The Rise of Stranger-Originated Life Insurance Lawsuits

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The Clash of Insurable Interest and the Evolving Secondary Life Insurance Market:The Rise of Stranger-Originated Life Insurance Lawsuits

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SUMMARY: This commentary focuses on "stranger-originated life insurance" or "STOLI"-- in which a life insurance policy is originated primarily or solely for the purpose of resale. It chronicles how the clash of the insurable interest requirement and the evolving secondary life insurance market have led to the rise of STOLI lawsuits. It analyzes the myriad of legal issues that STOLI and stranger-originated annuity transactions raise.

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ARTICLE: I. INTRODUCTION

Life settlements have garnered attention in recent years from life insurance companies, state insurance regulators, members of Congress, the Securities and Exchange Commission, the General Accountability Office and the Internal Revenue Service. Many participants in the world of finance, including banks, investment banks, hedge funds and money managers, have also become involved with life settlements. This attention is attributable to the sheer size of the U.S. life insurance market, the vast amounts of money represented by in-force policies and the fact that such policies constitute a significant asset for many families, so that any potential threat to the market or abuse of the product can have major financial, political and social implications. Proponents of life settlements claim they can be an attractive investment, capable of generating double-digit returns over the long term that are largely uncorrelated with the ups and downs of the equity and debt markets, and that they provide seniors with a valuable alternative to the lapse of their policies or the return of such policies to the insurers for their cash surrender value. Detractors argue that life settlements are a perversion of life insurance, which should be used to protect the family or business of a provider in the event of untimely death, rather than as a means by which unscrupulous investors can gamble on the longevity of unrelated persons.

This commentary analyzes one of the phenomena that has prompted so much public discussion of life settlements - so-called "stranger-originated life insurance" or "STOLI"- in which a life insurance policy is originated primarily or solely for the purpose of resale. STOLI transactions are undertaken by third party sponsors and investors with the expectation that the proceeds they will receive when the insured individual dies will significantly exceed the costs of purchasing the policy from the original owner and paying all or a substantial part of the premiums during his or her lifetime. The insured is typically induced to enter the transaction by the promise of an attractive cash settlement for merely applying for a life insurance policy and agreeing to pay a fraction of the premiums (often by way of a financing charge) for a two-year period until the policy is sold. For the life insurance agent, who receives a sizable commission from the insurance company upon issuance of the policy, there is a strong incentive to generate new policies, and the larger, the better. The life insurance companies have competing interests: while they are eager to obtain new business and receive the resulting premiums, they have sometimes been forced to pay out large sums in death benefits to previously unknown investors holding policies that turn out to have been fraudulently procured based upon gross misrepresentations in the applications. In some instances, the seniors who have been persuaded to apply for the policies have also been duped by the producers and are unaware of the misstatements contained in the applications.

STOLI transactions raise a host of legal issues. These range from the extent to which life insurance policies should be freely transferable under state insurable interest laws to questions of conflicts of law to disputes regarding the rights of an insurer to retain premiums upon a policy rescission and to challenge the validity of a policy after expiration of the contestability period. Because insurance is regulated under the laws of the 50 states, state insurance departments and legislators, as well as the courts, have responded differently to these issues. This commentary traces the development of STOLI and describes these responses as the debate, and the disputes, continue. It also discusses a parallel phenomenon - stranger-originated annuities - that has emerged within the past year and raises similar legal questions.

II. LEGAL BACKGROUND

As described below, beginning sometime in the early 2000s, as life settlements became more prevalent, some policyholders began to purchase life insurance policies with the intent to sell, or at least the cognizant possibility of later selling, the policy to an unrelated third party for cash. In certain egregious cases, not only did policyholders allegedly enter into agreements, prior to the purchase of a policy, to sell that policy to investors who did not have an insurable interest in the insureds' lives, but, in order to reap a higher purchase price, grossly inflated their income or net worth statements in the policy's application to obtain a larger policy, thereby commiting fraud against the insurance company. In addition, in some instances, the investors facilitated the purchase of policies by agreeing to finance all or most of their premiums, oftentimes concealed from the insurer, relieving the initial policyholder from virtually all financial obligation with respect to the contract. The primary impetus for the purchase of a life insurance policy was the resale of that policy by the owner to an unaffiliated investor or stranger.

While some of these situations are clearly abusive, such practices raised the legal issue of whether they justify a complete ban on the sale of life insurance by a policyowner to an investor without an insurable interest in a secondary market transaction. Some would answer "yes," contending that the only legitimate basis for the procurement of a life insurance policy is for the protection of family members in the event of the death of a breadwinner (usually a spouse or parent) or for estate planning purposes, notwithstanding the fact that life insurance is also frequently sold as a savings vehicle and investment product. The views of those, however, who support rigorous restrictions on resales of policies conflict with the longstanding legal precedent that treats a life insurance policy as personal property of its owner, capable of being resold after issuance to an unaffiliated person without an insurable interest in the life of the insured.

In any event, as sales of "manufactured" life insurance began to rise in the mid 2000s, the life insurance and life settlements industries, as well as state insurance regulators and both federal and state legislators, recognized that the development of a secondary market for life policies heightened the risk that policies would be issued in circumstances where the "real" owner at policy inception did not have an insurable interest. Indeed, the concern that there was a dark pool of outstanding life insurance policies, hibernating during their contestability periods and waiting to be securitized, for which the owners lacked a bona fide insurable interest in the lives of the insureds spawned a wave of lawsuits and regulatory reform during the latter part of the last decade. As a result, STOLI is now regulated through life settlement statutes by 20 state insurance codes as a means to deter this type of insurable interest violation, n1 although very few insurable interest statutes have been amended to address this serious problem. n2

III. HISTORICAL PERSPECTIVES

A. Insurable Interest for Life Insurance

In order for a life insurance policy to be a valid contract, the policyholder must have an insurable interest in the insured's life. However, insurable interest must exist only at the time of issuance of the life insurance policy and need not exist at the time of an insured's death. n3 The insurable interest principle is codified in almost every state's insurance code and typically reads as follows:

"(a) An insurable interest, with reference to personal insurance, is an interest based upon a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by reason of such person's death or disability or a substantial interest engendered by love and affection in the case of individuals closely related by blood or by law.

"(b) An individual has an unlimited insurable interest in his or her own life, health, and bodily safety and may lawfully take out a policy of insurance on his or her own life, health, or bodily safety and have the policy made payable to whomsoever such individual pleases, regardless of whether the beneficiary designated has an insurable interest.

. . . .

"(h) An insurable interest must exist at the time the contract of personal insurance becomes effective but need not exist at the time the loss occurs.

"(i) Any personal insurance contract procured or caused to be procured upon another individual is void unless the benefits under the contract are payable to the individual insured or such individual's personal representative or to a person having, at the time when the contract was made, an insurable interest in the individual insured. In the case of a void contract, the insurer shall not be liable on the contract but shall be liable to repay to the person or persons who have paid the premiums all premium payments without interest." n4

As specified in the statutes, an individual has an unlimited insurable interest in his or her own life. n5 Aside from this, insurable interest arises most typically in two instances: (1) a close familial relationship between the original policyholder and the insured or, more generally, a relationship engendered by love and affection in which the policyholder is presumed to benefit from the continued life of the insured, and (2) a debtor-creditor relationship between the insured and the policyholder. There are also a few variations on these two bases of insurable interest, such as the insurable interest of an employer in the lives of its directors, officers and employees, n6 and the right of an individual, in effect, to convey insurable interest to a charitable organization by providing written consent to allow the charity to purchase life insurance on his or her life. n7 In many states, if the original policyholder is not also the insured life, the initial beneficiary or beneficiaries of the life insurance policy must have an insurable interest in the insured's life when the policy is issued. n8

A life insurance policy issued where the policyholder does not have a valid insurable interest in the insured's life on the date of policy issue is an illegal wagering contract. n9 Such contracts are void, and thus unenforceable, as being against public policy because they give the policyholder a sinister interest in the early termination of the insured's life. n10 As a result, such policies historically have not had the benefit of the preservation from rescission effect of the incontestability clauses required by state insurance codes to be included in a life insurance contract. These clauses bar an insurer from voiding a policy after two years on the basis that the application was fraudulent, contained a material misstatement or omitted material information sought for underwriting purposes. n11 Accordingly, since a life insurance policy issued without an insurable interest has been treated as having no legal effect, there is no generally accepted statute of limitations that prevents an insurer, at any time after policy issuance, from seeking to invalidate such a policy on the grounds of lack of insurable interest.

Notwithstanding the insurable interest requirement for issuance of a life insurance policy, the U.S. Supreme Court in the 1911 case of *Grigsby v. Russell*, n12 resolving a conflict between the circuit courts of appeal, held that a life insurance policy purchased by one with an insurable interest in the insured may later be transferred to another without such an interest:

"A life insurance policy, taken out in good faith by the insured, with no idea of assigning it, payable to his 'executor, administrator or assigns,' can afterwards, in good faith, and for a valuable consideration, with the knowledge and assent of the insurer, be sold and assigned to one who has no insurable interest in the life of the insured; and such assignee, after he had bought a policy, taking an absolute assignment thereof, and in good faith, with the knowledge and consent of the company, pays the subsequent premiums, acquires the right to collect the proceeds of the policy at maturity." n13

Acknowledging that "life insurance has become in our days one of the best recognized forms of investment and self-compelled saving," n14 the Court stated "[t]o deny the right to sell except to persons having [an insurable] interest is to diminish appreciably the value of the contract in the owner's hands." n15 Thus, while the Supreme Court in *Grigsby* expressly affirmed the right of a life insurance policyholder to obtain the economic value of that policy by transferring it to another, the Court distinguished between transactions entered into in good faith and those "in which a person having an [insurable] interest lends himself to one without any as a cloak to . . . a wager. . . ." n16 This dichotomy has continued to challenge the courts, insurance regulators, insurance carriers and those in the life settlements business to draw a commonly understood line between valid policy sales and invalid STOLI transactions.

B. Regulation of Viatical and Life Settlements

The secondary market for life insurance emerged in the early 1980s with insured individuals who had been diagnosed with AIDS or HIV and did not have a long life expectancy. In what became known as "viatical settlements," n17 investors offered to purchase the life insurance policies of sick individuals for cash to permit them to pay their medical expenses. The purchasers of these policies would pay the insured a percentage of the policy's face amount, but upon his or her death would collect the entire policy's proceeds. Soon, purchases of life insurance policies from patients suffering from cancer or other terminal illnesses followed viatical settlement transactions. In 1993, the National Association of Insurance Commissioners ("NAIC") promulgated the first iteration of its Viatical Settlements Model Act (the "NAIC Act") to assist states in regulating the viatical settlements market and protecting life insurance consumers who had a catastrophic, life-threatening or terminal illness from being solicited to sell their life insurance policies. The NAIC Act recognized a policyholder's right to sell an in-force life insurance policy, but regulated this right by allowing sales only after expiration of a two-year holding period (running concurrently with the policy's contestability period). n18

Trade in viatical settlements declined in the late 1990s because of the development of significant enhancements in medical treatment for individuals afflicted with AIDS, HIV and cancer. The market in secondary life insurance policies then shifted to the broader group of older-aged individuals who had life expectancies of greater than two years. Sales of such policies became known as "life settlements." Older policyholders would sometimes sell policies that they had held for a number of years because their families were well provided for and no longer needed the benefits. In other instances, the policyholder might want to use the sale proceeds to pay for long-term care, other living expenses or, perhaps, to purchase a less expensive policy. Policyholders sometimes would sell their life insurance policies simply to free up the funds otherwise used to pay premiums, which increase as the insured ages for many types of life insurance.

In addition to these circumstances, some life insurance agents, investors and lenders developed programs to persuade older Americans to purchase new policies, sometimes through the use of premium financing, primarily for the purpose of selling the policies upon the expiration of the contestability period. Following this two-year period, the original owner would receive a lump sum cash settlement (sometimes after using a portion of it to repay a premium finance loan), and the investor would assume the obligation to pay premiums to maintain the policy in force and receive the right to collect the death benefit upon the death of the insured. Such investor or stranger-originated life insurance transactions gave rise to the acronym "STOLI."

In response to the secondary life insurance market's shift from viatical to life settlements, the NAIC amended the NAIC Act in 2000 to revise and expand the definition of a viatical settlement contract to include all sales of in-force life insurance policies without regard to the health or medical status of the insured.

As the phenomenon of STOLI grew, and resales of life insurance policies in the secondary market, including to large institutional investors, became more common, the NAIC in 2007 again amended the NAIC Act to institute a ban on the sale by the original policyholder of a life insurance policy for five years after its issuance if the policy had been purchased using a non-recourse financing arrangement. n19 (The NAIC Act continues to prohibit, subject to certain exceptions, settlement of a policy during its contestability period.) n20 The NAIC Act has now been adopted in some form in 20 states. n21

Reflecting its concern about the rapid rise in secondary sales of life insurance and then the development of STOLI transactions, the National Conference of Insurance Legislators ("NCOIL") had promulgated its own model act, the Life Settlements Model Act (the "NCOIL Act"), in 2000 to regulate both viatical and life settlements. The NCOIL Act, like the NAIC Act, sought to regulate life settlements at the state level by requiring the licensing of life settlement brokers and providers. However, unlike the NAIC Act, in 2007 when NCOIL amended the NCOIL Act to address STOLI, NCOIL did not propose to increase the waiting period for a sale of a policy beyond the two-year contestability period. Instead, the NCOIL Act defines STOLI to, among other things, distinguish legitimate sales of life insurance policies from abusive ones. The NCOIL Act transformed STOLI from an invented phrase into a legal term:

"'Stranger-Originated Life Insurance' or 'STOLI' is a practice or plan to initiate a life insurance policy for the benefit of a third party investor who, at the time of policy origination, has no insurable interest in the insured. STOLI practices include but are not limited to cases in which life insurance is purchased with resources or guarantees from or through a person, or entity, who, at the time of policy inception, could not lawfully initiate the policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy and/or the policy benefits to a third party. Trusts, that are created to give the appearance of insurable interest, and are used to initiate policies for investors, violate insurable interest laws and the prohibition against wagering on life. STOLI arrangements do not include those practices set forth in Section 2L(2) of this Act." n22

In practice, a STOLI transaction typically worked as follows, according to many of the complaints filed in STOLI cases. A life insurance agent, sometimes working in concert with other transaction intermediaries, convinced an elderly individual to form a trust to purchase and become the beneficiary of a newly issued life insurance policy with a large face amount insuring the life of that individual. The senior would be the grantor of the trust the beneficiaries of which would usually be members of the insured's family. In many STOLI cases, statements of the insured's net worth and/or annual income made in the trust's insurance application were alleged to have been fraudulently and grossly overstated to induce the insurer to issue the sizable policy.

During the period the insurer was evaluating the application, the STOLI promoters would obtain a life expectancy estimate for the proposed insured based upon a physician's examination and would discuss with the insured an arrangement whereby the trust's beneficiary/ies would sell the beneficial interest in the trust to an investor, in effect, monetizing the coverage premised upon a valid insurable interest. Sometimes the sale was planned as soon as several days after the insurer had issued the policy to the trust. n23 The sales price for the interest would typically be an amount representing a small fraction of the policy's death benefit, such as three percent of the face amount, depending on the duration of the insured's life expectancy, with a policy insuring an individual having a more limited life expectancy commanding a higher price than a comparable policy covering an insured with a longer life expectancy.

Because the beneficial interest in the trust was the property transferred to the investor, the trust would continue to own and be the beneficiary of the policy without the insurer knowing (at least at the time of policy issuance and the sale of the trust's beneficial interest to the investor) that this transfer had occurred. Transfers of the beneficial interest in a trust that owned a life insurance policy did not expressly fall within the definition of a viatical settlement contract under the NAIC Act, which was the form of legislation most often adopted prior to 2008 in states which then regulated viatical and/or life settlements. Instead, the NAIC Act's definition covered only the sale of a policy or the right to receive payment of its death benefits. As a result, some investors took the position that their purchase of the beneficial interest in a trust that owned a life insurance policy was not a regulated viatical or life settlement transaction and that such a purchase and sale were valid even during the policy's two-year contestability period. n24 However, the current form of the NCOIL Act addresses this issue and expressly includes within its definition of a life settlement contract an agreement for the purchase and sale of a beneficial interest in a trust that owns a life insurance policy. n25

Under the NCOIL Act, while STOLI is expressly labeled a fraudulent life settlement act, the Act does not declare that STOLI constitutes a violation of the insurable interest requirement. n26 Nevertheless, it is difficult to conceive of a transaction that satisfies the definition of STOLI that does not violate insurable interest law. The NCOIL Act has been enacted in 18 states. n27

In summary, viatical or life settlements laws now exist in one form or another in a total of 38 states. All states have insurable interest laws governing life insurance contracts. Laws prohibiting STOLI have been enacted in 20 states.

STOLI policies pose a significant problem for both the life settlement industry and the life insurance industry. For life insurers, STOLI transactions have resulted in the payment of both large commissions to insurance producers and large death benefits to beneficiaries of policies which became investor owned and thus did not lapse for want of premium payment, as well as instances of fraud by rogue life insurance agents. Indeed, as the court in *Lincoln National Life Ins. Co. v. Calhoun* n28, aptly stated:

"Though framed as a dispute between an individual insurer and an individual insured, the instant case offers a glimpse into a larger debate between the insurance industry and investment speculators that has been brewing for the last several years. This suit requires the Court to contemplate stranger-originated life insurancetransactions, in which individuals are able to obtain third party financing to purchase a life insurance policy and to fund the premiums owed under that policy, with some understanding or expectation that the policy will be immediately assigned to an individual lacking an insurable interest, following the expiration of the policy's two-year contestability period." n29

For life settlement companies, the abuses associated with STOLI transactions have focused negative media attention on their business, accusing them of unethical and illegal activities and, in their view, obscuring the benefits conferred on the consumer by the opportunity to sell an unwanted or unneeded life insurance policy, rather than surrendering or lapsing it. n30 By creating an accepted definition of STOLI transactions and stemming their spread, the NAIC and NCOIL Model Acts have permitted the life insurance and life settlement industries to co-exist, albeit uneasily. Similarly, prudent investors support anti-STOLI laws as they want to avoid investing in risky STOLI policies that may be challenged by insurers and may never pay death benefits or may not result in the return of premiums paid if rescinded. In addition, if investors do unknowingly purchase STOLI policies, they may be unable to resell them later.

C. Regulation of Life Insurance Premium Finance Loans

Most state insurance codes regulate the insurance premium finance business. n31 All states that regulate insurance premium finance loans do so for property and casualty insurance, but several of these states do not regulate insurance premium finance loans made to facilitate the purchase of life insurance. n32

Under both the NAIC Act and the NCOIL Act, certain types of life insurance premium finance loan arrangements are deemed to be viatical or life settlement contracts as a result of the frequency with which they were used to procure policies that were later sold in the secondary market. n33 Such arrangements include loans under which part of the loan proceeds are used for purposes other than paying life insurance premiums and loan transaction costs or for which there is some form of guaranty to the policy owner of the future secondary market value of the financed life insurance policy. n34

In certain instances in which premium finance loans have been made to owners of life insurance policies that have been challenged as STOLI and where the policies served as collateral for the loan, the lenders have successfully intervened to protect their security interest in the questionable policies. n35 In a contrasting case, *PHL Variable Life Ins. Co. v. Lucille E. Morello 2007 Irrevocable Trust*, n36 the insurer sought to rescind a life insurance policy purchased with premium finance loans provided by New Stream Insurance. The policy application allegedly contained misrepresentations as to the amounts of the insured's net worth and annual income. However, in this case, New Stream lost in its attempt to recover a portion of its loan by forcing the insurer to return the premiums paid for the rescinded policy where the insured had died within the policy's contestability period. n37

IV. THE RISE OF STOLI LAWSUITS

A. Salient Issues

Between 2005 and 2010, over 150 STOLI lawsuits were filed, predominantly by life insurers, although in a few cases policyholders or family members of the insureds initiated the actions. Most complaints made by insurers that alleged a policy was the product of a STOLI transaction sought to rescind the policy to avoid paying the death benefit. The insurers contended that because the ultimate policyholder did not have an insurable interest in the life of the insured at the time the policy was issued, the policy was void or voidable *ab initio*. Many of these cases also sought policy rescission based on alleged misrepresentations or fraud in the policy's application. Other salient issues at play in the litigations include the effects of the states' incontestability laws, whether the party or parties challenging a policy based on absence of insurable interest have legal standing, the role of premium financing, the obligation of an insurer to return premiums paid for a rescinded policy and questions of conflicts of law.

The critical issue the courts have had to examine in determining whether an insurable interest existed at the policy's inception involves the insured or policy owner's state of mind and the extent to which he or she anticipated the possibility of selling the policy at some future time. Since, in most instances, the policy owner will have died and cannot be examined in court, evidence of intent to sell must necessarily be inferred from the nature, timing and substance of communications between the policy owner, the insured and third parties regarding the potential resale of the policy or the beneficial interest in a life insurance trust.

B. Proving Violation of Insurable Interest

The courts have approached this analysis by asking one or more of the following questions: (1) was there a pre-arranged plan or agreement in place before policy issuance between an identified investor and the policyholder for the sale of the policy, or by the beneficiary of a life insurance trust to sell the trust's beneficial interest to the investor (*i.e*., a traditional contract formation analysis), (2) is there evidence of bilateral intent prior to policy issuance on the part of an identified investor and the policyholder for the sale of the policy, or by the beneficiary of a life insurance trust to sell the trust's beneficial interest to an investor, and (3) is there evidence of unilateral intent on the part of the policyholder prior to policy issuance to sell the policy or by the beneficiary of a life insurance trust to sell the trust's beneficial interest to an investor? The involvement of a third party (usually an intermediary acting between an insured and an investor) prior to the purchase of the policy in facilitating its purchase for later resale is usually essential to the insurer's ability to challenge insurable interest on any one of these theories.

Some courts have rejected the argument that a policyholder's unilateral intent, at the time of policy purchase, to sell the policy in the secondary life insurance market is sufficient to prove that the policy was procured without a bona fide insurable interest. For example, in *Sun Life Assurance Co. of Canada v. Paulson*, n38 the insured, Mr. Paulson, had purchased eight policies on his own life with an aggregate of $15 million of death benefits with the intention of selling them in the secondary market. Coventry First, a life settlement provider, had purchased one of those policies, which Sun Life sought to rescind. In dismissing the case, the court found that Mr. Paulson's unilateral intent to sell the policies at some future point did not negate his insurable interest in his own life, stating "[t]he law of this case... requires evidence of the intent of a third party to buy the policies at the time they were procured, which necessarily requires identification of that party..." and "...the mutual intent of the parties to avoid the prohibition on wagering contracts determines whether a policy is void *ab initio* for lack of an insurable interest." n39

The Fourth Circuit case of *First Penn-Pacific* soon followed *Paulson*, affirming that even where a serial life settlor intended to buy life insurance policies for resale in the secondary market, without proof of a counterparty to the prospective sale transaction, there was no clear violation of the insurable interest requirement. The court stated:

"The district court correctly held that in this case - in which Moore intended to sell the policy when he applied for it but where 'there is no evidence that anyone other than Moore was a participant in the scheme at the time Moore obtained the First Penn policy' - Moore had an insurable interest when he obtained the policy. No 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. Furthermore, as amicus curiae noted in its brief and at oral argument, *evaluating insurable interest on the basis of the subjective intent of the insured at the time the policy issues, as First Penn would have us do, would be unworkable and would inject uncertainty into the secondary market for insurance*" (citation omitted). n40 (Emphasis added.)

Late last year, in what is widely considered to be the most important STOLI decision to date, *Kramer v. Phoenix Life Insurance Co.* n41 dealt a major setback to life insurers attacking STOLI as violating insurable interest laws. In this case, the New York Court of Appeals, largely following the reasoning adopted by the *Paulson* and *First Penn-Pacific* decisions, held that a person may, under New York's insurable interest law, purchase a life insurance policy on his or her own life and immediately transfer the policy to another person without an insurable interest in the insured's life. Finding that the insurable interest statute in question uniquely and expressly provides that a policy owner has the right immediately to transfer or assign a policy, the court rejected the argument of Phoenix Life that the insured's subjective intent to purchase a policy and then assign it, without planning to retain insurance coverage on his life for the benefit of his family, violated the statute. In explaining its holding, the court stated:

"Finally, we recognize the importance of the insurable interest doctrine in differentiating between insurance policies and mere wagers (*see Caruso, 73 N.Y.2d at 77-78),* and that 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 onto a statute that so manifestly permits an insured to immediately and freely assign such a policy." n42

In another recent appellate decision involving STOLI policies in which the court held against the challenging life insurer, *Lincoln Life and Annuity Company of N.Y. v. Teren,* n43 the California court overturned the trial court's decision invalidating two policies totaling $20 million for lack of insurable interest. The insured, a California resident, had agreed to the establishment of a trust to own the policies and named his son as the sole beneficiary of the trust. The son, shortly after issuance of the policies, sold his interest in the trust to a New York company on behalf of a group of investors. The court, relying upon the reasoning in another California case, *Lincoln National Life Insurance Company v. The Gordon R.A. Fishman Irrevocable Life Trust* (discussed below) stated as follows:

"[T]he Legislature enacted legislation in 2009 [the California Life Settlements Act] making an arrangement like the one at issue here unlawful, but the new legislation does not retroactively apply to it. In the present case, [the insured] had an unlimited insurable interest in his own life. (Cal. Ins. Code § 10110.1 subd. (b).) Because [he] was the settlor of the trust, which acquired and owned the policies, the trust also had an insurable interest in [his] life. [Citations omitted.] [The insured's] son...[as] the beneficiary of the trust when it was formed and when the policies were issued, undisputedly had an insurable interest in [the insured's] life 'engendered by love and affection.' (Cal. Ins. Code § 10110.1 subd. (a).) Thus, the insurance policies Lincoln issued were supported by an insurable interest at their inception.... Although the evidence shows the trust intended that [the stranger investors] ultimately would acquire the beneficial interest in [the] policies, that intent does negate the fact that when the trust acquired the policies, they were supported by an insurable interest." n44

Thus, the court concluded that "Because the policies in question here were supported by an insurable interest when they took effect and California law allowed the beneficial interest in the policies to be transferred to a transferee without an insurable interest, the trial court erred by ruling the policies are void *ab initio* because of the absence of an insurable interest." n45 Some commentators may contend that by refusing to acknowledge the realities of the transaction at issue in the *Teren* case, the California court ignored the concerns, expressed even in *Grigsby v. Russell,* n46 that an insured's right to transfer the economic value of his life insurance policy to a third party without an insurable interest should not be permitted to shield a transaction in which an insured lacking good faith but "having an [insurable] interest lends himself to one without any as a cloak to...a wager...." n47

Some courts have rejected the reasoning behind the foregoing decisions, allowing life insurers' challenges to policies to withstand motions to dismiss to permit the insurers to attempt to prove that the insured had a subjective intent to transfer the policy at its inception. For example, in *Lincoln National Life Insurance Company v. Calhoun*, n48 the court refused to dismiss the insurer's claim for policy rescission based on its allegation that prior to policy issuance the policyholder had entered into an informal arrangement to assign the policy to an unidentified party that would finance the policy's premiums. In doing so, the court noted that no decisions of the Third Circuit or the New Jersey Supreme Court had addressed the question of whether an alleged violation of the insurable interest law can be based on the insured's unilateral intent prior to policy issuance to sell the policy later to a person without an insurable interest, or instead requires evidence of mutual intent on the part of the insured and the stranger to void the policy on insurable interest grounds. n49

C. Fraud Alleged as a Practically Necessary Element to STOLI Cases

Every STOLI case resulting in a reported opinion has alleged some element of fraud by the policyholder or insured, or both, in addition to claiming that a policy is void for lack of insurable interest. Usually, the alleged fraud consists of false statements made in the life insurance application. These misstatements primarily relate to the financial wherewithal of the proposed insured, namely either or both of his financial net worth and/or annual income and earnings, n50 or misrepresentations about the proposed insured's health or medical condition. n51 To date, no life insurer has filed a single STOLI suit in which only an insurable interest violation has been alleged, *i.e.*, there have been no pure STOLI lawsuits yet. Insurers, while using the STOLI rhetoric pervasively in their complaints, strategically rely on financial or medical fraud in their STOLI rescission cases knowing that such fraud in the procurement of life insurance, which existed well before the creation of the term STOLI and the advent of the secondary life insurance market, is usually easier to prove than is an insurable interest violation claim based upon the intent of a policyholder and/or other parties to purchase a policy solely for purposes of its resale.

D. Effects of the Incontestability Clause

Prior to the recent wave of STOLI cases, most courts that had addressed the question of whether the incontestability clause of a life insurance contract prevents an insurer from challenging the validity of the contract on insurable interest grounds after expiration of the two-year contestability period had determined that this clause does not bar such challenges. The courts reasoned that (a) the public policy concern against wagering contracts outweighs the public policy concern against allowing insurers to collect premiums for many years and then seek to rescind policies and (b) there is no operative incontestability clause in a contract that is void for being an illegal wagering contract. Some courts have continued to apply this rule of law in STOLI cases. n52 In New York, however, an insurer cannot rescind a life insurance policy, even on insurable interest grounds, after it has been in force beyond its contestability period. n53 Thus, no clear rule on this issue has emerged from the modern-day STOLI lawsuits. Indeed, in *Lincoln National Life Insurance Company v. Joseph Schlanger 2006 Insurance Trust*, a case of first impression in Delaware, the court remarked that:

"[T]here appears to be no consensus from other jurisdictions with statutorily required incontestability clauses....

"While New York courts have held that expiration of the contestability period bars the insurer from thereafter asserting that the contract was void *ab initio* for lack of an insurable interest, other state jurisdictions have generally allowed the insurer to contest the validity of a policy that is void *ab initio*, even after the passage of the contestability period. [Citations omitted.]

"The majority of courts to have considered the question have ruled that the public policy underlying the requirement of an insurable interest outweighs that behind the incontestability clause, often reaching that result by holding the insurance policy to have been void ab initio . . . . In New York, however, and perhaps one or two other states, the courts have adopted [the view] that the incontestability clause trumps the absence of an insurable interest. Richard A. Lord, 7 Williston on Contracts § 17:5 (4th ed. 2010) (citations omitted)." n54

In some states, the incontestability clause has been construed not to be a bar to an insurer's rescission of a life insurance policy after expiration of the two-year contestability period if the insurer can prove fraud in the life insurance application. n55 However, in the majority of states, upon expiration of the contestability period, an insurer cannot contest a policy even in the case of fraud by the applicant. n56

In *PHL Variable Life Insurance Company v. U.S. Bank National Association*, a STOLI case involving a $5 million policy, the court dismissed the plaintiff insurer's claim for rescission of the policy because the insurer filed its complaint one day after expiration of the policy's contestability period. The insurer had sought rescission based on material misrepresentations in the policy application related to the insured's net worth and the statement that she had not received any financial inducement to procure the policy. The court held that the only way in which an insurer can "contest" a policy is to bring a suit against the policyholder. n57 Furthermore, the court held that the provision of the incontestability clause at issue that excepted from the two-year contestability period fraud committed against the insurer was invalid because it conflicted with the insurance code section that clearly requires policies to be incontestable after two years. n58 By contrast, in *Lincoln National Life Insurance Company v. Schwartz*, the court's denial of defendants' motion to dismiss plaintiff insurer's claim for rescission of a life insurance policy was based, in part, on fraud in the life insurance application even though the insured died after expiration of the two-year contestability period. This decision suggests that an insurer can obtain a policy rescission based on a fraud even after two years under New Jersey law. n59

E. Premium Financed Life Insurance as a Species of STOLI

Some STOLI cases have centered around premium finance loans made to allow the policyholder to fund the purchase price and premiums for a life insurance policy, especially when the loans were concealed from the insurer. For example, in *Lincoln National Life Insurance Company v. The Gordon R.A. Fishman Irrevocable Life Trust*, one of the few reported STOLI cases involving a premium finance loan arrangement, the court granted the lender's motion for summary judgment. It found that the premium finance loan at issue provided for the policyholder-borrower to make a significant contingent interest payment to the lender, which could likely result in the policyholder's transfer of the policy to the lender in satisfaction of the debt. The court nonetheless found that this loan transaction did not violate California's insurable interest law because the granting by the policyholder-borrower of a collateral assignment to the lender was not an outright transfer of the policy to the lender. n60 While the court did not invalidate this transaction, it chided the financier, stating:

"All that being said, and despite the fact that the Court finds that the law compels that it award summary judgment to defendants, it must be added that MCC's finance program skirts close to the letter, and certainly can be viewed as violating the spirit, of the law. Defendants may have found a loophole in the law barring a STOLI finding, but it is clear to the Court that this whole arrangement with the Fishmans was nothing but a more creative version of the same. Unfortunately for Lincoln, the law as it presently exists allows this kind of insurance arrangement to be valid. In such a circumstance, it is perhaps best to follow the wisdom expressed long ago by President Ulysses S. Grant, who said that 'the best way to get rid of a bad law is to enforce it.'" n61

In another case, by contrast, the court held for the plaintiff insurer, denying, in part, the motion to dismiss of the defendant trustee of the policy owner trust. The court found that the insurer's allegation that a person other than the trust had paid the premiums for the life insurance policy sought to be rescinded for lack of insurable interest was sufficient to allow an inference that payment of these premiums through the trust was a method of concealing the purported STOLI nature of the policy. n62

In a Georgia case where the insurer successfully avoided paying a death benefit because of the insured's gross misrepresentations of his net worth and annual income on the life insurance application, although the insurer did not claim that there was no valid insurable interest supporting the policy or that it was a STOLI policy, the court admonished the lender, Liberty One Funding Trust, stating:

"The involvement of the Liberty Program in this case emphasizes the importance of the Georgia legislature's policy decision to allocate the risk of material misrepresentations to the applicant. If, as Defendants seek to argue, the insurer was responsible for discovering misrepresentation, enterprises like the Liberty Program would be encouraged to submit insurance applications containing material falsehoods, to the extent that doing so results in increased profit.

"Life insurance is designed to empower individuals by permitting them to secure their estates and their families against the unknown. Life insurance provides security, financial certainty, and a measure of comfort in the face of death. There are significant policy reasons for striving to ensure that the Liberty Program, and other similar enterprises, restrain their speculation in the area of life insurance to the boundaries permitted by law. If enterprises like the Liberty Program are permitted to avoid the risks of misrepresentation, misrepresentation becomes an attractive way to reduce the risks inherent in the Liberty Program's business plan. The Court is not inclined to encourage this behavior." n63

Misrepresentations by an applicant for a life insurance policy in response to a question as to whether she intends to use premium financing to purchase or fund the policy may provide a basis for an insurer to contest a policy during its contestability period or may constitute evidence of a STOLI transaction, as discussed above. Under both the NAIC Act and NCOIL Act, certain types of premium finance loan agreements are classified and regulated as life settlement contracts rather than falling within the STOLI definition resulting in the policy being deemed void for lack of insurable interest. n64 The treatment as a life settlement of a purchase money premium finance loan for a newly issued life insurance policy, *i.e*., the sale of a policy in the secondary market, arguably creates an anomaly inasmuch as under both the NAIC Act and NCOIL Act it is, subject to certain exceptions, impermissible for a policy owner to sell a policy within its contestability period.

F. Insurer's Retention of Premiums Paid for STOLI Policies

Another critical issue that has arisen in the STOLI cases where insurers have sought to rescind policies involves the right of the issuing insurance company to retain the premiums paid to it by the policy owner. Generally, where a life insurance policy was issued to a policyholder without an insurable interest in the life of the insured, the insurer has the right, as an equitable remedy, to rescind the policy. As part of the rescission process, an insurer will typically tender the premiums paid into court pending a decision in the matter. In most instances where the court permits rescission, which is designed to return the insurer and policyholder to their original, pre-contracting positions, the insurer must return the premiums previously paid to it in respect of the policy. However, in many STOLI suits, life insurers have sought to retain the premiums they received arguing that these premiums should be used to offset the insurer's damages. These damages often include large sales commissions paid to the agent, who may have committed fraud against the insurer in the procurement of the policy or acquiesced having knowledge of, or a reasonable basis to believe, that an insured committed fraud or made misrepresentations regarding a policy application. Only a few courts so far have held that the insurer should be entitled to retain the premiums paid to it. n65 In one such case, *Lincoln Life and Annuity Company. of NewYork v. Teren*,a California state trial court permitted the insurer to rescind the policy and to keep the premiums received based on the extent of the STOLI fraud involved, which was a significant ruling favoring the life insurer. n66 In allowing Lincoln Life to retain the premiums it had received for the rescinded policy, the *Teren* court ruled that the defendant had unclean hands and was not entitled to a refund of the premiums because it had committed actual fraud. The court, in the exercise of its equitable powers in the rescission action, had the power to adjust the equities of the parties. However, in a recent appeal of this decision, a California appellate court reversed this decision, finding that the policies at issue were issued with a validly supporting insurable interest. The court therefore, did not have to rule on the propriety of the insuerer's retention of premiums. n67 Additionally, in *West Coast Life Insurance Company v. Life Brokerage Partners*, the court denied the defendant's motion to dismiss the insurer's claim for policy rescission for its failure to state a claim against defendant because the insurer did not tender return of premiums to the policyholder; the court held, however, that the insurer's constructive payment of return premiums to the court's registry sufficed. n68 In another case, an insurer was not estopped from rescinding a purported STOLI policy because it had retained premiums previously paid to it on the grounds that the insurer could legitimately retain the premiums until the policy was legally determined to have been void. n69

Other courts, however, have held that based on an election of remedies rule, a life insurer seeking to rescind a life insurance policy based on fraud or lack of insurable interest cannot seek both policy rescission and retention of premiums paid for the policy contended to be void. n70

Another method, aside from an action for rescission, by which an insurer can challenge the validity of a life insurance policy for lack of insurable interest, is a suit for declaratory action. In such a suit, although it may result in the policy being voided, the defense that the insurer waived its right to rescind the policy by continuing to accept premium payments with knowledge that the policy may have been an illegal wagering contract is not available to the policyholder. n71 A declaratory action challenging the enforceability of a life insurance policy still in effect based on fraud in the policy's application or lack of insurable interest in the insured's life is a proper remedy for an insurer. n72 This tactical alternative for invalidating a life insurance policy may allow an insurer to avoid having to return the premiums to the policyholder as it normally would be required to do in a policy rescission action.

G. Choice of Law Questions

Choice of law questions comprise an important element of STOLI litigation. Because there are differences among the state laws concerning insurable interest, whether fraud by an insured provides grounds for invalidating a policy despite the incontestability clause and other critical issues, the application of the laws of one state over those of another may determine the outcome of a dispute. For example, New York law limits the ability of an insurer to challenge a policy on the grounds of lack of insurable interest after expiration of a policy's contestability period based on the *Caruso* decision. The New York insurance law has also been held expressly to permit a policy owner to buy a policy with intent to resell it later under the recent *Kramer* decision, as echoed by a California appellate court in the *Teren* case, both discussed earlier. Under the liberal insurable interest law of Texas, any person may buy a policy insuring an individual's life if the individual consents in writing to the policy's purchase. n73 Similar disparate results may occur depending upon whether a state embraces the fraud exception to the rule of incontestability, and which party has standing to challenge insurable interest.

In *2004 Stuart Moldaw Trust v. XE L.I.F.E.*, n74 the deceased insured's estate, his surviving spouse and the trust which had purchased the policies brought suit in New York seeking to recover under New York law the death benefits totaling $78 million paid to investors under several life insurance policies which the trust had sold to the investors. Plaintiffs alleged that they, not the investors, should receive the policy proceeds because the investors lacked an insurable interest in the life of the insured. The court dismissed this claim, finding that California law governed it and that, under California law, only the insurer may challenge a policy based on the absence of insurable interest. New York law, by contrast, allows the rightful heirs of the insured to obtain payment of death benefits from the named beneficiaries under a policy lacking insurable interest. Here, the insured had resided in California when the trust purchased the policies, the trust had been formed under California law and the policies were delivered in California. The court found the fact that the financing agreements with the investor contained a New York choice of law clause did not make the issue of the validity of insurable interest a matter of New York law based on its application of the "grouping of contacts" approach to the choice of law issue. n75

In *Settlement Funding, LLC v. AXA Equitable Life Insurance Company*, n76 a case brought in federal court in New York, the insurer which sought to have a policy declared void for lack of insurable interest argued for the application of Ohio law rather than New York law. Had New York law governed the question, it would not have allowed the insurer to void the policy on insurable interest grounds because the challenge was brought after the policy's contestability period had run. The trust that purchased the policy had been formed in New York, and the insured grantor of the trust resided in Ohio at the time of the trust's formation and the purchase of the policy at issue. However, the court ruled in favor the life settlement company which argued that, even if Ohio law were to apply, because Ohio's statute requiring incontestability clauses in life insurance policies did not contain an exception for lack of insurable interest, the insurer could not challenge the validity of the policy on that basis; therefore, no conflict of law existed between the Ohio and New York laws. The court further stated that even if a conflict of law had existed, New York law would have applied because the dispute's center of gravity was in New York.

In addition, AXA had counterclaimed that the life settlement company's purchase of the policy was void because it violated the Ohio Life Settlements Act's provision prohibiting the settlement of a policy less than five years after its issue, which had occurred in this case. The life settlement company maintained that Ohio's life settlement act did not apply to its purchase of the policy from the New York trust. Because the Ohio Life Settlements Act provided, however, that it applied to an insurance policy that affects the rights of an Ohio resident or bears a reasonable relationship to Ohio, the court denied the life settlement company's summary judgment motion on AXA's counterclaim, finding there was a question of fact as to whether the policy bore a reasonable relationship to Ohio because the insured had resided there. n77

In several cases involving choice of law issues, the courts have held that where one party has moved to dismiss the action, it would be premature to resolve the question of which law applies when the laws of the two jurisdictions were substantially similar and further factual development of the issues was necessary. n78

The foregoing cases provide only a handful of examples of the many variations of the facts and the law represented by the STOLI litigations, but reflect the complexity of some of the determinative issues and competing public policy concerns confronted by the courts in these cases. The final portion of this article addresses a more recent, yet related, development involving the issuance of deferred variable annuity contracts to enable investors to capture the value of the death benefits provided for in these instruments.

V. Stranger-Originated Annuity Transactions

A. Characteristics and Objectives of the Transactions

One of the hottest topics for the life insurance and annuity industry in 2010 was stranger- originated annuity ("STOA") transactions. n79 Similar to STOLI transactions, STOA transactions involve producers and/or investors who offer individuals a cash payment in exchange for their permission to be named as the annuitant or measuring life on an application for an annuity contract, which specifies a third party having no relationship to the annuitant (*i.e.*, the investor) as the contract beneficiary. Generally, the individual annuitant is in poor health and is not expected to live beyond the first anniversary of the policy purchase. The investor or financing entity pays the premiums for issuance of the contract. When the annuitant dies, the third-party beneficiary, not the annuitant's family, receives the death benefit, which can be substantial. As with sales of STOLI policies, many feel that purchases of variable annuities in such circumstances, in which the named annuitant receives a small share of the contract benefits while unrelated parties initiate the purchase and receive the lion's share of those benefits, are abusive. This section analyzes the issues related to STOA transactions and their treatment by regulators and the courts.

While variable annuities are issued by insurers, they are typically used as a means of obtaining tax-deferred retirement savings, similar to a 401(k) plan. The annuity purchaser contributes funds, either as a single, upfront payment or through periodic payments, to buy the contract, and the insurer invests the proceeds in underlying securities (typically, mutual funds) designated by the annuitant. When the annuitant retires, she can withdraw the funds, convert the investment into a series of annual payments for her lifetime or leave the funds in the policy for her heirs. She is only taxed at the time of the withdrawal. Thus, like certain life insurance policies, variable annuities can provide a tax-efficient method for accumulating wealth. Variable annuities differ from life insurance policies, however, in that because they are marketed and sold mainly as investment products, n80 the issuing insurers do not generally require information on the health of the annuitant upon whose death the insurer must pay the annuity's value. The insurers also may not inquire about the relationship between the annuitant and the beneficiary or beneficiaries named in the contract. Another feature that makes variable annuities particularly attractive to a potential investor is a guaranteed minimum death benefit offered by some policies that assures that the beneficiaries receive the specified sum if the annuitant or covered individual dies within a short period after the effective date of the annuity, even if the investments supporting the annuity have lost their value.

B. Responses by Regulators

Two state insurance departments, those of New Jersey and Louisiana, issued bulletins encouraging insurers to detect, mitigate, and report STOA transactions.

New Jersey. The New Jersey Department of Banking and Insurance issued a bulletin on July 2, 2010 recommending that insurers strengthen their oversight regarding sales of annuities. n81 More specifically, the bulletin encouraged insurers to consider asking applicants for annuities and/or producers targeted questions to elicit information on the purpose of the purchase and the health status of the annuitant; to monitor contract deposits; and to place follow-up calls to annuitants and contract owners. It also suggested that carriers consider redesigning variable annuity contracts to remove guaranteed minimum death benefits. The Department's bulletin also urged insurers to report promptly all suspected STOA transactions. n82

Louisiana. The Louisiana Department of Insurance issued a bulletin on July 6, 2010 to all life insurers and producers selling annuity products encouraging them to implement safeguards to prevent STOA transactions. n83 The Louisiana bulletin specifically recommended that insurers establish detection measures for STOA transactions and carefully review annuity applications to confirm the collection of all relevant information concerning the annuitant's health status and life expectancy. The bulletin also urged insurers to act to ensure compliance by both company personnel and producers with applicable federal and state law, including measures to assure the suitability of the investment for the applicant and adherence to the prohibitions against misleading communications. Finally, it encouraged insurers to report potential STOA transactions to the department. n84

NAIC. The NAIC has been actively drafting a proposed model bulletin for the states to adopt regarding STOA transactions. The NAIC's initial draft was distributed in late September 2010 and elicited comments from various state insurance departments, life insurers and industry organizations. n85 During the NAIC's 2011 spring meeting, a final draft was adopted by the Life Insurance and Annuities (A) Committee. n86 The model bulletin explains how STOA transactions work and provides suggestions for insurers to follow to preventthem. These suggestions include reviewing chargeback policies; considering the possibility of adjusting commissions if facts indicate an annuity was used to facilitate a STOA transaction; creating detection methods, including controls to flag questionable applications; revising annuity application processes; and reporting actual and potential STOA transactions to the applicable state insurance departments.

C. Litigation

The United States District Court for the District of Rhode Island issued an opinion adverse to life insurers on June 2, 2010 that raised questions as to whether life insurers can rely on state insurable interest and incontestibility laws to void sales of STOA. n87 In these combined cases, plaintiffs Transamerica Life Insurance Company and Western Reserve Life Assurance Company of Ohio sued various sponsors, agents, brokers and owners, alleging that the defendants had created a fraudulent scheme in which investors paid individuals in poor health to participate in a plan to issue variable annuities in those individuals' names, but where the premiums were paid by the investors. n88 The annuity policies provided for guaranteed minimum death benefits, so that if the annuitant died, the named beneficiaries would be entitled to receive the principal originally invested, even if the underlying investments had decreased in value. n89

The insurers argued that the annuities should be rescinded or declared void because the beneficiary and the investor had no insurable interest in the life of the annuitant. n90 Under Rhode Island law, however, an insurable interest is not required for an annuity because annuities are not life "insurance contracts based upon the life of another." n91 In rejecting plaintiffs' argument, the court distinguished annuities from life insurance policies:

The basic bargain embodied by the policies in dispute is that in exchange for premiums the owners receive a future income stream [citations omitted]. The death benefits merely sweeten the deal; they do not define it. n92

Thus, the court held that the lack of an insurable interest would not defeat the defendants' claims

to death benefits under the annuities.

The court further determined that the incontestability provisions in the annuity contracts barred the insurers' claims against the policy owners. n93 The insurers had argued that the defendants' commission of fraud should invalidate the annuities' express incontestability provisions. n94. The court, however, declined to accept this argument, stating that "In Rhode Island, incontestability clauses prevent insurers from rescinding policies even on grounds of fraud...", and noting that because these provisions are for the benefit of the insured, state statutes require all policies to contain either two-year contestability periods or shorter terms more favorable to policyholders. n95

While dismissing the insurers' claims for rescission against the annuity owners, the judge permitted certain fraud, conspiracy, and other claims to proceed against the sponsors, agents and brokers on the grounds that while owners of the annuities could invoke the benefits of the incontestability clause, this protection did not shield strangers to the contracts. n96

Two other reported decisions address instances of alleged STOA transactions involving annuities issued by Nationwide Life and MetLife, but neither involves the issues of insurable interest or incontestability. n97 In the *Nationwide* case, the issuer of a variable annuity sought to rescind the contract following the attempt by the owners to redeem the policy. The owners were unrelated to the annuitant, who had died of a terminal illness shortly after the policy was purchased. Nationwide claimed it had the right to terminate the policy based on two specific contractual provisions: one purported to permit the insurer to rescind the policy if "[i]nformation provided by the Contract Owner(s) is materially false, misleading, incomplete or otherwise deficient," n98 and the other authorized termination if "[t]he Contract is being used with other contracts to cover a single life or risk." The court found against the issuer on both claims." n99

As to Nationwide's allegations that the owners' failure to answer a question in the annuity application regarding the beneficiary's relationship to the annuitant activated its termination rights, the court found that having accepted the incomplete application and the policy purchase price of $1 million, Nationwide had waived its right to challenge the omission later. n100

On the question of whether the annuity provided coverage of the same risk (*i.e.*, the death of the annuitant) as that which Nationwide had sold under another contract, thereby entitling it to rescind either one, the court also held for the owners. First, it found that since the language in the annuity was internally inconsistent and created ambiguities, it should be construed against Nationwide, as drafter. n101 Second, the court found that Nationwide's termination of the contract based on its flawed interpretation constituted a breach of contract entitling the owners to the death benefit. n102

In the *MetLife* case, a terminally ill annuitant died shortly after the purchase of an annuity by an unrelated trust. The annuitant's estate filed claims against both MetLife, which had issued the annuity, and the unrelated owner of the annuity for fraud and breach of the annuitant's statutory and common law rights of privacy. MetLife sought to rescind the contract, deposited the purchase price into court and filed an interpleader action, and cross-claimed against the estate. The owners of the annuity filed cross-claims against the estate for the interpleaded funds and for dismissal of the estate's claims. The court rejected the claims of the estate against both parties, finding, among other reasons, that the estate had suffered no harm. n103 The court required MetLife to pay the interpleaded funds to the annuity's owners, n104 but since the owners had sought only the return of the annuity's purchase price, waiving their contractual right to the additional investment income earned under the policy, there was no discussion of unjust enrichment, nor were the issues of incontestability or insurable interest raised.

D. SEC and Federal Grand Jury Investigations; Applicable FINRA Rules

The STOA transactions at issue in the Rhode Island case gave rise to both a federal criminal grand jury investigation and an investigation by the SEC as to whether the annuity transactions had violated federal securities laws. As of this writing, neither proceeding has resulted in a determination.

Under the federal securities laws, because variable deferred annuities are treated as securities, they may only be sold by SEC-registered broker-dealers who are members of FINRA, the Financial Industry Regulatory Authority, under detailed rules governing the sale and the conduct of the broker-dealers. FINRA Rule 2330, entitled "Members' Responsibilities Regarding Deferred Variable Annuities," requires under paragraph (b)(1) that prior to recommending to any customer the purchase of a deferred variable annuity, the FINRA member "(A) ...must have a reasonable basis to believe...that the transaction is suitable [for the customer]... and, in particular, that there is a reasonable basis to believe that

"(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59[frac12]; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk;

"(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

"(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by paragraph (b)(2) of this Rule; ....

"The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction."

FINRA Rule 2330 (b)(1)(A).

In connection with the broker's suitability determination, FINRA Rule 2330 further specifies the information that must be elicited from the customer:

"(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers."

FINRA Rule 2330(b)(2).

Furthermore, the Rule requires that "(c) ...[p]rior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing...[and within] seven business days after [a supervisor within] the member receives a complete and correct application package, a registered principal shall review and determine whether he or she approves of the recommended purchase or exchange of the deferred variable annuity." The Rule provides that the approval by the registered principal may be granted only if he or she has determined "that there is a reasonable basis to believe that the transaction would be suitable based on the foregoing factors delineated in paragraph (b) of this Rule" and the determination as to suitability must be documented and signed by the registered principal who reviewed and then approved or rejected the transaction. FINRA Rule 2330(c).

Finally, in addition to the general recordkeeping and supervisory requirements applicable to broker-dealers, the Rule prescribes that FINRA members who engage in recommendations and sales of variable deferred annuities must develop written supervisory procedures to assure compliance with the Rule's provisions and must "develop and document specific training policies or programs reasonably designed to ensure that...[both the brokers who recommend the transactions and the principals who review them] comply with the requirements of this Rule and that they understand the material features of deferred variable annuities...." FINRA Rule 2330, paragraphs (d) and (e). Accordingly, even though the STOA transactions that occurred in Rhode Island may not have been prohibited by that state's insurable interest laws or subject to attack under the incontestability provisions of the annuities themselves, they may well have been effected in violation of the FINRA Rules applicable to the recommendation and sales of variable deferred annuities generally.

E. State Law Requirements for Annuities

Contrary to the laws of Rhode Island, the laws of most states appear to require that the purchaser of an annuity have an insurable interest in the life of the annuitant because they treat annuities as life insurance. n105 For example, California Insurance Code Section 101 states: "Life insurance includes insurance upon the lives of persons or appertaining thereto, and the granting, purchasing or disposing of annuities" and California Insurance Code Section 10110.1(f) provides: "An insurable interest shall be required to exist at the time the contract of life... insurance becomes effective, but need not exist at the time the loss occurs."

By contrast, in New York, the provision of the insurance law that addresses and defines "insurable interest" contains the following text:

"No person shall procure or cause to be procured, directly or by assignment or otherwise any *contract of insurance upon the person* of another unless the benefits under such contract are payable to the person insured or his personal representatives, or to a person having at the time when such contract is made, an insurable interest in the person insured." [Emphasis added.] n106

No mention is made of annuities. Indeed, a subsequent clause in this section states that: "No *contract of insurance upon the person*" -- defined to include a policy of life, health, or accident insurance - "shall be made or effectuated unless at or before the mailing of such contract the person insured... applies for or consents in writing to the making of the contract, except in [certain explicitly stated] cases...." [Emphasis added.] n107 Thus, annuities are not included within the general statutory rules governing life insurance. Nor are annuities brought within the ambit of New York's recently enacted life settlement law. n108

The text of Florida's insurance law is very similar to that of New York, requiring that for a person other than the insured "to procure or cause to be procured... an insurance contract on the life or body of another individual..." that person must have an insurable interest in the individual insured. n109 The balance of the Florida insurance code also does not tie annuities into the provisions that govern life insurance. n110 Furthermore, the Florida viatical settlements law makes no mention of annuities. n111 Other states that clearly exclude annuities from the provisions of their insurance codes addressing insurable interest include Virginia, Hawaii, Oregon, and Illinois. n112 Certain other state insurance laws are ambiguous in their treatment of annuities, and are unclear as to whether they require the purchaser of an annuity to have an insurable interest in the life of the annuitant. n113

Accordingly, in states in which the consent of the insured is required for the issuance of a life insurance policy to another person, and where annuities are treated as life insurance contracts, the consent of an annuitant is also required for the purchase of an annuity. n114 The Nebraska Insurance Code, for example, contains the following proscription:

"(1) Except as provided in subsection (2) of this section, no policy of insurance shall be issued upon the person of any individual except upon the application of the individual insured or with the written consent of the individual insured ....

"(3) The term *policy of insurance* as used in this section shall include any life insurance policy, ***annuity contract***, and contract of sickness and accident insurance but shall not include a contract of group life insurance or a contract of blanket or group sickness and accident insurance." n115 [Emphasis added.]

However, few state insurance statutes are as clear as that of Nebraska, providing an opportunity for third persons to obtain annuities on the lives of others without their consent in a number of jurisdictions.

F. Conclusion

The phenomenon of stranger-oriented annuity transactions received widespread publicity earlier this year suggesting that these arrangements were about to become the new form of STOLI and represented another example of abusive insurance-related practices by unscrupulous investors seeking to profit from the deaths of covered individuals. In fact, very few of such transactions appear to have been effected to date. Only a single reported case addresses the questions of whether the insurable interest and contestability laws provide grounds for an insurer to rescind such annuities. In this case, the Rhode Island district court held against the plaintiff insurers, finding that (1) under the applicable state law, variable annuities do not constitute life insurance contracts and, therefore, do not require an insurable interest and (2) incontestability clauses prevent insurers from voiding policies even on the grounds of fraud.

While two state insurance departments issued bulletins encouraging insurers to detect, mitigate and report STOA transactions, the NAIC has not yet completed its own model bulletin for the states to adopt. In the meantime, many states' insurance codes already forbid these arrangements and for states that don't, both the case law and the regulatory bulletins suggest that, as with STOLI transactions, the most effective means to prevent STOA practices remain within the power of the insurers: for example, by revising their annuity application forms and approval processes and more closely monitoring the issuance of variable annuities.

Return to Text

n1 Ariz. Rev. Stat. Ann. § 20-443.02; Ark. Code Ann §§ 23-81-802(7)(A)(i)(j), 23-81-802(24)(A); Cal. Ins. Code §§ 10113.1(g)(1)(B), 10113.1(w); Conn. Gen. Stat. §§ 38a-465(24); 38a-465j(a)(2)(i); Ga. Code Ann. § 33-59-2(6)(A)(i)(X); Idaho Code §§ 41-1951(15), 41-1962; 215 Ill. Comp. Stat. §§ 159/5, 50(a), 159/5, 72(d)(1)(C); Ind. Code §§ 27-8-19.8-7.8, 27-8-19.8-20.1; Iowa Code § 508E.2(6), 508E.(12); Kan. Stat. Ann. §§ 40-5002(f)(5), 40-5002(l); Ky. Rev. Stat. Ann. §§ 304.15-020(7)(a)(1)(k), 304.15-020(15); Me. Rev. Stat. Ann. tit. 24-A, §§ 6802-A(6)(A)(3), Me. Rev. Stat. Ann. tit. 24-A, §§ 6802-A(12A); Minn. Stat. §§ 60A-0782 (Subd. 12), 60A-784, 60A-0786; N.H. Rev. Stat. Ann. §§ 408-D:2(VI)(J), 408-D:2(XVI); 408-D:12(I); N.Y. Ins. Law § 7815; N.D. Cent. Code §§ 26.1-33.4-01(7)(a)(1)(j), 26.1-33.4-01(23); Ohio Rev. Code Ann. §§ 3916.01(W), 3916.18(C)(3), 3916.171(B)(15), 3916.172; Okla. Stat. tit. 36, §§ 4055.2(7)(e), 4055.2(13); Or. Rev. Stat. §§ 744.318(18)(a), 744.369(10); R.I. Gen. Laws §§ 27-72-2(9)(i)(A)(X), 27-72-2(26); Tenn. Code Ann. §§ 56-50-102(6)(A)(iii), 56-50-102(12); Utah Code Ann. §§ 31A-36-102(18), 31A-36-113(2)(a)(iii); Vt. Stat. Ann. tit. 8, §§ 3835(18), 3844(a)(2); Wash. Rev. Code §§ 48.102.006(8)(a)(ii), 48.102.006(25); W. Va. Code §§ 33-13C-2(5)(F), 33-13C-2(18); Wis. Stat. §§ 632.69(1)(g)(7), 632.69(1)(w).

n2 Ala. Code § 27-14-3; Alaska Stat. § 21.42.020; Ark. Code Ann. § 23-79-103; Ariz. Rev. Stat. Ann. § 20-1104; Del. Code Ann. tit. 18, § 2704; Fla. Stat. § 627.404; Idaho Code § 41-1804; Minn. Stat. §§ 60A-0783.

n3 *See* statutes cited in note 2 above. Note that in Texas and Utah, generally insurable interest must also exist in the insured at the time of his or her death, but both states permit life settlements. *See, e.g., Allen v. United of Omaha, 236 S.W.3d 315, 322 (Tex. App. 2007).*

n4 Ga. Code Ann. § 33-24-3.

n5 *See* statutes cited in note 2 above.

n6 *See* statutes cited in note 2 above. Regardless of the statutory provisions governing insurable interest, life insurers impose underwriting limitations on how much coverage they will issue on an individual based on his or her financial condition for fear of an insured becoming "over-insured", thereby creating an incentive for a policyholder to prefer an early death of the insured, which is anomalous inasmuch as the insurable interest requirement is supposed to have eliminated that concern.

n7 *See* statutes cited in note 2 above.

n8 *See* statutes cited in note 2 above.

n9 *See* statutes cited in note 2 above.

n10 *See Grigsby v. Russell, 222 U.S. 149, 154 (1911).*

n11 Some states allow an insurer to void a life insurance policy after the expiration of a life insurance policy's contestability period if the applicant or insured committed fraud in the life insurance application. *See, e.g.,* Ark. Code Ann. § 23-81-105 (2011) (excluding fraud in the procurement of a life insurance policy from the required incontestability provision); *Unity Mut. Life Ins. Co. v. Moses, 621 F. Supp. 13 (E.D. Pa. 1985); Paul Revere Life Ins. Co. v. Haas, 644 A.2d 1098 (N.J. 1994)* (dealing with fraud in procurement of a disability insurance policy); Cal. Ins. Code § 10113.5(b)(1) (2011) (stating that under certain circumstances a life insurance contract is void if an imposter is substituted for a named insured in the application process, notwithstanding the incontestability clause), *Valant v. Metropolitan Life Ins. Co., 23 N.E.2d 922 (Ill. App. Ct. 1939)* (recognizing an exception to the incontestability clause when an imposter signed the insurance policy application and underwent the medical examination).

n12 *Grigsby v. Russell, 222 U.S. 149 (1911).*

n13 *Id., at 149-150.*

n14 *Id., at 156.*

n15 *Id.*

n16 *Id., at 157.*

n17 The term is derived from the word "viaticum," a Latin word meaning the Christian Eucharist as administered to a person dying or in danger of death. *See* Webster's Ninth New Collegiate Dictionary, 1991.

n18 NAIC Viatical Settlements Model Act, Model 697, §11 A(3).

n19 *Proceedings of the NAIC*, 1998 Proc. 4th Quarter II 609-610, (comments on the NAIC Viatical Settlements Model Act), as follows:

"[The NAIC president] asked regulators to consider whether there were insurable interest concerns and to deal with the public policy questions. A member of his staff described four categories of viatical settlements that needed to be considered: 1) people with a life expectancy of no greater than two years; 2) the chronically ill, who do not have a normal life expectancy, but were expected to live more than two years; 3) persons with a normal life expectancy; and 4) people who do not now own life insurance. He said there was activity in all four of these categories that needed to be considered by the regulators. [Citation omitted.]

The state regulator described a letter that he had recently received that was addressed to agents encouraging them to look at life insurance policies they had written to identify those who might be approached to viaticate the policies. He noted advertisements that encouraged people to buy life insurance and immediately viaticate the policies. He pointed out a newspaper article that said billions of dollars of insurance were being viaticated. It concluded that "homicide becomes more than a remote possibility." He said that inaction on the part of the NAIC would endorse the direction of the market. [Citation omitted.]"

n20 NAIC Viatical Settlements Model Act, Model 697, § 11A(1)-(3).

n21 Of these 20 states, eight of them embrace the five-year prohibition on settling a life insurance policy that is subject to a non-recourse financing arrangement based on the 2007 version of the NAIC Act (IA, NE, NV, ND, OH, OR, VT, WV), one state embraces a four-year prohibition on settling a life insurance policy that is subject to a non-recourse financing arrangement based on a modified adoption of the 2007 version of the NAIC Act (MN), and the remaining 11 states simply prohibit settling a life insurance policy during its two-year contestability period based on the 2000 version of the NAIC Act.

n22 NCOIL Life Settlements Model Act, § 2, Y.

n23 *See, e.g., American Gen. Life Ins. Co. v. Goldstein, 741 F.Supp. 2d 604 (D. Del. 2010),* in which the beneficiary of the life insurance trust sold the beneficial interest in the trust less than a month after American General had issued the policy to the trust.

n24 The 20 states that have adopted the NAIC Act still do not expressly regulate the purchase and sale of a beneficial interest in a trust owning a life insurance policy as a viatical settlement transaction.

n25 NCOIL Life Settlements Model Act, §2, L.

n26 25.1 However, the drafting note to the NCOIL Act states that "[t]rusts, that are created to give the appearance of insurable interest, and are used to initiate policies for investors, violate insurable laws and the prohibition against wagering on life." NCOIL Life Settlements Model Act, Drafting Note.

n27 The states that have adopted the NCOIL Life Settlement Model Act or a version thereof are Arkansas, California, Connecticut, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Maine, Montana, New York, Oklahoma, Rhode Island, Tennessee, Texas, Utah, and Washington. Arizona has adopted a STOLI statute, but Arizona does not regulate viatical or life settlements. By contrast, the new Life Settlements Act enacted in Texas on June 17, 2011 to become effective on September 1, 2011 (H.B. No. 2277) does not include a definition of STOLI or mention it at all. An industry observer advised that the American College of Life Insurers had objected to adding a reference to STOLI so as not to limit the broad scope of the Texas insurable interest statute. *See* text below accompanying note 72.

n28 *Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882 (D.N.J. 2009).*

n29 *Id. at884.*

n30 *See, e.g., Lincoln Life & Annuity Co. of NY v. Bernstein, 08-2641, 2009 NY Slip Op. 51421U* at *2 (N.Y. Sup. Ct. June 29, 2009), stating:

"In some [STOLI] cases, the life settlement company loans money to the insured to pay the premiums on the policy for two years-or whatever the "wet ink" law in the state provides as the contestability period in which any claim on the proceeds can be "contested" by the insurance company. In some cases the premiums are reimbursed only after the life settlement company procures a beneficial interest in the policy. Under either arrangement, the life settlement company is loaning the insured the money for the premium payments in order to buy the beneficial interest in the policy."

n31 *See, e.g.,* Ala. Code § 27-40-1 *et seq*. ; Cal. Ins. Code § 778 *et seq*., Fla. Stat. § 627.826 *et seq*.; N.Y. Banking Law § 554 *et seq*.; Ohio Rev. Code Ann. § 1321.71 *et seq*.; Pa. Cons. Stat. § 40-3301 *et seq*.; Tex. Ins. Code § 651.101 *et seq*.; and Wash. Rev. Code § 48.56.010 *et seq*.

n32 Ga. Code. Ann. § 33-22-16(5); 215 Ill. Comp. Stat. 5/513a1(a); 215 Ill. Comp. Stat. 5/4; Kan. Stat. Ann. § 40-2602; Wis. Stat. § 138.12.

n33 NAIC Viatical Settlements Model Act, Model 697, §2 N (2) NCOIL Life Settlements Model Act, § 2, L

(1).

n34 *Id.*

n35 Principal Life Ins. Co. v. DeRose, No. 1:08-*CV-2294, 2010 U.S. Dist. LEXIS 64220,* at *2-7 (M.D. Pa. Jun. 29, 2010).

n36 *PHL Variable Life Ins. Co. v. Lucille E. Morello 2007 Irrevocable Trust, No. 08-572, 2010 U.S. Dist. LEXIS 29501* at *2-3, 10-11 (D. Minn., Mar. 3, 2010), *aff'd, No. 10-1696, 2011 U.S. App. LEXIS 14338* (8th Cir., July 14, 2011).

n37 *Id.*

n38 *Sun Life Assurance Co. of Canada v. Paulson, No. 07-3877, 2008 U.S. Dist. LEXIS 11719* (D. Minn., Feb. 15, 2008).

n39 *Id*. at *5-7.

n40 First Penn-Pacific Life Ins. Co. v. Evans, No. 07-2020, 313 Fed. Appx.633, 636, *2009 U.S. App. LEXIS 3921* (4th Cir,, Feb. 26, 2009) at *7-8.

n41 *Kramer v. Phoenix Life Ins. Co., 15 N.Y.3d 539 (2010).* This case may have a limited impact outside New York for two reasons: first the New York insurable interest statute contains a unique provision which allows "immediate" assignment of a life insurance policy and second, after May 2010, New York began regulating life settlements and prohibiting them during a life insurance policy's contestability period.

n42 *Id. at 553.*

n43 Super. Ct. No. 37-2008-00083905-CU-CO-CTL (Cal. Ct. App., 4th App. Dist., Div. 1, May 17, 2011).

n44 *Id.*

n45 *Id.*. The majority opinionwas accompanied by a blistering dissent, characterizing the majority's failure to look behind the formalities of the transaction as "in derogation of public policy" and a reward for the investors who created a "sham transaction" and "perpetrated an astounding fraud," complete with major misrepresentations in the policy application and phony financial statements for the insured. The dissent dismisses the majority's finding that because the insured signed the insurance application and formed the trust a valid insurable interest existed, pointing to evidence of a pre-existing arrangement in place prior to issuance of the policy to sell the beneficial interests in the trust to the investor group for cash. Notwithstanding the majority's reliance on the rationale in *Fishman*, the dissent points to a number of factual distinctions between the cases (*e.g.*, in *Fishman*, the insurance trust held the policies for more than two years during which time Dr. Fishman's sons remained the beneficiaries). With respect to the Teren trust's contention that there was no wager contract involved, the dissent states, "The unmitigated gall that the Trust exhibits in making this argument is truly breathtaking." *Id.*, Aaron, J. dissenting.

n46 *See* textaccompanying note 12 above.

n47 *Id.*

n48 *Lincoln Nat'l Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882;* at 890 (D.N.J. 2009).

n49 *Id.*

n50 *American General Life Ins. Co. v. Goldstein, 741 F. Supp. 2d 604 (D. Del. 2010)*

n51 *See Paulson*, above, in which the insured misrepresented to potential purchasers of his life insurance policies that he was terminally ill so as to try to increase the value of his policies in the secondary life insurance market.

n52 American General Life Ins. Co. v. Germaine Tomlinson Ins. Trust, No. 1:08-CV-1747-SEB-TAB, 2010 LEXIS 103730 (S.D. Ind. Jun. 8, 2010).

n53 *New England Mut. Life Ins. Co. v. Caruso, 73 N.Y.2d 74 (1989).*

n54 Lincoln Nat'l Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust, No. 09-506-G*MS, 2010 U.S.Dist. LEXIS 72637* (D. Del. Jul. 20, 2010).

n55 *See, e.g.,* Ark. Code Ann. § 23-81-105 (2011) (excluding fraud in the procurement of a life insurance policy from the required incontestability provision)l; *Unity Mut. Life Ins. Co. v. Moses, 621 F. Supp. 13 (E.D. Pa. 1985); Paul Revere Life Ins. Co. v. Haas, 644 A.2d 1098 (N.J. 1994)* (dealing with fraud in procurement of a disability insurance policy); Cal. Ins. Code § 10113.5(b)(1) (2011) (stating that under certain circumstances a life insurance contract is void if an imposter is substituted for a named insured in the application process, notwithstanding the incontestability clause); *Valant v. Metropolitan Life Ins. Co., 23 N.E.2d 922 (Ill. App. Ct. 1939)* (recognizing an exception to the incontestability clause when an imposter signed the insurance policy application and underwent the medical examination).

n56 *Cf*. Settlement Funding v. AXA Equitable Life Ins. Co., No. 06 CV 5743(HB), *2010 U.S. Dist. LEXIS 104451* (S.D.N.Y. Sept. 30, 2010).

n57 *PHL Variable Life Ins. Co. v. U.S. Bank Nat'l Ass'n., No. 10-1197, 2010 U.S. Dist. LEXIS 105576* (D. Minn. Oct. 4, 2010).

n58 *Id.*

n59 Lincoln Nat'l Life Ins. Co. v. Schwartz, No. 09-03361, 2010 LEXIS 85044 (D.N.J. Aug. 18, 2010).

n60 *Lincoln Nat'l Life Ins. Co. v. The Gordon R.A. Fishman Irrevocable Life Trust, 638 F. Supp. 2d 1170 (C.D. Cal. 2009).*

n61 *Id. at 1179-1180* (citing State *ex rel. Skilton v. Miller, 128 N.E.2d 47, 52 (Ohio 1955)).*

n62 *Lincoln Nat'l Life Ins. Co. v. Snyder, 722 F. Supp. 2d 546 (D. Del. 2010).*

n63 *Am. Gen. Life Ins. Co. v. Schoenthal Family, LLC, 248 F.R.D. 298; 2008 U.S. Dist. LEXIS 2972* (N.D. Ga. Jan. 15, 2008) at *47-48.

n64 Accordingly, the premium finance lender would need to be licensed as a life settlement provider, and the premium finance loan agreement would need to be filed with, and approved by, the applicable state insurance department.

n65 *See* Pruco Life Ins. Co. v. Brasner, No. 10-80804-*CIV-COHN/SELTZER, 2011 U.S. Dist. LEXIS 1598* (S.D. Fla. Jan. 7, 2011) and *PHL Variable Ins. Co. v. Morello, No. 08-572, 2010 U.S. Dist. LEXIS 29501* (D. Minn. Mar. 2, 2010) ("stating that public policy requires allowing an insurer to seek to retain premiums, as '[a] contrary rule would be an invitation to commit fraud'").

n66 *See* Lincoln Life and Annuity Co. of N.Y. v. Teren, No. 37-2008-83905 (Cal. Sup. Ct. Aug. 27, 2009).

n67 Lincoln Life & Annuity Co. of N.Y. v. Teren, Super. Ct. No. 37-2008-00083905-CU-CO-CTL (Cal. Ct. App., 4th App. Dist., Div. 1, May 17, 2011.)

n68 West Coast Life Ins. Co. v. Life Brokerage Partners, No. 09-81049, 2010 LEXIS 5269 (S. D. Fla. Jan. 5, 2010).

n69 Lincoln Nat'l Life Ins. Co. v. Snyder, No. 09-888, 2010 LEXIS 71127 (D. Del. Jul. 15, 2010).

n70 *Sun Life Assurance Co. of Canada v. Berck, No. 09-498, 2010 U.S. Dist. LEXIS 65192* (D. Del. Jun. 29, 2010); *see also,* PHL Variable Life Ins. Co. v. Robert Gelb Irrevocable Trust, No. 10 C957, 2010 U.S. Dist. LEXIS 114162 (N.D. Ill. Oct. 27, 2010).

n71 *Principal Life Ins. Co. v. Rucker, No. 08-488, 2010 U.S. LEXIS 89243* (D. Del. Aug. 30, 2010).

n72 Penn Mutual Life Ins. Co. v. Wolk, No. 09 Civ. 1808, 2010 LEXIS 59507 (S.D.N.Y. Jun. 28, 2010).

n73 Tex. Ins. Code Ann. § 1103.056.

n74 *642 F. Supp. 2d. 226 (S.D.N.Y. 2009).*

n75 *Id. at 236-238.*

n76 *Settlement Funding, LLC v. AXA Equitable Life Ins., No. 06 CV 5743 (HB), 2010 U.S. Dist. LEXIS 104451* (S.D.N.Y. Sept. 30, 2010).

n77 *Id*.

n78 *See*, *e.g.*, Lincoln National Life In. Co. v. Schwartz,No. 09-03361(FLW), *2010 U.S. Dist LEXIS 85044 (D.N.J. 2010)* (New York and New Jersey laws); *Lincoln National Life Ins. Co. v. Calhoun, 596 F. Supp. 2d 882, 887 n.6 (D.N.J. 2009)* (New Jersey and California laws); American General Life Ins. Co. v. Ellman Savings Irrevocable Trust, No. 08-cv-03489, transcript at 55 (D.N.J., Dec. 17, 2009) (New York and New Jersey laws).

n79 *See*, *e.g.*,Mark Maremont and Leslie Scism, *Investors Recruit Terminally Ill to Outwit Insurers on Annuities*, Wall Street Journal, Feb. 16, 2010 at A1.

n80 Variable annuities are treated as "securities" for purposes of the Securities Act of 1933 because the amount of the periodic payment made to the annuitant varies based upon the performance of the equity, debt or money market funds in which the purchase price is invested and the insurer assumes no true risk. *See SEC v. Variable Life Ins. Co. of America, 359 U.S. 65 (1959).* Fixed annuities, by contrast, which provide to the annuitant a fixed amount on each payment date, are not treated as securities.

n81 N.J. Dept. Banking and Ins. Bulletin 10-14 (2010).

n82 *Id.*

n83 La. Dept. of Ins. Bulletin 2010-02 (2010).

n84 *Id.*

n85 *See* Materials for the NAIC's 2010 Fall National Meeting at *http://www.naic.org/documents/committees_a_101910_ materials.pdf*.

n86 *See http://www.naic.org/documents/committees_a_draft_stoa_industry_bulletin.pdf*.

n87 *See* W. *Reserve Life Assurance Co. of Ohio v. Conreal, LLC, 715 F. Supp. 2d 270 (D.R.I. 2010).*

n88 *Id. at 273*.

n89 *Id*.

n90 *Id. at 276.*

n91 *Id.*; R.I. Gen. Laws § 27-4-27.

n92 *W. Reserve Life Assurance Co. of Ohio v. Conreal, LLC, 715 F. Supp. 2d 270, 279 (D.R.I. 2010).* The court noted that Rhode Island's legislature had reinforced the statutory distinction between annuities and life insurance through its enactment of the Life Settlements Act, which prohibited stranger-originated life insurance contracts and defined a STOLI as a life insurance policy without ever mentioning annuities. *Id. at 277*.

n93 *Id. at 280*.

n94 *Id.*

n95 *Id.*

n96 *See id., at 281-290.*

n97 *See Nationwide Life Insurance Company v. Steiner*, *722 F. Supp. 2d 179* (D.R.I., 2010), and*MetLife Investors USA Insurance Company v. Zeidman, 734 F. Supp 2d 304 (E.D.N.Y. 2010).*

n98 *Nationwide Life Insurance Company v. Steiner ,722 F. Supp. 2d 179,181* (D.R.I., 2010).

n99 *Id.*

n100 *Id.* at 186.

n101 *Id*. at 183.

n102 *Id*. at 184-*185*.

n103 *MetLife Investors USA Insurance Company v. Zeidman, 734 F. Supp 2d 304, 313 (E.D.N.Y. 2010).*

n104 *Id. at 315.*

n105 *See, e.g.*, Ala. Code §§ 27-14-2, 27-14-3, 27-15-1; Alaska Stat. § 24.42.020(d); Del. Code Ann. tit. 18, §§ 2701, 2704; Ga. Code Ann. §§ 33-24-2, 33-24-3; Idaho Code Ann. §§ 41-1801, 41-1804; Ky. Rev. Stat. §§ 304.14-010, 304.14-040; La. Rev. Stat. § 22:856; Me. Rev. Stat. tit. 24-A, §§ 2401, 2404; Mass. Gen . Laws ch. 175, §§ 118, 119, 119A; Mich. Comp. Laws §§ 500.602(1) and (2) and 500.2207(2); Nev. Rev. Stat. §§ 687B.010, 687B.040; N.J. Stat. Ann. 17B:24-1.1; N.M. Stat. Ann. §§ 59A-18-1, 59A-18-4; S.D. Codified Laws §§ 58-10-1, 58-10-3; W.V. Code §§ 33-1-10, 33-13-1, and 33-6-2; Wyo. Stat. Ann. §§ 26-15-101, 26-15-102.

n106 N.Y. Ins. Law § 3205(b)(2).

n107 N.Y. Ins. Law § 3205(c).

n108 *See* Chapter 499, Laws of New York, 2009, which repealed Article 78 of the Insurance Law entitled "Viatical Settlements" and added a new Article 78 entitled "Life Settlements."

n109 Fla. Ins. Law § 627.404.

n110 *See generally* Fla. Stat. tit. 37.

n111 *See* Fla. Stat. tit. 37, ch. 629.

n112 *See generally* Haw. Rev. Stat. §§ 431:10-101, 431:10-102, 431:10-204; Or. Rev. Stat. § 743.024; Va. Code Ann. §§ 38.1-328, 38.2-301. *See also* Mont. Code Ann. § 33-1-208, the case notes for which cite *In re Estate of Miles v. Miles, 298 Mont. 312, 994 P.2d 1139 (2000)* for the proposition that tax-deferred variable annuities are investments, not life insurance, because they do not "involve indemnification, loss, damage, liability or contingent events...." Mont. Code Ann. § 33-1-208, *Id*.

n113 For example, 215 Ill. Comp. Stat. 5/4(a), indicates annuities are generally to be treated as life insurance but the code contains no reference to them in the provisions governing insurable interest or in the new Viatical Settlements Act of 2009 (Public Act 096-0736) effective July 1, 2010; and Okla. Stat. tit. 36, §§ 3601, 3604, 1161, 1510 indicate that for certain purposes annuities are dealt with in a similar manner to life insurance contracts, but they are not referred to in the provisions addressing insurable interest.

See also Md. Code, Ins. §§ 1-101(d)(3), 12-201, 16-101, 16-201(b)(3); Miss. Code Ann. §§ 83-5-253, 83-7-1, 83-7-203; Mo. Rev. Stat. § 376.1075; N.C. Gen. Stat. §§ 58-58-1, 58-58-100, 58-58-95; N.D. Cent. Code §§ 26.1-29-01, 26.1-29-09.1, 26.1-02.1-01(4), 26.1-33.4-07a(4); Wis.Stat. §§ 600.01; 600.03-25(a), 631.01(4), 632.47.

n114 *See* statutes referred to in note 104 above.

n115 Neb. Rev. Stat. § 44-704.

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