related by blood and affinity; and (2) for all other persons "a lawful and substantial economic interest" in the continued life, health, and bodily safety of the person insured.[55] A crucial requirement for either category, however, is that to have an insurable interest in another person's life, the owner of a life insurance policy must reasonably expect to receive a pecuniary gain from the insured's continued life or suffer financial loss as a result of the insured's death.[56]

a. Close Family "Love and Affection" Insurable Interest—Traditionally, each spouse in a life insurance contract is considered to have a "love and affection" insurable interest in the life of the other spouse,[57] and this "love and affection" insurable interest applies with equal force to a parent and child relationship.[58] Most other family relationships, however, have required a concomitant economic dependency or a pecuniary interest in the prolonged life of the insured to establish a valid insurable interest in the life of an extended family member.[59]

52. *See supra* note 50.

53. *See generally infra* the discussion in Part I.D.

54. *See, e.g.*, N.Y. INS. LAW § 7813(j)(1) (2010) which provides in relevant part: "No person, at any time prior to, or at the time of, the application for, or insurance of, a policy, or during the two-year period commencing with the date of insurance of the policy, shall enter into a life settlement contract, regardless of the date the compensation is to be provided and regardless of the date the assignment, transfer, sale, devise or bequest of the policy is to cover."

55. *See supra* note 28 and accompanying text.

56. *See, e.g.*, Hillaird v. Jacobs, 874 N.E.2d 1060, 1063 (Ind. Ct. App. 2007).

57. *See, e.g.*, Hopkins v. Hopkins, 614 A.2d 96, 99 (Md. 1992); Meechan v. Transam. Occidental Life Ins. Co., 499 N.E.2d 602, 604 (Ill. Ct. App. 1986); Jennings v. Jennings, 33 So. 2d 251, 253 (Ala. 1948); *see generally* JOHN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 802 (2d ed. 1966).

58. *See, e.g.*, Mutual Sav. Life Ins. v. Noah, 282 So. 2d 271, 274 (Ala. 1973) ("It is generally held that a parent, because of the close ties of blood, has an insurable interest in the life of a child, and vice versa"); Dixon v. W. Union Assurance Co., 164 S.E.2d 214, 218 (S.C. 1968) (similar holding); N. River Ins. Co. v. Fisher, 481 S.W.2d 443, 445 (Tex. Civ. App. 1972) (similar holding); *see generally* APPLEMAN & APPLEMAN, *supra* note 58, § 791.

59. *See, e.g.*, Liberty Nat'l Life Ins. Co. v. Weldon, 100 So. 2d 696, 704 (Ala. 1957) (holding that for an aunt to have an insurable interest in the life of her niece, she needed to show a

b. "Lawful and Substantial Economic Interest" Requirement—If no close familial "love and affection" insurable interest in the life of another family member exists, a person insuring the life of another generally must have a "lawful and substantial economic interest in the continued life, health, and bodily safety of the person insured" in order to prevent illegal wagering contracts.[60]

This "substantial economic interest" insurable interest requirement in the life of another is generally found in certain business relationships, including: (1) an economic interest of one business partner in the life of another;[61] (2) an economic interest of a business entity in the life of a "key" employee;[62] and (3) a creditor's economic insurable interest in the life of his or her debtor, at least up to the amount of the debt.[63] Finally, there may be other business or commercial interests based upon certain contractual obligations between the parties, where the death of an individual

"reasonable expectation of possible profit or advantage to her from the continued life of [her niece]"); People's First Nat'l Bank and Trust Co. v. Christ, 65 A.2d 393, 395 (Pa. 1949) (demanding more than a mere familial relationship for an aunt and uncle to procure life insurance on the life of a nephew); *see generally* Swisher, *supra* note 9, at 498–510.

60. *See, e.g.*, Rubenstein v. Mutual Life Ins. Co. of N.Y., 584 F. Supp. 272, 278 (E.D. La. 1984) ("A beneficiary who is not related by blood or marriage to the insured does not have an insurable interest unless he has a reasonable expectation of pecuniary gain from the continued life of the insured, or a [a] reasonable expectation of sustaining loss from his death").

61. *See, e.g.*, Graves v. Norred, 510 So. 2d 816, 818 (Ala. 1987) (holding that a business partner had an insurable interest in the life of another partner); Ridley v. VanderBoegh, 511 P.2d 273, 279–80 (Idaho 1973) (similar holding).

62. The relationship of an employer and an employee in itself is not sufficient to give an employer a valid insurable interest in the life of its employee. Rather, an employer must have a reasonable expectation of a substantial pecuniary gain through the continued life of the employee, or a substantial pecuniary loss in case of the employee's death, to sustain a valid and enforceable insurable interest in such a "key man" or "key woman" employee. *See, e.g.*, Mayo v. Hartford Life Ins. Co., 354 F.3d 400, 407 (5th Cir. 2004); *see generally* Lee Russ & Thomas Segalla, Couch on Insurance § 43:13 (3d ed. 1997). Thus, an employer would have an insurable interest only "in the lives of its employees who are crucial to the operation of the employer's business enterprise," such as the life of its key corporate officers, directors, or managers, whose death would have a substantial negative economic effect on the overall business enterprise. *See, e.g.*, United States v. Supplee-Biddle Hardware Co., 265 U.S. 189, 195 (1924) (company president); Chapman v. Lipscomb-Ellis Co., 22 S.E.2d 393, 398–99 (Ga. 1942) (corporate officer and shareholder); Mut. Life Ins. Co. v. Board Armstrong & Co., 80 S.E. 565, 567 (Va. 1914) (company president and general manager). *But see also* Tillman v. Camelot Music Co., 408 F.3d 1300, 1306 (10th Cir. 2005) (applying Okla. law) (holding that an employer did not have an insurable interest in the life of a rank-and-file employee); Annotation, *Insurance on Life of Officer for Benefit of Private Corporation* 143 A.L.R. 293 (1943).

63. *See, e.g.*, Jimenez v. Protective Life Ins. Co., 10 Cal. Rptr. 2d 326, 334 (Cal. Ct. App. 1992) (holding that a creditor's insurable interest in the life of the debtor is limited to the amount of debt, plus premiums paid, plus interest); *see also* Crotty v. Union Mut. Life Ins. Co. 144 U.S. 621, 623–24 (1891) (similar holding); Bank Credit Life Ins. Co., v. Pine Bluff Nat'l Bank, 448 S.W.2d 333, 334–35 (Ark. 1969) (similar holding); *see generally* Appleman & Appleman, *supra* note 58, §§ 851–59; Vance & Anderson, *supra* note 13, § 32; Swisher, *supra* note 9, at 510–22.

arguably would cause a substantial economic loss to another in the fulfillment of a specified contractual arrangement.[64]

Thus, any insurable interest in the life of another that is not related to a close family "love and affection" insurable interest must be supported by a lawful and substantial economic interest in the continued life and health of the person insured, or the life insurance contract will be declared null and void because it would constitute an illegal wagering contract.

3. When an Insurable Interest in the Life of Another Must Exist

Most courts and commentators agree that because property insurance generally is characterized as indemnity insurance,[65] if there is no insurable interest in the property at the time of loss, there is no insurable loss, due to the lack of a valid insurable interest in the property.[66] However, life insurance has been characterized as an investment contract rather than as a contract of indemnity, although one could make a strong argument that business-related life insurance, such as partnership life insurance policies, "key employee" life insurance, and creditor-debtor life insurance policies also may be characterized in the nature of indemnity insurance as well as a contractual investment in the life of another.[67]

Nevertheless, the prevailing view, held by a vast majority of courts and commentators today, is that an insurable interest in the life of another need only exist at the time of the policy inception and not at the time of the insured's death.[68] However, there is also a minority rule that re-

64. *See, e.g.*, Beard v. Am. Agency Life Ins. Co., 550 A.2d 677, 681–83 (Md. 1988) (involving a contractual option for the purchase and sale of property); Theatre Guild Prods. Inc. v. Ins. Corp. of Ireland, 267 N.Y.S.2d 297, 299–300 (App. Div. 1966), *affirmed*, 278 N.Y.S.2d 625 (N.Y. 1966) (holding that the producer of a play had an insurable interest in the play's star actress, covering her illness, death, or disability, and indemnifying the producer against financial loss resulting from her inability to perform).

65. Under the insurance doctrine of indemnity, an insured may recover only the amount of his or her actual loss and nothing more. *See, e.g.*, KEETON & WIDISS, *supra* note 13, § 3.1(a) at 135.

66. *See, e.g.*, Dairyland Ins. Co. v. Hawkins, 292 F. Supp. 947, 951 (S.D. Iowa 1968); Ins. Co. of N. Am. v. Sealbord Homes Inc., 273 N.Y.S.2d 470, 472 (Sup. Ct. 1965); *see generally* KEETON & WIDISS, *supra* note 13, § 3.3(b)(2) at 154; VANCE & ANDERSON, *supra* note 13, § 30 at 180.

67. I made this argument in a previous law review article. *See* Swisher, *supra* note 9, at 522–31.

68. *See, e.g.*, Hilliard v. Jacobs, 874 N.E.2d 1060, 1064–65 (Ind. Ct. App. 2007); *In re* Estate of D'Agostino, 139 P.3d 1125, 1128 (Wash. Ct. App. 2006); Herman v. Provident Mut. Life Ins. Co. of Philadelphia, 886 F.2d 529, 533–34 (2nd Cir. 1989) (applying N.Y. law); Trent v. Parker, 591 S.W.2d 769, 770–71 (Tenn. Ct. App. 1979); *see generally* KEETON & WIDISS, *supra* note 13, § 3.3(b)(1) at 151 (stating the general rule that a life insurance contract is enforceable, regardless of whether this insurable interest exists at the time of death); JERRY & RICHMOND, *supra* note 13, § 44(b) at 284–85.

quires an insurable interest in the life of another to exist both at the inception of the policy and at the time of the insured's death.[69]

Professor Edwin Patterson tells us that originally the courts did require that an insurable interest in the life of another must exist both at the inception of the life insurance contract and at the time of the insured's death, or the life insurance policy would be unenforceable as soon as the insurable interest was extinguished.[70] However, the insurers "did not take advantage of this ruling: they continued to pay the full amount of the [life insurance] policy, although the [insurable] interest had been extinguished." In short, "life insurance custom conquered the law."[71]

4. Incontestability Provisions Versus Lack of an Insurable Interest in Life Insurance Contracts

Life settlement companies, investors, and other speculators in life insurance policies who do not have an insurable interest in the life of the insured often use incontestability clauses in the life insurance policy to protect their investments, even if the insured has been guilty of fraudulent misrepresentation in the insurance application.[72] By statute, forty-seven of the fifty states require incontestability clauses in individual life insurance policies[73] that prevent insurers from raising stale defenses to coverage after two years and make life insurance a more reliable form of investment, in that beneficiaries can rely upon its existence after the two-year contestability period expires, except for nonpayment of premiums.[74]

69. *See, e.g.*, Allen v. United of Omaha Life Ins. Co., 236 S.W.3d 315, 322 (Tex. Civ. App. 2007) (holding that the beneficiary of a life insurance policy must have an insurable interest in the insured's life when the policy is issued and when the insured dies. "Two policies guide this rule: A practice that encourages one to take another's life should be prohibited, and no one should be permitted to wager on the life of another"); *see also* William T. Vulowich, *Insurable Interest: When It Must Exist in Property and Life Insurance*, 7 WILLAMETTE L.J. 1, 38 (1971):

> The rule requiring an insurable interest both at the inception of the policy and at death would probably provide a greater deterrence against homicide. An ex-creditor and an ex-spouse receive no advantage by the continued life of the ex-debtor and ex-spouse; on the contrary, they would profit by their early deaths. Considering that there is substantial evidence that insurance often provides a motive for homicide, even in cases where the policy owner has an insurable interest, such a rule would possibly be desirable.

Id.

70. *See, e.g.*, Godsall v. Boldero, 9 East 72 (1807) (holding that where a creditor of William Pitt insured Pitt's life, he was denied any claim to the insurance proceeds on Pitt's death, since the debt had already been paid).

71. Patterson, *supra* note 13, 162–66, 163.

72. *See* Richmond, *supra* note 14, at 678–80.

73. *See, e.g.*, Sun Life Ins. Co. of Canada v. Berck, 770 F. Supp. 2d 728, 731–32 (D. Del. 2011).

74. *See* Richmond, *supra* note 14, at 678–80.

An incontestability provision, however, generally provides no defense to the claim that a life insurance policy is void ab initio based upon the lack of a bona fide insurable interest.[75] For example, in the case of *Sun Life Assurance Company of Canada v. Berck*,[76] the court held that under Delaware law, an insurer was entitled to contest the validity of a STOLI life insurance policy on grounds of fraud and misrepresentation, allegedly rendering the policy void ab initio based upon the lack of a bona fide insurable interest, even after the expiration of a two-year incontestability period provided by statute because public policy and a majority of case law supported this determination.[77]

Thus, due to the crucial underlying public policy importance of an insurable interest requirement in the life of another in order to prevent wagering contracts, and in order to prevent the unwelcome possibility of homicide, the vast majority of American courts currently hold that the insurable interest requirement on the life of another is not subject to incontestability provisions[78] nor to any defenses of waiver or estoppel.[79] Moreover, most courts follow the general view that only the

75. *See, e.g.*, Paul Revere Life Ins. Co. v. Fima, 105 F.3d 490, 492 (9th Cir. 1997) (applying Cal. law) ("California law provides that a policy which is void ab initio may be contested at any time, even after the incontestability period has expired"); Beard v. Am. Agency Life Ins. Co., 550 A.2d 667, 689 (Md. 1988) (finding that an incontestability clause does not apply to an insurance policy that is void ab initio because "the invocation of an incontestability provision presupposes a basically valid contract").

There is a minority "New York" approach, holding that a state incontestability statute would also apply to a lack of an insurable interest claim. *See, e.g.*, New Eng. Mut. Life Ins. Co. v. Caruso, 535 N.E.2d 270, 272–75 (N.Y. 1989); *see also* Bogacki v. Great West Life Assur. Co., 234 N.W. 865, 866 (Mich. 1931) (similar holding). The overwhelming majority of other states, however, do not recognize this questionable "New York" approach, based upon a strong public policy rationale against wagering contracts in life insurance. *See generally* the related discussion in Part I of this article.

76. 770 F. Supp. 2d 728 (D. Del. 2011).

77. *Id.* at 732–34, *citing with approval* Warnock v. Davis, 104 U.S. 775, 779 (1881); Grigsby v. Russell, 222 U.S. 149, 154 (1911); Sun Life Assurance Co. of Canada v. Paulson, 2008 WL 451054, at * 2 (D. Minn. 2008); N. Am. Co. for Life and Health Ins. v. Lewis, 535 F. Supp. 2d 755, 759 (S.D. Miss. 2008); Herman v. Provident Mut. Life Ins. Co. of Philadelphia, 886 F.2d 529, 534 (2d Cir. 1989); *see also* PHL Variable Ins. Co. v. Price Dawe 2006 Insurance Trust, 28 A.3d 1059 (Del. 2011) (similar holding).

78. *See* MARTINEZ ET AL., *supra* note 13, § 34.09(3)(e) at 34–28, 29:

> Most states have statutory incontestability periods that do not have exceptions for fraud [citation omitted]. Thus, one might conclude that after the contestability period ends the policy is incontestable and insurers would not be able to attack viatical or STOLI transactions. Such a conclusion would be in error in most jurisdictions. Courts routinely permit inquiry after the incontestability date has passed into whether there was an insurable interest at the inception of the policy . . .

Id.

79. *See, e.g.*, Beard v. Am. Agency Life Ins. Co., 550 A.2d 677, 688 (Md. 1988); *see also* Colver v. Cent. States Fire Ins. Co., 287 P. 266, 268 (Kan. 1930); Natl'l Life & Accident Ins. Co. v. Ball, 127 So. 268, 268 (Miss. 1930); Swisher, *supra* note 9, at 537:

insurer has standing to raise the lack of an insurable interest in life insurance.[80]

Troubling questions nevertheless continue to exist within this general doctrine. As I have queried in a previous law review article:

> Is it fair, on one hand, for a life insurance company or its agent to insure the life of another and accept multiple premium payments over the years, knowing that the policy owner does not have a valid insurable interest in the life of the insured? Yet, on the other hand, without a bona fide insurable interest, is not such a policy a wagering contract, pure and simple, which is void at its inception, regardless of the parties' good faith? How might we resolve this doctrinal conundrum?[81]

Some courts, admittedly a minority, have carved out an exception to the general rule that an insurer cannot waive, or be estopped to assert, the insurable interest doctrine whenever the insurer or its agent writing the policy knew that the person obtaining insurance lacked an insurable interest in the insured person or property but wrote the policy anyway.[82] A second viable remedy against an insurer, however, would sound in tort—for negligently issuing a life insurance policy to someone who lacked a bona fide insurable interest in the life of another.[83]

In the context of life settlement arrangements, Professor Martin writes:

> Life settlement companies know they are acting illegally when they participate in STOLI schemes; they and their investors should not benefit from their involvement. The insured should not be able to have it both ways: getting

Due to the crucial underlying public policy importance of an insurable interest requirement in the life of another in order to prevent wagering contracts, and in order to prevent the unwelcome, but very real, possibility of homicide, the vast majority of American courts and commentators have held that the insurable interest requirement on the life of another is *not* subject to the defenses of waiver or estoppel. (footnotes omitted)

80. *See, e.g.*, *In re* Estate of D'Agostino, 139 P.3d 1125, 1130 (Wash. Ct. App. 2006); Ryan v. Tickle, 316 N.W.2d 580, 582–83 (Neb. 1982).

81. Swisher, *supra* note 9, at 539.

82. *See, e.g.*, Rogers v. Atl. Life Ins. Co., 133 S.E. 215, 220 (S.C. 1926) (life insurance); Nat'l Sec. Fire & Cas. Co. v. Hester, 298 So.2d 236, 243–44 (Ala. 1974) (fire insurance). Professor Robert Jerry notes that: "[These cases] and others like [them] are good candidates for recognizing an exception to the general rule that the insurer cannot waive or be estopped to assert the insurable interest doctrine, but not all cases follow this approach, even when the agent disregards information showing lack of an insurable interest." JERRY, *supra* note 30, § 45 at 321.

83. *See, e.g.*, Liberty Nat'l Life Ins. Co. v. Weldon, 100 So. 2d 696, 708 (Ala. 1957) (holding that a life insurance company has "the duty to use reasonable care not to issue a policy of life insurance in favor of a beneficiary who has no interest in the continuation of the life of another"); *see generally* Francis M. Dougherty, Annotation, *Insurer's Tort Liability for Wrongful or Negligent Issuance of Life Policy*, 37 A.L.R.4th 972 (1985 & 2014 Cum. Supp.) (discussing circumstances in which life insurance companies can be held liable in tort for negligently issuing a life insurance policy to one without a valid insurable interest in the life of another).

> money while alive from a life settlement company in exchange for illegally buying life insurance policies for them, and, if that does not work out for the investors, then the insured's heirs will get the proceeds from the policies—a win-win situation for participating in an illegal scheme. The insurance company should have to forfeit premiums collected if they failed to perform due diligence in writing policies where there is no insurable interest.[84]

A number of courts, however, have held the opposite. For example, in *Penn Mutual Life Insurance Company v. GreatBanc Trust Company*,[85] all the parties agreed that a STOLI scheme was void ab initio because it was procured through material misrepresentation and in the absence of a valid insurable interest. The investors requested a return of their premium payments. The federal district court, however, applying Illinois law, held that the equitable remedy of rescission did not apply in this particular case because, in the absence of a valid insurable interest, there was no valid contract to rescind.[86] "[I]n the case of illegal contracts the courts would not, on one hand, undo what has been done, nor on the other, perfect what has been left unfinished," and therefore the court "will leave the parties . . . where they have placed themselves" with the insurance company keeping the premium payments.[87] While I agree with the legal analysis of the *Greenbanc Trust* court, it should still be noted that the insurance company, while arguably retaining the premiums, may also be liable in a concomitant tort action for failing to perform reasonable diligence in writing life insurance policies where there is no bona fide insurable interest in the life of another.[88]

D. *Assignment of Life Insurance Policies to One Who Lacks an Insurable Interest in the Life of Another*

Should the owner of a life insurance policy be able to assign the policy to one who lacks an insurable interest in the life of the insured? This is a crucial question for life settlement providers and investors when applied to

84. Martin, *supra* note 8, at 209.

85. Penn Mut. Ins. Co. v. Greatbanc Trust Co., 887 F. Supp. 2d 822 (N.D. Ill. 2012).

86. *Id.* at 827–28.

87. *Id.* at 830–31. The court distinguished the case of *Principal Life Insurance Co. v. Lawrence Rucker 2007 Insurance Trust*, 774 F. Supp. 2d 674 (D. Del. 2011), where the court held that, under Delaware law, the insurer could not retain the premiums from an illegal STOLI scheme. But in *Rucker*, "[a]lthough the court had declared the [STOLI] policy void *ab initio*, it nevertheless (and without explanation) went on to rely on rescission cases for the proposition that the insurer could not elect both rescission and retention of premiums." *Id.* at 829–30; *see also* PHL Variable Ins. Co. v. Lucille Morello 2007 Irrevocable Trust, 645 F.3d 965, 969–70 (8th Cir. 2011) (applying Minn. Law) (also recognizing the insurance company's right to retain the premiums paid on a fraudulently procured STOLI policy); *see generally infra* Part III.D.

88. *See supra* note 83 and accompanying text.

viaticals, life settlements, and STOLI transactions, all of which involve stranger-owned life insurance.

Until the early part of the twentieth century, state courts were divided on whether an insured could assign his or her life insurance policy to a third party stranger who lacked any insurable interest in the life of the insured. Some courts held that such an assignment was invalid, even in the absence of any bad faith and even in the absence of any intention to assign at the time of the policy issuance.[89] Other courts, however, treated an assignment of a life insurance policy to one who lacked an insurable interest as a valid chose in action, as long as it was not intended to circumvent the law.[90]

Two highly influential Supreme Court cases subsequently clarified and "institutionalized" the law of life insurance assignments: *Warnock v. Davis*[91] and *Grigsby v. Russell*.[92] In *Warnock*, the insured entered into an agreement with an association that he would procure insurance on his life and then immediately assign his life insurance policy to the association, which would pay all the premiums and receive nine-tenths of the policy proceeds on the insured's death. The Supreme Court held the insured's preconceived intent to assign his policy to the association was void as against public policy because to hold it valid "would be to sanction speculative risks on human life and encourage the evils for which wager policies are condemned."[93]

In *Grigsby v. Russell*, the insured, John Burchard, being in need of money for a surgical operation, sold his life insurance policy to Dr. Grigsby for $100 and Grigsby's undertaking to pay the premiums due or to become due.[94] Justice Holmes, writing the opinion for the Court, held this assignment was valid. "[L]ife insurance has become in our days one of the best recognized forms of investment and self-compelled savings," he stated. "So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property [as a chose in action]"[95] But Justice Holmes also cited *Warnock* and warned

89. *See, e.g.*, Ala. Gold Life Ins. Co., v. Mobile Mut. Ins. Co., 1 So. 561, 563–65 (Ala. 1886); Mo. Valley Life Ins. v. McCrum, 12 P. 517, 518–19 (Kan. 1887); Barbour's v. Larue's Assignee, 51 S.W. 5, 7–9 (Ky. 1899); Schonfield v. Turner, 12 S.W. 626, 626–27 (Tex. 1889).

90. *See, e.g.*, Page v. Metro. Life Ins. Co., 135 S.W. 911, 912 (Ark. 1911); Curtiss v. Aetna Life Ins. Co., 27 P. 211, 214 (Cal. 1891); Bloomington Mut. Ben. Assoc. v. Blue, 11 N.E. 331, 332–33 (1887); Rittler v. Smith, 16 A. 890, 891–93 (Md. 1889); Dixon v. Nat'l Life Ins. Co., 46 N.E. 430, 430–31 (Mass. 1897); McDonald v. Birss, 58 N.W. 359, 360 (Mich. 1894); Brett v. Warnick, 75 P. 1061, 1064–65 (Or. 1904); Clement v. N.Y. Life Ins. Co., 46 S.W. 561, 564–65 (1898); Hurd v. Doty, 56 N.W. 371, 373–75 (Wis. 1893).

91. 104 U.S. 775 (1882).

92. 222 U.S. 149 (1911).

93. *Warnock*, 104 U.S. at 777.

94. *Grigsby*, 222 U.S. at 154. This case could be referred to as "America's first viatical."

95. *Id.* at 156.

against any preconceived assignment to a third-party stranger, which would still constitute an illegal wagering contract.[96] Consequently, since the Court decided the case of *Erie v. Tompkins* in 1938,[97] where federal courts must now apply substantive state law to decide the validity of an assignment of a life insurance policy, an overwhelming majority of state courts have now recognized and incorporated the *Warnock* and *Grigsby* decisions into their own common law jurisprudence.[98] Therefore, as Franklin L. Best concludes on the assignability of life insurance contracts:

> An assignment [of a life insurance policy] to one without [an] insurable interest who thereafter pays the premiums may be open to question as a wager, but the tendency of the decisions seems to be to allow assignments by the insured to anyone, irrespective of who subsequently pays the premiums, so long as the policy was taken out in good faith *and was not at its inception a wagering transaction*. This is justified on the ground that the policy is property, a chose in action, and should be freely transferable as far as reasonable safety permits.[99]

This is the general rule for life settlement assignments as well.[100] Put another way, an insured must obtain a life insurance policy "on his own initiative" and in good faith, that is, with a genuine intent to obtain life insurance protection for a family member, loved one, or business partner in order to validly assign the policy to someone else who does not have an insurable interest in his life.[101] This would normally constitute a valid

96. *Id.* at 156–157.

97. Erie v. Tompkins, 304 U.S. 64 (1938).

98. *See, e.g.*, Chapman v. Lipscomb-Ellis Co., 22 S.E.2d 393, 395–98, 143 A.L.R. 286 (Ga. 1942); Gray v. Penn. Mut. Life Ins. Co., 126 N.E.2d 409, 414–15 (Ill. Ct. App. 1955); Elliot v. Metro. Life Ins. Co., 64 N.E.2d 911, 917 (Ind. Ct. App. 1946); Peel v. Reibel, 286 N.W. 345, 346 (Minn. 1939); Schneider v. Kohler, 201 S.W.2d 499, 502 (Mo. Ct. App. 1947); Thompson v. Pilot Life Ins. Co., 67 S.E.2d 444, 446–47 (N.C. 1951); Hammers v. Prudential Life Ins. Co., 216 S.W.2d 703, 704–05 (Tenn. 1948); *see generally* Annotation, *Validity of Assignment of Life Insurance Policy to One Who Has No Insurable Interest in Insured*, 30 A. L.R. 2d 1310, § 16 (1953 & 2013 Cum. Supp.).

99. BEST, *supra* note 13, ch. 4:4 at 86 (emphasis added).

100. *See, e.g.*, Sun Life Assur. Co. of Canada v. Moran, 2009 WL 2450443 (D. Ariz. 2009); Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, 2011 WL 759554 (C.D. Cal. 2011); PHL Variable Ins. Co., v. Price Dawe 2006 Insurance Trust, 28 A.3d 1059 (Del. 2011); Sun Life Assurance Co. of Canada v. Berck, 770 F. Supp. 2d 728 (D. Del. 2011); Am. Gen. Life Ins. Co. v. Goldstein, 741 F. Supp. 2d 604 (D. Del. 2010); Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882 (D. N.J. 2009); PHL Variable Life Ins. Co. v. Robert Gelb Irrevocable Trust, 2010 WL 4363377 (N.D. Ill. 2010); Sciaretta v. Lincoln Nat'l Life Ins. Co, 899 F. Supp. 2d 1318 (S.D. Fla. 2012); TTSI Irrevocable Trust v. Reliastar Life Ins. Co. 60 So.3d 1148 (Fla. Dist. Ct. App. 2011); AXA Equitable Life Ins. Co. v. Infinity Fin. Grp. LLC, 608 F. Supp. 2d 1349 (S.D. Fla. 2009) (applying Fla. law); Principal Life Ins. Co. v. DeRose, 2011 WL 4738114 (M.D. Penn. 2011).

101. *See, e.g.*, Life Prod. Clearing LLC v. Angel, 530 F. Supp. 2d 646, 653 (S.D.N.Y. 2008).

assignment, then, for viaticals and life settlements,[102] when an insured is trying to sell an existing life insurance policy on the secondary market that is no longer needed, wanted, or affordable.

However, a life insurance policy, such as various STOLI schemes today,[103] obtained when there is a preconceived intent by the parties at the time of the policy inception to assign it to a third party stranger would constitute a void ab initio wagering contract.[104] This is because STOLI schemes are more than stranger-owned life insurance on the secondary market. They are stranger-originated life insurance and, as such, are void ab initio as illegal wagering contracts.

In conclusion, the insurable interest requirement for life insurance is well-recognized and well-entrenched in American jurisprudence, and it continues to serve an important and viable public policy function in prohibiting void ab initio wagering contracts in the lives of others. Contrary to the arguments of some of its critics,[105] the insurable interest requirement for life insurance has long been validated and enforced by state statutes and judicial opinions in almost every state,[106] and the doctrine of life insurance assignments[107] applies with equal force to the life settlement industry as well.[108] Viewed in this context, therefore, "the insurable interest requirement emerges as a relevant, powerful tool to combat unsavory life insurance practices" in the secondary insurance market.[109]

Abandoning the insurable interest requirement and leaving securitized life settlement contracts to the unregulated whims of Wall Street investors and other speculators seems both foolish and unrealistic—similar to the subprime mortgage fiasco of the past decade. In short, the demise of the insurable interest requirement for life insurance has been greatly exaggerated. It is an ancient doctrine that has found new relevance in protecting policyholders and insurers in the secondary life insurance market.

II. VIACTICALS AND LIFE SETTLEMENTS

A. *What are Viaticals and Life Settlements?*

The development of the life settlement industry began with the AIDS epidemic in the late 1980s. At that time, HIV/AIDS victims required continuous end-of-life medical and care giving treatment, and their chances

102. *See generally infra* Part II.
103. *See, e.g., infra* Part III.
104. *Angel*, 530 F. Supp. 2d at 653–54; *see also* Bloink, *supra* note 14, at 65–67.
105. *See, e.g.*, Loshin, *supra* note 13.
106. *See supra* notes 20–27 and accompanying text.
107. *See supra* notes 89–90 and accompanying text.
108. *See supra* notes 100–104 and accompanying text.
109. Bloink, *supra* note 14, at 57.

of survival were minimal, even with access to top quality medical care. A viatical settlement[110] therefore allowed a policyholder who had contracted HIV/AIDS—or another terminal disease—to sell his or her interest in a life insurance policy to a third party life settlement provider (LSP) and associated investors for a sum that was more than the cash surrender value, but less than the policy's death benefit. The third party investors continue to pay the policy premiums until the death of the insured and collect the policy's resulting death benefit.[111]

The viatical settlement market subsequently expanded to include other terminal illnesses, especially since AIDS became a more treatable disease. Thus, people suffering from cancer, heart disease, Alzheimer's disease, and other progressive illnesses, as well as elderly people in need of funds for assisted living, found viatical settlements to be a useful source of immediate cash. Today, the life settlement industry "is growing exponentially as investors seek out not only the terminally ill, but the swelling ranks of generally healthy, elderly Americans."[112] Indeed, investors in the viatical and life settlement market now include institutional investors such as Merrill Lynch, Lloyds of London, Citibank, CNA, Deutsche Bank, GE Capital, AIG, Zurich, Gen Re (a former unit of Berkshire Hathaway), Bank of New York, Maple Financial, and U.S. Bank & Trust.[113]

According to one often-quoted study, a viatical policy generally is less than $100,000, and the policyholder typically is an AIDS patient, or another terminally ill person, whose life expectancy is less than two years and usually twelve months or less. A life settlement policy, on the other hand, typically is more than $100,000 and usually over $250,000. Life settlement policyholders are normally citizens over sixty-five years of age, frequently (but not always) with impaired health, and with life expectancies as high as twelve to fifteen years.[114]

110. A viaticum in ancient Rome was a purse containing money and provisions for a journey. A viatical settlement, by which a dying person is able to acquire provisions for the remainder of his life's journey by selling his life insurance policy, is thus thought to provide a viaticum. *See* Life Partners Inc. v. Morrison, 484 F.3d 284, 286–87 (4th Cir. 2007) (applying Va. law).

111. *See generally* Matthews, *supra* note 14, at 523–27; Bloink, *supra* note 14, at 76–79; Martin, *supra* note 8, at 184–87.

112. *See* Life Partners Inc. v. Morrison, 484 F.3d 284, 287 (4th Cir. 2007) (applying Va. law).

113. Kohli, *supra* note 3, at 286 n. 27. "Consequently, there has been less fraud in the life settlement market when compared to the viatical settlement market because institutional investors perform a much higher level of due diligence before making an investment." *Id.* at 286.

114. *See* Deloitte Consulting LLP, *The Life Settlements Market*, *supra* note 7, at 3. Commentator Eileen Shovlin provides the following "Life Settlement Profile":

1. The target market is affluent people, over age 65.
2. The insured has a life expectancy of 13 years or less but is not [necessarily] terminally ill.

The typical scenario for obtaining a life settlement is as follows:

> Once a policyholder decides to sell his policy, the life settlement broker submits the life insurance policy to a handful of [life settlement providers or LSPs] that are available, requesting quotes on how much they would pay for the life insurance policy given the insured's and the policy's profile. After the LSPs perform their legal, financial, medical, and actuarial due diligence on the insured and the policy, and assuming the policy and the insured meet [their] requirements, the LSPs submit an offer to purchase the policy. Upon receipt of all the offers, the policyholder and his broker will evaluate each offer tendered by the respective LSPs. . . . After selecting a provider, the policyholder is paid the agreed-upon amount and the policy is assigned to the LSP or its designee. After the policyholder has accepted a life settlement offer, the policyholder no longer has any obligation to pay premiums on the life insurance policy because the owner and beneficiary of the policy is now the LSP. The original owner assigns the policy to the LSP; therefore it is the responsibility of the LSP [and subsequent investors] to continue to pay the premiums in order to collect the death benefit when the insured dies.[115]

The need for regulating viaticals and life settlements, however, became apparent from the beginning. The significant power imbalance between a policyholder and life settlement provider created a substantial potential for abuse, where a policyholder often was in financial hardship due to medical and health care costs and was often ignorant of sophisticated industry knowledge and practices. There also was an increased risk of fraud, not only from the life settlement providers and investors, but also from potential insureds. Various commentators, therefore, urged further regu-

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3. The insured's health has declined since issue of the life [insurance] policy.
4. The average face amount of the purchased policy is large, easily $ 1 million or more.
5. Life settlement financing typically comes from institutional buyers.

Shovlin, *supra* note 7, at 1; *see also* PHL Variable Ins. Co. v. Price Dawe 2006 Insurance Trust, 28 A.3d 1059, 1069–70 (Del. 2011):

> Over the past two decades . . . an active secondary market for life insurance, sometimes referred to as the life settlement industry, has emerged. This secondary market allows policyholders who no longer need life insurance to receive monetary cash during their lifetimes. The market provides a favorable alternative to allowing a policy to lapse, or receiving only the cash surrender value. The secondary market for life insurance [including viaticals and life settlements] is perfectly legal. Indeed, today it is highly regulated. In fact, most states have enacted statutes governing secondary market transactions, and all jurisdictions permit the transfer or sale of legitimately procured life insurance policies. Virtually all jurisdictions, nevertheless, still prohibit third parties from creating life insurance policies for the benefit of those who have no relationship to the insured. These policies, commonly known as "stranger originated life insurance" or STOLI, lack an insurable interest and are thus an illegal wager on human life.

Id.

115. *Life Partners Inc.*, 484 F.3d at 289–90.

lation of the viatical and life settlement industry,[116] as will be further discussed below.

B. *Regulation of Viaticals and Life Settlements*

In response to the AIDS epidemic of the late 1980s, Congress amended the Internal Revenue Code to exclude from taxable income any proceeds from the sale of a life insurance policy by a person who was terminally or chronically ill to a viatical or life settlement provider, as long as the viatical or life settlement provider was licensed in the state in which the insured resided.[117] Concurrently, a number of commentators argued that more state regulation was needed to protect elderly life insurance policyholders from possible predatory practices of unlicensed fly-by-night life settlement companies and their investors and provide transparency, fairness, and full disclosure to life settlement contracts.[118]

Subsequently, the National Association of Insurance Commissioners (NAIC) promulgated a Model Act and Model Regulations that was first adopted in 1993 to address the viatical industry's growth in response to the AIDS epidemic. In 2000 the NAIC expanded its definition of "viator" to include persons who were not terminally ill, thus including life settlements within the scope of the NAIC Model Act and Model Regulations.[119] The National Conference of Insurance Legislators (NCOIL) also proposed an NCOIL Life Settlements Model Act, which regulates both viaticals and life settlements.

Both Model Acts seek to protect sellers of life insurance policies (viators) by ensuring that purchasers of these preexisting life insurance policies refrain from unfair business practices or take unfair advantage of the sellers' vulnerability, but both Model Acts "do very little to protect the companies or individuals that purchase the policies [or] the investors that fund the purchase of the policies."[120] Both the NAIC Model Act and Regulations and the NCOIL Model Act provide that life settlement brokers must be licensed in the state where the insured resides,[121] and

116. *See, e.g.*, Lisa M. Ray, Comment, *The Viatical Settlement Industry: Betting on People's Lives is Certainly No "Exacta,"* 17 J. CONTEMP. HEALTH L. & POL'Y 321 (2000); *see also Life Partners Inc.*, 484 F.3d at 288.

117. 26 U.S.C. § 101(g)(2)(B)(i)(I) (1996).

118. *See, e.g.*, Joy D. Kosiewicz, *Death for Sale: A Call to Regulate the Viatical Settlement Industry*, 48 CASE W. RESERVE L. REV. 701 (1998).

119. *See* Jessica M. Perez, Comment, *You Can Bet Your Life on It! Regulating Senior Settlements to be a Financial Alternative for the Elderly*, 10 ELDER L.J. 425, 439 (2002).

120. *See, e.g.*, Fiona M. Jones, Comment, *The Viatical Settlement Industry: The Regulation Scheme and Its Implications for the Future of the Industry*, 6 CONN. INS. L.J. 477, 486 (1999–2000).

121. *See, e.g.*, NAIC VIATICAL SETTLEMENTS MODEL ACT § 3(A) (Nat'l Ass'n of Ins. Comm'rs 2004); NCOIL LIFE SETTLEMENTS MODEL ACT § 3 (Nat'l Conf. of Ins. Legislators 2007). In June 2004, the NAIC amended its licensing requirements to allow individuals li-

both Model Acts also provide important disclosure requirements for every viatical or life settlement transaction.[122]

Accordingly, forty-two states to date have enacted "front-end" legislation based on these Model Acts, covering both viaticals and life settlements,[123] in order to provide state regulation, control, and transparency over viators and life settlement providers within this secondary market for unwanted, unneeded, or unaffordable life insurance policies.[124] It is

censed as an insurance producer with a life insurance company for at least one year to act as settlement brokers with no additional training or licensing requirements. *See* NAIC VIATICAL SETTLEMENTS MODEL REGULATION § 3(H) (Nat'l Ass'n of Ins. Comm'rs 2004). The NCOIL Model Act requires that all settlement providers and brokers be licensed by the state where they are conducting a life settlement transaction. NCOIL LIFE SETTLEMENTS MODEL ACT § 3(A) (Nat'l Conf. of Ins. Legislators 2007).

122. *See* NAIC VIATICAL SETTLEMENTS MODEL ACT §§ 8(A) to 8(F) (Nat'l Assn. of Ins. Comm'rs 2004); NCOIL LIFE SETTLEMENTS MODEL ACT §§ 9, 10 (Nat'l Conf. of Ins. Legislators 2007). For example, the NAIC Model Act mandates certain disclosures to the policyholder at the front end of the transaction, including: alternatives to life settlements, including accelerated death benefits and/or policy loans, are available; the proceeds of a settlement may be taxable; there is a fifteen-day window in which the seller may rescind the life settlement contract; and how the settlement broker's commission is calculated. *Id.* §§ 8(A)(2)-(6) and 8(B)(3). On the back-end transaction between the life settlement broker and the investors, the NAIC Model Act requires that: there will be no return until the insured dies; the rate of return cannot be guaranteed and is dependent on how long the insured lives; certain risks are associated with life insurance policy contestability; and if the insured lives longer than his or her projected life span, the investor may have to fund future premium payments. *Id.* § 8 (D)(1)-(11). For an excellent analysis of both the NAIC Model Act and Regulations, and the NCOIL Model Act, see Kohli, *supra* note 3, at 303–20.

123. "It is important to note that a majority of lawmakers have treated both viatical and life settlements the same for legislative purposes. Most classify the settlement transaction, irrespective of whether it is a life settlement or a viatical settlement, as a 'viatical settlement.'" Kohli, *supra* note 3, at 303 n.112.

124. *See, e.g.*, ALASKA STAT. § 21-96-110 (2000) (viatical statute); ARIZ. REV. STATE. ANN. § 20-3201(10)(a) (2013) (viatical statute); ARK. CODE ANN. § 23-81-801 (2009) (life settlement statute); CAL. INS. CODE § 10113.3 (2009) (life settlement statute); COLO. REV. STAT. § 10-7-601 (2006) (viatical statute); CONN. GEN. STAT. ANN. § 38a-465 (2008) (life settlement statute); DEL. CODE ANN. tit. 18. § 7501 et seq. (1999) (viatical statute); FLA. STAT. § 626.991 (1996) (viatical statute); GA. CODE ANN. § 33-59-1 (West 2009) (life settlement statute); IDAHO CODE ANN. § 41-1950 (2009) (life settlement statute); 215 ILL. COMP. STAT. 159/1 (2010) (viatical statute); IND. CODE ANN. § 27-8-19.8 et seq. (2005) (viatical statute); IOWA CODE § 508e.1 (2008) (viatical statute); KAN. STAT. ANN. § 40-5001 (2008) (viatical statute); KY. REV. STAT. ANN. § 304.15-20 (2010) (viatical statute); LA. REV. STAT. ANN. § 22:1791 (2009) (viatical statute); ME. REV. STAT. tit. 24-a, § 6801 (2003) (viatical statute); MD. CODE ANN. INS. § 8-601 (2004) (life settlement statute); MASS. GEN. LAWS ANN. ch. 175, § 212 (2013) (viatical statute); MICH. COMP. LAWS ANN. § 550.521 (1997) (viatical statute); MINN. STAT. § 60A.957 (2009) (viatical statute); MISS. CODE. ANN. § 83-7-203 (2000) (viatical statute); MONT. CODE ANN. § 33-20-1301 (1997) (viatical statute); NEB. REV. STAT. ANN. § 44-1101 (2008) (viatical statute); NEV. REV. STAT. ANN. § 688C.010 (2009) (viatical statute); N.H. REV. STAT. ANN. § 408-D:1 (2010) (life settlement statute); N.J. STAT. ANN. § 17B:30B-1 (2005) (life settlement statute); N.M. STAT. ANN. § 59A-20A-1 (2000) (viatical statute); N.Y. INS. LAW § 7801 (2010) (life settlement statute); N.C. GEN. STAT. ANN. § 58-58-200 (2002) (viatical statute); N.D. CENT. CODE ANN. § 26.1-33.3-01 (viatical statute); N.D. CENT. CODE ANN. § 26.1-33.4-01 (life settlement statute); OHIO REV. CODE ANN. § 3916.01 (2008) (viatical statute); OKLA. STAT. tit. 36 § 4055.1 (2008) viatical statute); OR. REV. STAT. ANN. § 744.318

important to understand, however, that these state acts do not regulate the "back-end" relationship between life settlement providers and their investors, which is a relationship that is most often regulated by securities law.[125]

C. *Legal Challenges to State Regulation of Viaticals and Life Settlement*

State regulation[126] of viators and life settlement providers has not been without legal challenges in various federal courts. In the case of *Life Partners, Incorporated v. Morrison*,[127] for example, "Jane Doe," a resident of Martinsville, Virginia, who was terminally ill with AIDS and had six to eighteen months left to live, sold her life insurance policy at a deep discount to Life Partners, Inc., a Texas corporation, in order to be provided with cash needed for the remaining months of her life.[128] Life Partners, Inc. engages nationally in the business of viatical settlements and was licensed as a viatical settlement provider under Texas law, but was not licensed to do business in Virginia.[129] Life Partners locates investors to buy life insurance policies and pay the premiums and negotiates with viators or their brokers for the purchase of their life insurance policies. Its profits, and those of its investors, are determined by the difference between (1) the face amount of the policy paid on the viator's death and (2) the cost of the policy, the cost of paying premiums until the viator's death, and administrative expenses.[130]

In July 2004, Jane Doe accepted Life Partners' final bid of $29,900 for her life insurance policy, representing 26 percent of the face value of the

(2010) (life settlement statute); 40 PA. CONS. STAT. ANN. § 626.1 (2002) (viatical statute); R.I. GEN. LAWS ANN. § 27-72-1 (life settlement statute); S.C. CODE ANN. § 35-1-102 (2006) (viatical statute); TENN. CODE ANN. § 56-50-101 (2009) (viatical statute); TEX. CODE ANN. § 1111A.001 (2011) (life settlement statute); UTAH CODE ANN. § 31A-36-101 (2009) (life settlement statute); VA. CODE ANN. § 38.2-6000 (2003) (viatical statute); WASH. REV. CODE ANN. § 48.102.001 (2009) (life settlement statute); W.VA. CODE ANN. § 33-13C-1 (2008) (viatical statute); WIS. STAT. ANN. § 632.69 (proposed) (life settlement statute).

125. *See, e.g.*, Life Partners Inc. v. Morrison, 484 F.3d 284, 289–90 (4th Cir. 2007); *see also* Shovlin, *supra* note 7, at 1:

> If a policy owner sells a policy to a licensed [life] settlement provider and the transaction has been consummated in accordance with the state's viatical and life settlement laws and regulations (the "front end"), [then] the client and his insurance advisor have not participated in the transaction regulated as a security. If, however, an insurance advisor is raising funds for financing entities or reselling purchased policies to individual investors (the "back end") this, according to most states, *would* constitute a security.

Id.; *see also* Miriam R. Albert, *The Future of Death Futures: Why Viatical Settlements Must be Classified as Securities*, 19 PACE L. REV. 345 (1999).

126. *See supra* notes 119–25 and accompanying text.

127. Life Partners, Inc. v. Morrison, 484 F.3d 284 (4th Cir. 2007) (applying Va. law).

128. *Id.* at 290.

129. *Id.*

130. *Id.*

policy. However, five months later, she contacted Life Partners, demanding that it pay her more money, based upon the Virginia Viatical Settlements Act[131] and its enabling administrative regulations.[132] That Act would have required Life Partners to pay her at least $69,000, and maybe more, depending on the applicable range of her life expectancy. Life Partners refused her demand, and she filed a complaint with the Virginia Bureau of Insurance, which conducted an inquiry and concluded that Life Partners "had acted as an unlicensed viatical settlement provider with a Virginia resident."[133] In May 2005, Life Partners commenced an action under 42 U.S.C. § 1983, asserting that the Virginia State Corporation Commission and the Virginia Bureau of Insurance violated the dormant Commerce Clause by attempting to enforce the Virginia Viatical Settlements Act.[134]

The Fourth Circuit found that the Virginia Act "relates to" and "regulates" the business of insurance under the McCarren-Ferguson Act,[135] and therefore there was no violation of the Commerce Clause:

> In sum, we have little difficulty in concluding that the Virginia Viatical Settlements Act relates to the regulation of the business of insurance; was enacted for the purpose of regulating the business of insurance; and indeed regulates directly and substantially the actual business of insurance. Thus, the McCarren-Ferguson Act saves the Act from any dormant Commerce Clause challenge.[136]

The Fourth Circuit was careful to note, however, that the Viatical Settlements Act only regulated the front-end insurance"side of the viatical transaction—involving the provider's purchase of life insurance policies from viators—and did not regulate the relationship between the life settlement providers and their investors, the so-called back-end securities side of the life settlement business.[137]

Likewise, in the case of *National Viatical, Inc. v. Oxendine*,[138] the plaintiffs brought a constitutional challenge against the Georgia Life Settlements Act,[139] which once again was based on model legislation drafted by the NAIC.[140] The Georgia district court judge dismissed with prejudice the plaintiffs' contention that the Georgia Life Settlements Act allegedly violated the Commerce, Contracts, Takings, and Supremacy Clauses,[141]

131. *See* VA. CODE ANN. § 38.2-6000 *et seq.* (2003).
132. *See* 14 VA. ADMIN. CODE § 5-71-60(A) (2006).
133. *Life Partners*, 484 F.3d at 290.
134. *Id.* at 291.
135. 15 U.S.C. §§ 1011, 1012.
136. *Life Partners*, 484 F.3d at 299.
137. *Id.* at 289–90, 297–98.
138. Nat'l Viatical, Inc. v. Oxendine, 2006 U.S. Dist. LEXIS 25851 (N.D. Ga. 2006).
139. GA. CODE ANN. § 33-59-1.
140. *See supra* notes 119–22 and accompanying text.
141. *Oxendine*, 2006 U.S. Dist. LEXIS 25851, at *4–10.

and the Eleventh Circuit subsequently affirmed this lower court decision.[142]

Consequently, state regulation of front-end viatical and life settlement transactions between viators and life settlement brokers has been upheld by various courts under the state's power to regulate the business of insurance under the McCarren-Ferguson Act,[143] and the core provisions of state life settlements acts "ensure that the [life settlement] providers are reliable; require full disclosures to viators; protect the privacy of viators; establish minimum prices for policies; and prohibit fraud."[144] However, the back-end transactions between life settlement providers and their investors are normally regulated by securities law.[145]

D. *Voluntary Regulation of the Life Settlement Industry*

In addition to state governmental regulation of the life settlement industry, a number of life settlement companies have joined together to create a voluntary nonprofit Life Insurance Settlement Association (LISA), which presently includes more than a hundred companies.[146] LISA further publicizes and helps fund various papers and articles that are supportive of the life settlement industry.[147]

142. Nat'l Viatical Inc. v. Oxendine, 2007 U.S. App. LEXIS 7497 (11th Cir. 2007) (applying Georgia law).

143. 15 U.S.C. § 1012.

144. *Life Partners*, 484 F.3d at 288.

145. *See supra* notes 125 and 137 and accompanying text.

146. *See generally* Life Insurance Settlement Association, at www.lisa.org:

> Established in 1994, the Life Insurance Settlement Association is the oldest and largest trade organization in the life settlement market. Its goal is to advance the highest standards of conduct for market participants and to promote education and awareness to consumers, investors, and public officials. LISA represents more than 100 member firms including 2,500 professionals from life settlement brokers, life settlement providers, institutional investors, life settlement servicers, and other service providers.

147. *See, e.g.*, LISA White Paper, *supra* note 3; *see also* Alfonso V. Januario & Narayan Y. Naik, *Empirical Investigations of Life Settlements: The Secondary Market for Life Insurance Policies* (June 10, 2013), *available at* http://ssrn.com/absract=2278229:

> *Abstract:* In recent years, a secondary market for life insurance policies, known as the life settlement market, has developed in the United States. This market enables policy holders wishing to discontinue their life insurance policies to realize the market value of their policies. Using comprehensive data set from a single large market participant of 9,002 policies insuring 7,164 individuals with an aggregate net death benefit of $ 24.14 billion purchased as life settlements from their original owners between 2001 and 2011 across 50 different U.S. states, we answer two important questions. First, to what extent did the presence of the secondary market make the policy owners wishing to sell their policies better off? Second, what rates of return could investors purchasing these policies have expected to make, given the life expectancy estimates of the insureds, optimized cash flow projections over time, and other policy characteristics?
>
> We find that by selling their policies in the secondary market, the policy holders in our sample collectively received more than four times the amount they would have received

LISA does not recognize or condone STOLI settlements.[148] In 2008, Doug Head, LISA's executive director, testified in a written statement to the Florida Office of Insurance Regulation that the "secondary market for life insurance has brought great benefits to consumers, unlocking the value of life insurance policies."[149] He asserted that the life insurance settlement industry is opposed to STOLI, but cautioned that merely because someone buys a life insurance policy and subsequently assigns it to a third party, it cannot be assumed that the buyer is participating in an illegal STOLI scheme by making a straw purchase for a third party.[150] This distinction is of crucial importance. Although stranger-originated life insurance policies (like STOLI) are arguably illegal because they lack any bona fide insurable interest requirement at their inception, stranger-owned life insurance policies (like viaticals and life settlements) that have been validly assigned are legal.[151]

E. *Securitization of Viaticals and Life Settlements*

Although most states have now enacted front-end legislation covering both viaticals and life settlements in order to provide state insurance regulation and control over viators and their life settlement providers,[152] these acts do not regulate the back-end relationship between the life settlement providers and their investors, which is a relationship that is most often regulated by securities law.[153] One proponent of securitization, Professor Thomas E. Plank, defines securitization in this manner:

> Securitization transforms receivables—residential or commercial mortgage loans, automobile loans, credit card receivables, equipment leases and loans, student loans, trade receivables, and other receivables [arguably including viaticals and life settlements] into securities that can be sold in capital markets.[154]

> had they surrendered their policies to their respective life insurance companies. . . . Regarding expected returns to investors, we find that the average cost weighted internal rate of return investors purchasing this sample of life settlements could have expected to make is 12.5% per annum, which is 8.4% in excess of Treasury yields.

Id.; *see generally* Dougherty & Singer, *supra* note 5 (Wharton Business School study of the life settlement industry, funded in large part by LISA). *But see contra* Deloitte Consulting LLP, *The Life Settlements Market*, *supra* note 7 (a study largely funded by the traditional insurance industry, concluding that policyholders with impaired health should retain their life insurance contract until death).

148. *See generally infra* Part III.

149. Formal Written Submission of Doug Head, LISA Executive Director, to the Florida Office of Insurance Regulation (Sept. 3, 2008).

150. *Id.* at 1.

151. *See generally supra* Part I.D; *see also* Martin, *supra* note 8, at 189.

152. *See generally supra* Part II.B.

153. *See, e.g.*, Shovlin, *supra* note 1, at 1; *see also* Albert, *supra* note 127.

154. Thomas E. Plank, *The Security of Securitization and the Future of Security*, 25 CARDOZO L. REV. 1655, 1656 (2003–2004).

Replying to various critics of securitization[155] and stating that he has "personally benefitted from securitization, both intellectually and financially,"[156] Professor Plank notes that as of 2002, "there were more than 6 trillion dollars of outstanding securities issued in securitizations,"[157] including mortgage and other property securitizations.[158] He concludes that "the future of securitization is secure."[159] Unfortunately, Professor Plank's law review article predated by two years the Great Recession of 2006, brought about in large part by the sub-prime mortgage loan securitization debacle.

One might assume that Wall Street financiers and institutional investors might shy away from future securitization financial activities as a result of the subprime mortgage fiasco. However, in 2006, Goldman Sachs created its Longmore Capital unit to handle life settlements and two years later created its QxX mortality index, which tracked the mortality of 46,000 people over the age of sixty-five with diseases other than AIDS to provide information to institutional investors who were prospectively thinking of buying its life settlement securities. But in 2010, Goldman Sachs exited from its life settlement business, claiming that the decision was commercial, although some analysts believed that it did not want to antagonize traditional life insurance companies holding large stock and bond portfolios.[160] Accordingly, most viatical and life settlement contracts today are financed by private investors and hedge funds.[161]

III. STRANGER-ORIGINATED LIFE INSURANCE (STOLI)

A. *What is STOLI?*

Stranger-originated life insurance (STOLI) differs significantly from stranger-owned life insurance. Stranger-owned life insurance, including viaticals and life settlements,[162] generally involves the valid assignment of a preexisting and bona fide insurable interest.[163] Stranger-originated

155. *See, e.g.*, David Ray Carlson, *The Rotten Foundations of Securitization*, 39 WM. & MARY L. REV. 1055 (1998); Lois R. Lupica, *Asset Securitization: The Unsecured Creditor's Perspective*, 76 TEX. L. REV. 595 (1998); Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503 (2002).

156. Plank, *supra* note 154, at 1657 n. 9.

157. *Id.* at 1656.

158. *Id.* at 1672–78.

159. *Id.* at 1730.

160. Martin, *supra* note 8, at 192–196, 193. Credit Suisse also bought a life settlement company and created a group dedicated to buying, packaging, and reselling large numbers of life insurance policies. The company has not ruled out life settlement securitizations in the future. *Id.*

161. *Id.* at 197.

162. *See generally supra* Part II.

163. *See generally supra* Part I.D.

life insurance, on the other hand, is based on a fraudulent and deceitful insurance scheme, lacking any bona fide insurable interest in the life of another.

One court has described how a typical STOLI transaction is structured:

> An agent attempts to sell a life insurance policy to an elderly insurable candidate, and offers the candidate up-front cash in exchange for promising a future sale of the policy. The agent informs the candidate that the candidate will be able to obtain the policy at virtually no cost to himself, because the agent has secured non-recourse financing to purchase the policy. The candidate then acts as a 'nominal grantor' of a life insurance trust that is used to apply for the policy. At that time, the agent will tell the insured that, in all probability, the policy will be sold to investors for a price that will pay the loan and accrued interest, leaving a profit to split between the agent and the insured. . . . If the insured survives [the two-year incontestability period on the policy], the owner (the life insurance trustee) typically has two options, in addition to the sale of the policies to the investors: (1) have the insured pay the outstanding debt with accrued interest and retain the policy [but generally involving a very high interest rate on this 'loan']; or (2) transfer the policy to the lender in lieu of foreclosure. . . . The insureds are usually able to garner significantly greater sums from the [speculator-investors] than they would receive by surrendering the policy to the insurance company. . . . [164]

B. *Validity of STOLI Contracts*

1. The Majority Rule: STOLI Contracts Are Void Ab Initio Because They Lack any Bona Fide Insurable Interest in the Insured

The vast majority of courts today that have interpreted STOLI contracts have held that such contracts are void ab initio from their inception.[165]

164. Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882, 885 (D. N.J. 2009); *see also* Sun Life Assur. Co. of Canada v. Berck, 770 F. Supp. 2d 728, 730 (D. Del. 2011) ("In a STOLI arrangement, speculators collaborate with an individual to obtain a life insurance policy in the name of that individual and then sell some or all of the death benefit payable upon the death of the insured to stranger investors. . . . To maximize the expected rate of return, STOLI speculators often choose individuals over the age of 70 who have a net worth of at least $1 million to apply for the life insurance policies in which they will invest. . . . The speculators will usually pay for the insured's related costs, such as the application fees and premiums, and may even pay the insured some compensation upon issuance of the policy.").

165. *See, e.g.*, First Penn-Pacific Life Ins. Co. v. Evans, 2007 WL 1810707 (D. Md. 2007); AXA Equitable Life Ins. Co. v. Infinity Fin. Group LLC, 608 F. Supp. 2d 1349 (S.D. Fla. 2009); Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 662 (D.N.J. 2009); Sun Life Assurance Co. of Canada v. Moran, 2009 WL 2450443 (D. Ariz. 2009); Am. Gen. Life Ins. Co. v. Goldstein, 741 F. Supp. 2d 604 (D. Del. 2010); Lincoln Nat'l Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust, 2010 WL 2898315 (D. Del. 2010); Sun Life Assurance Co. of Canada v. Berck, 770 F. Supp. 2d 728 (D. Del. 2011); Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, et al., 2011 WL 759554 (C.D. Cal.

This is because if a life insurance policy lacks a bona fide insurable interest at its inception, it is void ab initio because it violates a state's strong public policy against wagering contracts.[166] As one court aptly summarizes this majority rule:

> The Supreme Court has long ago explained that a wagering contract "gives the [policyholder] a sinister counter interest in having the [insured's] life come to an end." *Grigsby v. Russell*, 222 U.S. 149, 154 (1911). . . . [A]s early as 1881, wagering contracts [involving life insurance] have been condemned as being against public policy. *Warnock*, 104 U.S. at 779. . . . However, it is well established that, so long as the insured does not take out the policy at the beginning as a mere cover for a wager, the beneficial interest may be legally transferred to an individual or entity without an insurable interest [such as with viaticals and life settlements]. *See, e.g.*, *Product Clearing v. Angel*, 530 F. Supp. 2d 646, 648 (S.D. N.Y. 2008) (*citing Grigsby*, 222 U.S. at 154).[167]

Therefore, according to this persuasive and well-reasoned majority rule, if a life insurance policy is obtained when there is a preconceived intent of the parties at the time of the policy inception to assign it to a third-party stranger who lacks any bona fide insurable interest in the insured, this would constitute a void ab initio wagering contract, regardless of how diligently the parties attempted to disguise their invalid STOLI contract in an attempt to defraud the insurance company.[168]

2. New York and Pennsylvania Minority Rule: Misguided Judicial Interpretations of State Insurance Statutes

The vast majority of states have held that the insurable interest requirement is of such significant public policy importance that an insurance company cannot waive or be estopped to assert the insurable interest requirement.[169] However, New York courts have adopted a controversial minority approach, holding that the passage of the contestability period in a life insurance contract bars not only misrepresentations made by an insured in a life insurance application, but also any assertion of the lack

2011); PHL Variable Ins. Co. v. Price Dawe 2006 Insurance Trust, 28 A.3d 1059 (Del. 2011); Sciaretta v. Lincoln Nat'l Life Ins. Co., 899 F. Supp. 2d 1318 (S.D. Fla. 2012); PHL Variable Ins. Co. v. Charter Oak Trust, 2012 WL 2044416 (Conn. Sup. Ct. 2012): PHL Variable Ins. Co. v. P. Bowie 2008 Irrevocable Trust, 718 F.3d 1 (1st Cir. 2013).

166. *See, e.g.*, PHL Variable Ins. Co. v. Price Dawe 2006 Insurance Trust, *supra* note 167, at 1067–68.

167. *Sun Life Assurance Co. of Canada*, 770 F. Supp. 2d at 733–34; *see also Lincoln Nat'l Life Ins. Co.*, 596 F. Supp. 2d at 888–89 (similar holding).

168. *See generally supra* Part I.D.

169. *See generally* JERRY & RICHMOND, *supra* note 13, § 45 at 286 ("Most courts that have considered the subject have held that the insurer cannot waive or be estopped to assert the insurable interest requirement, although the cases are not unanimous.") (citing to many opinions); *see also* notes 76-81, *supra*, and accompanying text.

of an insurable interest.[170] Once again, this is clearly counter to the prevailing view of most other jurisdictions.[171]

To make matters worse, the New York Court of Appeals in *Kramer*[172] basically recognized a STOLI scheme involving $56 million in combined coverage assigned to third-party investors. The *Kramer* court concluded that "New York law permits a person to procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest in that life, *even where the policy was obtained for just such a purpose*."[173] The insured's intent to assign his life insurance policies at their inception was never an issue in this case.[174] In a dissenting opinion to *Kramer*, Judge Smith argued that the common law prohibition against wagering policies under *Warnock* and *Grigsby* should prevail over the New York assignability statute that allowed an "immediate transfer or assignment" of life insurance policies.[175] The New York legislature apparently shared Judge Smith's concerns and in 2010 passed new legislation further regulating life settlements in New York, effectively making the *Kramer* case moot.[176]

In 2011, a Pennsylvania federal district court was presented with another STOLI dispute similar to the *Kramer* case.[177] The court needed to interpret the Pennsylvania assignment statute,[178] which, like the New York assignability statute, allowed for an immediate transfer or assignment of a life insurance policy. The magistrate judge, relying primarily on extra-jurisdictional cases, stated that the parties' intentions govern whether an insurable interest exists at the inception of the life insurance policy under Pennsylvania law.[179] Conceding that the "Supreme Court of Pennsylvania has yet to decide whether the parties' intent is relevant to the insurable interest requirement of Sec. 512," Judge Conner, the fed-

170. *See, e.g.*, New England Mutual Life Ins. Co. v. Caruso, 535 N.E.2d 270, 270 (N.Y. 1989) (holding that under New York law an insurer was barred from asserting the invalidity of a life insurance policy because the incontestability period had expired).

171. *See, e.g.*, Paul Revere Life Ins. Co. v. Fima, 105 F.3d 490, 492 (9th Cir. 1997) ("California law provides that a [life insurance] policy which is void ab initio may be contested at any time, even after the incontestability period has expired").

172. Kramer v. Phoenix Life Ins. Co., 914 N.Y.S.2d 709 (N.Y. 2010). The *Kramer* case is discussed earlier at length in Part I.C.1.

173. *Id.* at 710–11 (emphasis added).

174. A Connecticut court distinguished the *Kramer* case as "decided on a narrow set of issues applying unique New York insurance statutes, which are not applicable here." PHL Variable Ins. Co. v. Charter Oak Trust, 2012 WL 2044416 (Sup. Ct. Conn. 2012) (citing with approval PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust, 28 A.3d 1059 at 1075).

175. *Id.* at 716–720, 719 (Smith, dissenting) ("I see no reason to believe the [New York] Legislature ever intended to abolish the anti-wagering rule"). The New York assignability statute provides in relevant part that "Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a [life insurance] contract." N.Y. Ins. Law § 3205(b)(1).

176. *See supra* note 54.

177. Principal Life Ins. Co. v. DeRose, 2011 WL 4738114 (M.D. Pa. 2011).

178. 40 Pa. Cons. Stat. § 512.

179. *DeRose*, 2011 WL 4738114, at *5.

eral district court judge, found that the Pennsylvania assignment statute "does not contain any language referencing the 'intent of the parties' at inception or that subsequent transfers of the policies must be in 'good faith.'" [180] So this court, like the *Kramer* court, would legally recognize a fraudulent and duplicitous STOLI transaction, which, again, is against state public policy in the vast majority of other states. Judge Conner did try to justify his decision in a related footnote:

> This court is acutely aware of the law's general distaste for wager policies and recognizes the importance of the insurable interest doctrine. The court notes that this decision does not vitiate the statutory requirement that an insurable interest exist at the time of inception or that the insured must apply for the policy. . . . There may or may not be a fundamental difference between persons with an insurable interest using life insurance policies as a financial planning mechanism by immediately assigning the policies to third parties and direct wagering by third parties with no insurable interest. It is the job of the Pennsylvania General Assembly, however, and not this court to weigh the competing policy considerations. Neither this court nor the Pennsylvania Supreme Court can engraft an intent or good-faith requirement onto Sec. 512 based on its own policy preferences.[181]

A better-reasoned approach to this interpretive conundrum, however, is found in another STOLI coverage dispute in the certified case of *PHL Variable Insurance Co. v. Price Dawe 2006 Insurance Trust.*[182] In that case, the Dawe Trust argued that reading an intent requirement into the Delaware insurable interest statute[183] was at odds with its plain statutory language and that the Delaware Insurance Code "abrogates older Delaware cases decided at common law, which looked beyond the initial beneficiary to the intent of the parties when determining insurable interest." The Trust also emphasized "that life insurance policies are freely assignable under Delaware law."[184]

The Delaware Supreme Court disagreed with these arguments, which were similar to those made in the *Kramer* and *DeRosa* cases, stating:

> The language of [the Delaware insurable interest statute] is ambiguous because a literal reading of the statute would permit wagering contracts which are prohibited by the Delaware Constitution.[185] . . . A statute is ambiguous if it is susceptible to two [or more] reasonable interpretations, or

180. *Id.* at *5–6.

181. *Id.* n.17.

182. PHL Variable Ins. Co. v. Price Dawe 2006 Insurance Trust, 28 A.3d 1059 (Del. 2011).

183. 18 DEL. CODE § 2704(a).

184. *PHL Variable Ins. Co.*, 28 A.3d at 1069.

185. The Delaware Constitution "prohibits all forms of gambling" subject to limited exceptions. DEL CONST. art. II § 17.

> if a literal reading of its terms "would lead to an unreasonable or absurd result not contemplated by the legislature." *Courts should [also] interpret statutory law consistently with preexisting common law unless the legislature expresses a contrary intent.*[186]

Thus, this intent requirement did not have to be judicially "engrafted" onto the Delaware insurable interest statute because it already existed under the common law.[187] Accordingly, the Delaware Supreme Court held, along with the vast majority of other state and federal courts, that "[u]nder Delaware common law, if a life insurance policy lacks an insurable interest at its inception, it is void *ab initio* because it violates Delaware's clear public policy."[188]

C. *Proving the Intent Requirement to Invalidate STOLI Policies*

If an overwhelming majority of jurisdictions allow a court to declare a STOLI policy to be void ab initio based upon a pre-conceived intent to assign the policy to a third-party stranger without an insurable interest at the time of the policy inception,[189] what is the burden of proof to establish such intent? In a typical lawsuit to declare a STOLI policy to be void ab initio, an insurance company normally will plead two alternative defenses: (1) a material misrepresentation defense in the insurance application; and (2) the lack of an insurable interest requirement at the time of contracting the policy.[190]

1. Material Misrepresentations in the STOLI Application

A material misrepresentation[191] in a life insurance application normally will void the policy ab initio. For example, if a prospective insured lies

186. *PHL Variable Ins. Co.*, 28 A.3d at 1069–70 (emphasis added).

187. In support of this proposition, the Delaware court cited a U.S. Supreme Court decision, *Norfolk Redevelopment and Housing Authority v. Chesapeake and Potomac Tel. Co. of Virginia*, 464 U.S. 30, 35 (1983), holding in relevant part that "[i]t is a well-established principle of statutory construction that [the] *common law . . . ought not to be repealed, unless the language of a statute be clear and explicit for this purpose.*" (emphasis added) *PHL Variable Ins. Co.*, 28 A.3d 1059 at 1072–73 n.57; *see also id.* at 1070–74 (discussing Delaware's insurable interest common law precedents).

188. *Id.* at 1067–68; *see also* Frank v. Horton, 553 A.2d 1199, 1205 (Del. 1989) (holding that a contract that violates clear public policy is invalid as a matter of law).

189. *See generally supra* Part I.D.

190. *See, e.g.*, Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882, 887–90 (D.N.J. 2009); Am. Gen. Life Ins. Co. v. Goldstein, 741 F. Supp. 2d 604, 613–16 (D. Del. 2010); Sun Life Assurance Co. of Canada v. Berck, 770 F. Supp. 2d 728, 731–36 (D. Del. 2011); PHL Variable Ins. Co. v. Charter Oak Trust, 2012 WL 2044416, at *2–7.

191. *See, e.g.*, Kungys v. United States, 485 U.S. 759, 786 (1988) ("A misrepresentation is material if it would be likely to induce a reasonable person to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so."); *see also* Oglesby v. Penn. Mutual Life Ins. Co., 877 F. Supp. 872, 894 (D. Del. 1994) ("It is hornbook law that where the insurer seeks a specific answer, the fact elicited will usually be treated as a material one.")

in a life insurance application, denying that he or she has discussed assigning or selling the life insurance policy to another party at the time of its inception or that a third-party investor has agreed to make all the premium payments, this would constitute a material misrepresentation that would void the policy ab initio.[192] Likewise, an insurer would be entitled to rescind a $10 million life insurance policy upon learning that the prospective insured was not worth $12 million nor had an annual income of $500,000, but was instead a retired seamstress whose annual income never exceeded $40,000 and whose only valuable property was a condominium that had gone into foreclosure.[193]

When the two-year incontestability period has tolled on a STOLI life insurance policy, the courts are split as to whether the insured's fraudulent misrepresentations in the policy application will void the policy ab initio. Some courts hold that if the life insurance company has filed a complaint after the two-year contestability period has passed, the plaintiff insurer's claims regarding material misrepresentation would likely be barred unless the policy is void for lack of an insurable interest.[194] Other courts have held, however, that if a life insurance policy is void ab initio because there was no valid insurable interest at its inception, the contestability period is not applicable.[195] Under either approach, the lack of a bona fide insurable interest at the inception of the STOLI policy remains of paramount importance.

2. Lack of a Bona Fide Insurable Interest at the Inception of the STOLI Policy

Except for New York,[196] Pennsylvania,[197] and possibly Michigan,[198] the vast majority of states will declare a STOLI policy to be void ab initio

192. *See, e.g.*, Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, 2011 WL 759554, at *1 (C.D. Cal. 2011).

193. *See, e.g.*, PHL Variable Ins. Co. v. 2008 Christa Joseph Irrevocable Trust, 970 F. Supp. 2d 932, 942 (D. Minn. 2013).

194. *See, e.g.*, Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, 2011 WL 759554, at *4 (C.D. Cal. 2011). This is why transfer of ownership to STOLI investors normally takes place after a two-year contestability period, so (hopefully, for the investors) a court will not be able to void the life insurance policy for material misrepresentations in the life insurance application.

195. *See, e.g.*, Sciaretta v. Lincoln Nat'l Life Ins. Co., 899 F. Supp. 2d 1318, 1328 (S.D. Fla. 2012).

196. *See, e.g.*, New England Life Ins. Co. v. Caruso, 535 N.E.2d 270, 272–75 (N.Y. 1989); Kramer v. Phoenix Life Ins. Co., 914 N.Y.S.2d 709, 710–11 (N.Y. 2010); *see generally supra* notes 172–76 and accompanying text. This "New York rule," however, was subsequently limited by New York legislative statute. *See supra* notes 54 and 176.

197. *See, e.g.*, Principal Life Ins. Co. v. DeRose, 2011 WL 4738114 (M.D. Pa. 2011) (purportedly applying Pa. law); *see generally supra* notes 177–81 and accompanying text.

198. *See, e.g.*, Bogocki v. Great West Life Ins. Co., 234 N.W. 865, 866 (Mich. 1931) (holding that Michigan incontestability rules applied to life insurance contracts would also apply to the lack of an insurable interest).

if the intent of the parties at the inception of the policy was to assign or sell that policy to a third-party stranger or entity lacking any bona fide insurable interest in the life of the insured.[199] But how does a life insurance company go about proving such an intent?

Issues of intent "are crucial in assessing an insurable interest challenge"[200] and may be further complicated by the fact that the insured is dead.[201] A Florida federal district court judge has identified three factors to consider when determining the intent of the insured and third party investors in procuring a life insurance policy: (1) a preexisting agreement or understanding that the policy is to be assigned to one having no insurable interest; (2) the payment of some or all of the premiums by someone other than the insured, and in particular, by the assignee; and (3) the lack of a risk of actual future loss.[202] So if a prospective insured testified that she never intended to maintain the insurance policy and she knew that the policy would ultimately be owned by a third party who would collect the death benefits, this was sufficient to show "that there was a preexisting understanding that the policy would be assigned to someone with no insurable interest." The policy was therefore void ab initio due to the fraudulent conduct of the prospective insured as well as the fraudulent conduct of the third party STOLI investors.[203]

Likewise, the Ninth Circuit and a number of other courts have construed the "insurable interest" requirement to be violated when the insured is working together with an assignee to acquire a life insurance policy where the circumstances indicate that the assignee is the real purchaser of the policy.[204]

Finally, there is the largely unresolved issue of whether a bilateral plan, scheme, or agreement between the insured and third-party STOLI investors is necessary at the time of the policy procurement to establish a violation of the insurable interest requirement, or only a unilateral intent of

199. *See generally supra* Part I.D. For STOLI policies in particular, see *supra* notes 189–90 and accompanying text.

200. *See, e.g.*, Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882, 890 (D. N.J. 2009); Sun Life Assurance Co. of Canada v. Berck, 770 F. Supp. 2d 728, 734–35 (D. Del. 2011).

201. *See, e.g.*, Sciaretta v. Lincoln Nat'l Life Ins. Co., 899 F. Supp. 2d 1318, 1325 (S.D. Fla. 2012).

202. *Id.* at 1325–26.

203. *Id.* at 1325; *see also Lincoln Nat'l Life Ins. Co.*, 596 F. Supp. 2d at 889 ("Calhoun had already entered into an informal arrangement to assign the policy to a third party who would finance all of his premium payments for the Policy, therefore circumventing the insurable interest requirement.").

204. *See* McKee v. Penick, 947 F.2d 1403, 1405 (9th Cir. 1991) (interpreting Arizona law to prohibit the "deliberate attempt to evade the requirement of an insurable interest"), *cited with approval* in Sun Life Assurance Co. of Canada v. Moran, 2009 WL 2450443 (D. Ariz. 2009).

the insured is required. In the unpublished opinion *Paulson v. Sun Life Assurance Company of Canada*,[205] for example, a Minnesota federal district court judge granted the defendant trustees' motion to dismiss the insurer's lawsuit because there was no evidence of any mutual intent of the insured and the third party investors to avoid the insurable interest requirement at the time the policy was procured.[206] On the other hand, a New Jersey federal district court judge in *Lincoln National Life Insurance Co. v. Calhoun*[207] held that only a unilateral intent of the insured was sufficient in alleging an insurable interest challenge.[208] Under the former view, if a policyholder insures his own life and subsequently defrauds a viatical insurance company by falsely claiming that he had a terminal illness, the insurable interest defense would not be an appropriate remedy,[209] although breach of contract, fraud, and tortious misrepresentation defenses arguably would constitute valid alternate remedies.[210]

D. *Which Party Retains the Premiums Paid on a Void Ab Initio STOLI Policy?*

If a STOLI policy is void ab initio, which party should be entitled to the premium payments—the insurance company or the third party investors? According to general principles of contract rescission, if a life insurance company rescinds its policy ab initio for lack of a valid insurable interest, it must return the unearned premiums to the insured.[211] This would be

205. 2008 WL 451054 (D. Minn. 2008).

206. *Id.* at * 1, *2 ("[A unilateral intent] . . . is irrelevant without facts or allegations suggesting that a third party, lacking an insurable interest intended, at the time of [the policy procurement], to acquire the policy upon expiration of the contestability period."), *cited in* Sun Life Assurance Co. of Canada v. Berck, 779 F. Supp. 2d 728, 734 (2011).

207. 596 F. Supp. 2d 882 (D. N.J. 2009). *Calhoun* involved a legal action among a life insurance company, an insured, and the trustee of a trust that owned the policy and was the policy's beneficiary, seeking a declaration that the life insurance policy was void ab initio for lack of an insurable interest where the insured allegedly purchased policies using borrowed funds and with the intent of selling these policies to stranger investors in the secondary life insurance market. *Id.*

208. *Id.* at 890 (finding that a unilateral intent was sufficient in alleging an insurable interest challenge). Both *Paulson* and *Calhoun* are discussed in *Lincoln National Life Insurance Co. v. Joseph Schlanger 2008 Insurance Trust*, 2010 WL 2898315, at * 7 (D. Del. 2010); *American General Life Insurance Co. v. Goldstein*, 741 F. Supp. 2d 604, 616 (D. Del. 2010); and *Sun Life Assurance Co. of Canada v. Moran*, 2009 WL 2450443, at *5 (D. Ariz. 2009).

209. *See, e.g.*, First Penn Pac. Life Ins. Co. v. Evans, 313 Fed. App'x 633, 634–36 (4th Cir. 2009) (applying Ariz. law). The *Evans* case is discussed in depth *supra* in notes 36–43 and accompanying text.

210. *See, e.g.*, Sciaretta v. Lincoln Nat'l Life Ins. Co., 899 F. Supp. 2d 1318, 1328–30 (S. D. Fla. 2012).

211. *See, e.g.*, Principal Life Ins. Co. v. Lawrence Rucker 2007 Ins. Trust, 774 F. Supp. 2d 674 (D. Del. 2011) (holding that, under Delaware law, the insurance company could not retain the premiums from an illegal STOLI scheme, relying on contract rescission cases for the proposition that an insurer could not elect both a rescission remedy and retention of premiums).

the major argument of the STOLI trustees—that under this rescission "tender back" doctrine, a party who seeks rescission of an insurance contract, even if that contract was procured by fraud, is always required to return the entire premium consideration, under all circumstances.[212] However, a majority of courts interpreting invalid STOLI policies have held the opposite. According to one court:

> [The] Trust cites the general principal that when a party requests rescission of a contract, [that] party must return all [premium] consideration paid in order to restore the *status quo ante*. . . . Hartford [Life & Annuity Insurance Company], on the other hand, insists that "where a policy has been procured by fraudulent misrepresentation, concealment, or deception of the insured or his agent, 'the insured has no right to the return of his premium' . . . (quoting Couch on Insurance 3d Sec. 79:40). Moreover, Hartford argues that the rules governing return of [premium] consideration upon rescission do not apply because it is not specifically seeking rescission, but only a declaration that the Policy is void *ab initio*."[213]

Accordingly, a majority of courts have adopted the better-reasoned view that if a STOLI policy was procured through the actual fraud of the insured, an insurer is not required to return the STOLI premium upon rescission, even where the premium was funded by, and ultimately would be returned to, an innocent third party lender.[214] Moreover, a life insurance company may also allege that the defendants' fraudulent conduct caused the insurer "to expend money and resources, including . . . the costs of underwriting, issuance, payment of commissions, administration, services, and investigations associated with the Policy, in addition to those expenses incurred in bringing this action for relief" and this relief can also come from the premiums collected.[215]

However, if the insurance company knew—or should have known—that the applicant for a life insurance policy lacked a bona fide insurable interest at the inception of the policy, the life insurance company would be liable in tort for negligently issuing a life insurance policy to one lacking a valid insurable interest.[216]

212. *See, e.g.*, PHL Variable Ins. Co. v. P. Bowie 2008 Irrevocable Trust, 718 F.3d 1, 16 (1st Cir. 2013) (applying R.I. law).

213. Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, 2011 WL 759554, at *4 (C.D. Cal. 2011).

214. *See, e.g.*, PHL Variable Ins. Co. v. Lucille E. Morello 2007 Irrevocable Trust, 645 F.3d 965, 969–70 (8th Cir. 2011); *see also* PHL Variable Ins. Co. v. 2008 Christa Joseph Irrevocable Trust, 970 F. Supp. 2d 932, 945 (D. Minn. 2013); Penn Mutual Ins. Co. v. Greatbanc Trust Co., 887 F. Supp. 2d 822, 830–31 (N.D. Ill. 2012).

215. *See, e.g.*, PHL Variable Ins. Co. v. Clifton Wright Family Ins. Trust, 2010 WL 1445186, at *2–3 (S.D. Cal. 2010); Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust, 2011 WL 759554, at *5 (C.D. Cal. 2011).

216. *See, e.g.*, Francis M. Dougherty, Annotation: *Insurer's Tort Liability for Wrongful or Negligent Issuance of Life Policy*, 37 A.L.R. 4th 972 (1985 & Cum. Supp. 2014) (discussing cir-

E. *Legislative Regulation of STOLI Contracts*

In addition to judicial regulation of STOLI contracts, a number of states have supplemented their established insurable interest statutes with additional statutes designed to identify and prohibit STOLI-type transactions that violate the spirit, if not the letter, of the insurable interest requirement.[217] These supplemental state statutes are largely based upon the National Conference of Insurance Legislators (NCOIL) Life Settlements Model Act of 2000; the National Association of Insurance Commissioners Model Act, as amended in 2007 to deal with illegal STOLI transactions; or a hybrid of the two model acts.[218]

Basically, the NCOIL Model Act attempts to ban all STOLI transactions by prohibiting any "practice or plan to initiate life insurance for the benefit of a third-party investor who, at inception, has no insurable interest in the insured." The NAIC Model Act, on the other hand, attempts to eliminate STOLI indirectly, by establishing a five-year moratorium on policies sold to third parties when the insured is not suffering a medical, financial, or family downturn in circumstances. The NCOIL Model Act defines as fraud any violation of insurable interest laws while the NAIC Model Act has no such provision. The NCOIL Model Act also has a two-year ban, which coincides with the contestability periods in most states.[219]

Approximately twenty-two states have passed supplemental anti-STOLI statutes,[220] but the "variation in state [statutory] provisions, and the fact that life settlements are still unregulated in [many] states can be problematic for some life settlement participants."[221] Indeed, in a letter to NCOIL, LISA Executive Director Doug Head, admittedly concerned about the Model Acts' effect on legitimate viatical and life settlement agreements, stated that the solution to the STOLI problem lies in state

cumstances in which insurers can be held liable for negligently issuing a life insurance policy to one lacking a valid insurable interest).

217. *See generally* Bloink, *supra* note 14, at 91–98.

218. *Id.* at 91–94.

219. *See* Martin, *supra* note 8, at 200–202.

220. *See, e.g.*, ARK. CODE ANN. § 23-81-802(24) (2009); CAL. INS. CODE § 10113.1(w) (2009); CONN. GEN. STAT. § 38a-465j(a)(2) (2009); FLA. STAT. ANN. § 627.404(1) (2008); GA. CODE ANN. § 33-59-2(24) (2009); HAW. REV. STAT. § 431E-2 (2008) (repealed 2010); IDAHO CODE ANN. § 41-1962(1) (2009); 215 ILL. COMP. STAT. § 159/50(a) (2010); IND. CODE ANN. § 27-8-19.8-20.1 (2008); KAN. STAT. ANN. § 40-5002(1) (2009); KY. REV. STAT. ANN. § 304.15-020(7)(a)(1)(k) (2009); ME. REV. STAT. ANN. tit. 24-A §§ 6802-A(6)(A)(3) and (12A) (2009); MINN. STAT. § 60A.0782 sub. 12 (2009); N.Y. INS. LAW § 7815 (2009); N.D. CENT. CODE § 26.1-33.4-01(23) (2009); OHIO REV. CODE ANN. § 3916.172 (2008); OKLA. STAT. ANN. tit. 36 § 4055.2(7)(e) (2008); OR. REV. STAT. § 744.318(18) (2009); R.I. GEN. LAWS § 27-72-2(26) (2009); TENN. CODE ANN. § 56-50102(12) (2009); UTAH CODE ANN. § 31A-36-102(18) (2009); VT. STAT. ANN. tit. 8 § 3835(18) (2010); WASH. REV. CODE § 48.102.006(25) (2009); W. VA. CODE ANN. § 33-13C-2(18) (2008).

221. Martin, *supra* note 8, at 204.

insurable interest statutes rather than in upturning established law through new supplemental anti-STOLI state legislation.[222]

Professor Robert Bloink also believes that any further statutory regulation of the secondary life insurance market should be approached with extreme caution, writing:

> [E]fforts to curb STOLI abuses, such as NCOIL's Viatical Settlements Model Act, and many recent court cases, have taken a restrained approach to the insurable interest requirement, recognizing that a radical expansion of the insurable interest requirement is unnecessary, even in the face of modern insurance products and transactions (e.g., STOLI). . . . This conservative approach to the insurable interest requirement is wise, considering the drastic effect a failure of the insurable interest has on a policy, voiding it and entirely eliminating its value) . . . The insurable interest requirement has existed for over two centuries, but is still well equipped to serve the purpose for which it was intended: eliminating wager policies and curbing the moral hazard inherent when speculators insure the lives of unrelated third parties.[223]

I heartily agree with this assessment, since recent judicial decisions involving STOLI disputes have demonstrated that the insurable interest requirement for life insurance has been very effective in thwarting most fraudulent STOLI schemes today, even in the absence of additional statutory regulation.[224]

IV. CONCLUSION

The insurable interest requirement for life insurance is alive and well in twenty-first century America. The purpose of an insurable interest requirement in life insurance, as originally enacted in England in 1774 and as later adopted by most American courts and state legislatures, was two-fold: (1) to discourage the practice of using life insurance as a gambling or wagering device, and (2) to remove the incentive for the procurer of life insurance to commit homicide.

The Supreme Court in *Warnock* and subsequent state judicial and statutory insurable interest laws held that any preconceived assignment of a life insurance policy to a third-party stranger who lacked any bona fide insurable interest in the life of the insured was void ab initio as an illegal wagering contract. However, under *Grigsby* and subsequent state legislative and common law precedent, the assignment of a life insurance policy to a third-party stranger would be valid as long as the life insurance policy

222. *See* Bloink, *supra* note 14, at 96–98 n.157.
223. *Id.* at 99.
224. *See generally supra* Part III.A. to D.

was originally taken out in good faith and was not at its inception a wagering contract.

Over the past decade, an active secondary market for life insurance, often referred to as the life settlement industry, has emerged. The fundamental aspect of a life settlement transaction, whether characterized as a life insurance viatical, a life settlement, or a STOLI scheme, is relatively straightforward: a terminally ill policyholder (for viaticals) or an elderly policyholder, frequently with impaired health (for life settlements and STOLI), sells his or her unwanted or unaffordable life insurance policy to a third-party life settlement provider and investors for an amount that is lower than the policy's death benefit, but higher than the policy's cash surrender value. This secondary life insurance market therefore provides a favorable alternative to letting a policy lapse or receiving only the cash surrender value on the policy, which is often very low.

This secondary market for life insurance policies is perfectly legal for viaticals and life settlements and is highly regulated in most states through state statutes governing secondary life insurance market transactions. However, almost all jurisdictions still prohibit third parties from creating life insurance policies for the benefit of those who have no insurable interest in the life of the insured—so-called stranger-originated life insurance or STOLI.

The insurable interest requirement in life insurance has thus far successfully thwarted most of these illegal STOLI schemes, although numerous STOLI "trusts" are carefully drafted in an attempt to circumvent the insurable interest requirement, through the fraudulent conduct of the insured and third-party STOLI investors.

The insurable interest requirement for life insurance continues to play a vital role in this newly emerging secondary life insurance market in distinguishing between legitimate life settlements and invalid wagering arrangements.