SPIN-LIFE INSURANCE POLICIES: A DIZZYING EFFECT ON HUMAN DIGNITY AND THE DEATH OF LIFE INSURANCE

Anthony Alt†

INTRODUCTION

There's no such thing as a free lunch.[1]

~Milton Friedman

Since ancient times, people have recognized the usefulness of money because of its capacity to facilitate the exchange of goods.[2] Indeed, it would be difficult to find someone in modern American society that would refuse a "free" gift of $340,000. Yet such offers exist today in the form of speculator-initiated life insurance policies ("SPIN-Life").[3] Consider the following letter from an attorney to a senior citizen:

† Juris Doctor, Ave Maria School of Law, 2009. I thank the lawyers at Assurity Life Insurance Company for their inspiration and friendship, Professor Vanessa Rollins for her insights, and my parents for their selflessness. I also express gratitude to my wife, Nell O'Leary Alt, for helping me see the *extra* in the ordinary.

1. MILTON FRIEDMAN, THERE'S NO SUCH THING AS A FREE LUNCH, at xiii (1975).

2. *See, e.g.*, ARISTOTLE, NICOMACHEAN ETHICS, Bk. V, Ch. 5, at 89–90 (Joe Sachs trans., 2002).

3. Travelers Cas. & Sur. Co. of Am. v. Nw. Mut. Life Ins. Co., 480 F.3d 499, 502 (7th Cir. 2007). These agreements are sometimes referred to as stranger-originated life insurance ("STOLI"), OHIO REV. CODE ANN. § 3916.01(W)(1) (West 2008), investor-owned life insurance ("IOLI"), or stranger-owned life insurance ("SOLI"), Petition for Writ of Certiorari at 7, Continental Assurance Co. v. Martinez, 128 S. Ct. 491 (2007) (No. 07-215), 2007 WL 2363249, at *7; Stephan R. Leimberg, *Stranger-Owned Life Insurance: Killing the Goose That Lays Golden Eggs*, 28 INS. TAX REV. 811, 812 (2005). SPIN-Life means:

> a practice, arrangement, or agreement initiated at or prior to the issuance of a policy that includes both of the following:
>
> (a) The purchase or acquisition of a policy primarily benefiting one or more persons who, at the time of issuance of the policy, lack insurable interest in the person insured under the policy;

I have been working with certain bankers, life insurance professionals and actuaries who, along with me, can assist you with gaining access to . . . funds to provide a benefit to your family or to your favorite charity in a little more than two years at no cost to you through non-recourse "premium financing." We can accomplish this by using your excess "insurance capacity." This program is offered to individuals who are between the ages of 75 and 90 and who have a net worth in excess of $5,000,000.

Following is a simple example to demonstrate the concept: John Smith is 80 years old. He [h]as a net worth of $10 million and has $2 million of existing insurance on his life. [Our law firm] will work with John to take advantage of his excess "insurance capacity" (approximately $8 million) to purchase a new life insurance policy on John (with an $8 million death benefit).

During the underwriting process, we arrange for a "premium finance company" to agree to pay the premiums on John's behalf for the first 24 months (on a "non-recourse" basis, so John has no financial risk). Therefore, John will own the policy but will not be obligated to pay the annual premiums (which in this example could be approximately $300,000 per year including accrued interest).

After 24 months have passed, John's health and the policy's fair market value will be reevaluated. Offers to purchase the policy will be obtained from "life settlement" companies and the best offer will be selected. John then sells the policy to a life settlement company (usually in the range of 10–15% of the death benefit). Since the policy in this example had a death benefit of $8 million, the sale price could range between $800,000 and $1.2 million.

The sale proceeds must first repay the "non-recourse" loan to the "premium finance company," then John (or his designated beneficiary) will receive the excess, if any. In this example, assuming a $1 million sale price and a repayment of $600,000 to the "premium finance company," John will receive $400,000—*this amount will be treated as a long-term capital gain currently taxed at 15%, netting John $340,000 after taxes!*

(b) The transfer at any time of the legal or beneficial ownership of the policy or benefits of the policy or both, in whole or in part, including through an assumption or forgiveness of a loan to fund premiums.

(2) [SPIN-Life] also includes trusts or other persons that are created to give the appearance of insurable interest and are used to initiate one or more policies for investors but violate insurable interest laws and the prohibition against wagering on life.

OHIO REV. CODE ANN. § 3916.01(W)(1)–(2) (West 2008).

> I have enclosed the necessary forms to begin the insurance underwriting process. If you are interested in applying for this program, please complete the forms and return them in the enclosed envelope. . . .
>
> I look forward to working with you on this amazing opportunity![4]

Receiving such a letter appears to be an amazing opportunity indeed. Such an opportunity, however, although seemingly free, comes with a cost. This Note shows that SPIN-Life insurance policies contradict the nature and purpose of life insurance and should be considered securities or wagers, not insurance contracts; make human lives a commodity; violate current insurable interest laws and public policy against wager contracts; and should be declared void ab initio.

Part I of this Note provides an overview of the nature and purpose of insurance in general. Part II explains the requirement of an insurable interest and how such a requirement relates to an insurance contract. Part III sets forth a brief explanation of life insurance in particular, and how the insurable interest requirement makes a life insurance contract distinct from other contracts. Part IV delineates what SPIN-Life policies are, how they differ from other life insurance policies, and why they are problematic. Part V offers actions that state legislatures, state insurance departments, and insurance companies can take to discourage SPIN-Life insurance policies and prevent the death of the traditional understanding of life insurance.

I. A BRIEF OVERVIEW OF THE HISTORY AND NATURE OF INSURANCE

In order to understand why SPIN-Life policies violate insurable interest laws and should not qualify as life insurance contracts, it is necessary to consider the fundamentals of insurance in general. The origins of insurance can be traced back to Phoenician, Babylonian, and Greek merchants insuring their goods as they traveled around

4. Joseph M. Belth, Professor Emeritus, Ind. Univ., Statement on Speculator-Initiated Life Insurance to the Life Insurance and Annuities (A) Committee of the NAIC, Exhibit B (May 3, 2006) (second alteration in the original) (bolding omitted) (underlining omitted), *available at* http://www.lisassociation.org/vlsaamembers/orgdocs/files/2006_naic_may_3_meeting_Belth_Testimony.htm.

the Mediterranean Sea several centuries before Christ.[5] To protect against damage or loss to cargo, merchants entered into agreements to share among themselves on a pro rata basis the loss that any one of them suffered.[6] This form of insurance against risks at sea (marine insurance) was continued and developed by Italian merchants from the twelfth to sixteenth centuries, eventually leading to a formalized insurance business at Edward Lloyd's coffee house[7] in London in the sixteenth and seventeenth centuries.[8] Those desiring to obtain insurance to safeguard against marine risks provided pertinent information about the cargo, crew, and ship, and interested members of the upper class at Lloyd's contractually agreed to pay for the total amount at risk if "a fortuitous loss occurred."[9]

From these beginnings emerged the principles that define insurance. Although there is not a universally agreed upon definition of insurance,[10] certain elements are necessary for a contract to be an insurance contract. Essentially, insurance consists of a contractual agreement whereby one party transfers the risk of a fortuitous future event, in exchange for monetary consideration, to an insurance company that distributes the risk among a group of people subject to the same type of risk by establishing a common fund.[11] Thus,

5. 1 ERIC MILLS HOLMES & MARK S. RHODES, HOLMES'S APPLEMAN ON INSURANCE, 2D § 1.2, at 5 (1996) [hereinafter HOLMES'S APPLEMAN ON INSURANCE]; Robert H. Jerry, II, *May Harvey Rest in Peace:* Lakin v. Postal Life and Casualty Company, 2 NEV. L.J. 292, 304 (2002).

6. Jerry, *supra* note 5, at 304.

7. Edward Lloyd's coffee house is the origin of the well-known Lloyd's of London. Louis A. Chiafullo, Review Essay, *The Maelstrom at Lloyd's of London: Is It Sink or Swim for Policyholders?*, 26 SETON HALL L. REV. 1392, 1392 (1996).

8. 1 HOLMES'S APPLEMAN ON INSURANCE, *supra* note 5, § 1.2, at 5–6.

9. *Id.* § 1.2, at 6.

10. *Id.* § 1.3, at 9; Letter from Orice M. Williams, Dir., Fin. Mkts. and Cmty. Inv., to Michael G. Oxley, Chairman, Comm. on Fin. Servs., House of Representatives, at 7 (Feb. 23, 2006), http://www.gao.gov/new.items/d06424r.pdf.

11. JOHN F. DOBBYN, INSURANCE LAW IN A NUTSHELL 1–2 (3d ed. 1996). The federal government has not provided a unitary definition of insurance in the U.S. Code, but has instead left it to the states to define and regulate insurance. *See, e.g.*, 15 U.S.C. § 6712(c)(2) (2006) (defining insurance, in part, as "any product . . . which . . . a State insurance regulator determines shall be regulated as insurance in the State in which the product is provided because the product insures, guarantees, or indemnifies against liability, loss of life, loss of health, or loss through damage to or destruction of property"). Among the states there are various, though similar, definitions of insurance. *See, e.g.*, CAL. INS. CODE § 22 (West 2007) ("Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event."); COLO. REV. STAT. ANN. § 10-1-102(12) (West 2004) ("Insurance means a contract whereby one, for consideration, undertakes to indemnify another or to pay a specified or ascertainable amount or benefit upon determinable risk contingencies, and includes annuities." (internal quotation marks omitted)). Some states do not have a

insurance is composed of three primary elements: (1) insurance risk, (2) risk shifting, and (3) risk distribution.[12] These three elements set insurance apart from other contracts and provide its particular nature.[13] Insurance risk—the type of risk that qualifies a contract as *insurance*—"is coverage for exposures that have the potential for financial loss."[14] Although people often confront non-insurance risks in their daily lives, "a product must transfer insurance risk to qualify as an insurance product."[15]

Yet, these three elements—insurance risk, risk shifting, and risk distribution—were not always clearly understood throughout the historical development of the insurance contract. The blurring of wagering contracts[16] with insurance contracts became prevalent in eighteenth-century England.[17] People began to purchase "insurance" on the lives of people with whom they had no relation or connection,

statutory definition of insurance, but continue to use an understanding established by common law. *See, e.g.*, Griffin Sys., Inc. v. Washburn, 505 N.E.2d 1121, 1123–24 (Ill. App. Ct. 1987) (describing the requirements necessary for a contract to qualify as insurance in the state of Illinois). The underlying principle in the various definitions of insurance is that insurance risk is involved in the contractual arrangement, and that the transfer of that risk is the principal object and purpose of the transaction. *See* Jordan v. Group Health Ass'n, 107 F.2d 239, 248 (D.C. Cir. 1939).

12. These three elements are the hallmarks of insurance. *See* Sears, Roebuck & Co. v. Comm'r, 96 T.C. 61, 100–02 (1991), *aff'd*, 972 F.2d 858 (7th Cir. 1992); *see also* Comm'r v. Le Gierse, 312 U.S. 531, 539 (1941) (noting that "actual 'insurance risk' [must be present] at the time the transaction was executed" and that "risk-shifting and risk-distributing are essential to a[n] . . . insurance contract"); ROBERT E. KEETON, BASIC TEXT ON INSURANCE LAW § 1.2, at 2 (1971) ("Insurance is an arrangement for transferring and distributing risk."). In order to determine if a transaction constitutes part of the "business of insurance," the U.S. Supreme Court uses pre-existing risk, its transfer, and distribution as criteria. *See* Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119, 129 (1982) (listing the criteria that qualify an activity as part of the business of insurance); *see also* Michael A. Haskel, *Should Antitrust Principles Be Used to Assess Insurance Residual Market Mechanisms, Such as New York's Medical Malpractice Insurance Plan?*, 71 ALB. L. REV. 229, 288 (2008) (stating that the "essence of insurance" is the transfer of risk, and must involve the "contractual assumption and spreading of a policyholders' [sic] risk").

13. 1 HOLMES'S APPLEMAN ON INSURANCE, *supra* note 5, § 1.3, at 10–11.

14. Williams, *supra* note 10, at 2.

15. *Id.*

16. A wager contract or agreement is:

> A bargain in which a promisor undertakes that, upon the existence or happening of a condition he will render a performance
>
> (a) for which there is no agreed exchange, and
>
> (b) which does not indemnify or exonerate the promisee or a beneficiary of the bargain for a loss caused by the existence or happening of the condition . . . .

RESTATEMENT (FIRST) OF CONTRACTS § 520 (1932).

17. *See infra* notes 18–28 and accompanying text.

including those on trial for capital crimes,[18] public figures and celebrities,[19] people suffering from gout and alcoholism, or those preparing to fight in a duel.[20] These agreements were wagering contracts because the owners of the policies lacked a cognizable interest or relation to the lives covered by the insurance.[21] That is, without an interest or relation to the insured persons, the policy owners lacked risk to shift to the insurance company since they suffered no loss upon the deaths of the people whose lives were insured, making the transactions pure wagers.

Instead of trying to protect against a loss resulting from the insured person's death, the policyholder wanted the person to die—and the sooner, the better.[22] In fact, it was not uncommon for policy-holders to use various means to try to accelerate the death of the unknowing stranger whose life they insured, including offering drinks to those suffering from alcoholism.[23] In 1746, the English Parliament passed a statute "to put an end to insurances without real interest, which in process of time had become a cover for mere gaming contracts."[24] Although this statute pertained only to marine risks and insurance, the English Parliament adopted a similar statute in 1774 declaring any life insurance contract without an "interest" between the policy owner and the insured person's life to be null and void in an effort to stop gambling on human lives.[25]

18. Peter Nash Swisher, *The Insurable Interest Requirement for Life Insurance: A Critical Reassessment*, 53 DRAKE L. REV. 477, 481 (2005).

19. Michael J. Henke, *Corporate-Owned Life Insurance Meets the Texas Insurable Interest Requirement: A Train Wreck in Progress*, 55 BAYLOR L. REV. 51, 54 (2003).

20. Leimberg, *supra* note 3, at 813.

21. Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 460 (1876).

22. *See* Leimberg, *supra* note 3, at 812–13.

23. *Id.* at 813.

24. WILLIAM F. MEYER, LIFE AND HEALTH INSURANCE LAW § 4.1, at 86 (1972) (internal quotation marks omitted) (quoting Pritchet v. Ins. Co. of N. Am., 3 Yeates 458, 463 (Pa. 1803)).

25. *See id.* (providing the text to the Assurance Act of 1774). In relevant part, the Assurance Act states:

> Whereas it has been found by experience, that the making of insurances on lives, or other events, wherein the assured shall have no interest, hath introduced a mischievous kind of gaming:

Even though the English Parliament passed these statutes as part of an ongoing effort to suppress wagering in general,[26] they had the effect of formalizing the requirements for an *insurance* contract.[27] This historical link to an attempt to formalize an understanding of what constitutes insurance should not be overlooked. By passing these statutes and providing an implicit definition of what constitutes insurance, the English Parliament made an important distinction between an insurance contract and a wagering contract.[28] While some modern commentators argue that life insurance is not distinct from a wagering contract,[29] these English statutes introduced an idea that helped form the insurance industry by formalizing, in a general way, the requirements of an insurance contract.[30] Insurance shifts risk that already exists, which is tied to the concept of "insurable interest,"[31] while "gambling involves creating risk that did not exist previously."[32]

II. THE INSURABLE INTEREST REQUIREMENT

Insurable interest is "any lawful and substantial economic interest in the safety or preservation of the subject of the insurance free from

> For remedy whereof . . . no insurance shall be made by any person or persons, bodies politic or corporate, on the life or lives of any person . . . wherein the person or persons for whose use, benefit, or on whose account such policy or policies shall be made, shall have no interest, or by way of gaming or wagering; and that every assurance made, contrary to the true intent and meaning hereof, shall be null and void, to all intents and purposes whatsoever.

Id.

26. 1 HOLMES'S APPLEMAN ON INSURANCE, *supra* note 5, § 1.3, at 12.

27. *See* Henke, *supra* note 19, at 54 (describing the "roots of the insurable interest doctrine and the origins of modern insurance" as "intertwined").

28. In spite of these statutes, English common law enforced wagering contracts outside of the context of insurance until 1845. 1 HOLMES'S APPLEMAN ON INSURANCE, *supra* note 5, § 1.3, at 12.

29. *See, e.g.*, Roy Kreitner, Essay, *Speculations of Contract, or How Contract Law Stopped Worrying and Learned to Love Risk*, 100 COLUM. L. REV. 1096, 1096, 1126–27 (2000) (arguing that there is no distinction between risk allocation and wagering); *cf.* Samuel D. Zurier, *Will a Rhode Island Common Law Court Enforce a Gambling Contract? How Much Do You Want to Bet?*, R.I. B.J., SEPT.–OCT. 2006, at 21, 21 (arguing that gambling contracts should be enforceable and should not be considered against public policy).

30. Although the English Parliament provided a pivotal step in the history of the insurance industry and development of the insurance contract, the statutes were general at best and left much room for interpretation as to what precisely constituted a sufficient insurable interest. Swisher, *supra* note 18, at 481–82.

31. *Id.* at 481.

32. Belth, *supra* note 4, para. 8.

loss, destruction, or pecuniary damage."[33] In other words, the person seeking insurance (the owner) must have a particular interest or relation to the subject that is insured. A possible loss or damage to the subject of insurance presents a *risk* to the person seeking the insurance precisely because the person has an interest or relation to the subject that is insured. It is this risk which the person seeking insurance wants to shift to the insurance company, and for which he seeks compensation if the risk of loss or damage from a fortuitous future event occurs.

The United States adopted the doctrine of insurable interest through common law,[34] and later codified it in statutory law by various state legislatures.[35] Although an insurable interest was not immediately required for the validity of an insurance contract in all jurisdictions in the United States during the nineteenth century, it was not long before the insurable interest requirement became universal.[36]

Insurable interest within the context of life insurance is "an interest, arising from the relations of the party obtaining the insurance . . . as will justify a reasonable expectation of advantage or benefit from the continuance" of the person whose life is insured,[37] or a probability of a loss caused by the person's death.[38] The relations between the parties may be based on pecuniary ties or a relationship of blood or

33. 3 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D § 41:1, at 41-3 (2006) [hereinafter COUCH ON INSURANCE].

34. *See, e.g.*, Dodson v. Dodson, 825 S.W.2d 608, 611 (Ark. Ct. App. 1992). One of the first court cases in the United States that addressed the question of insurable interest in life insurance contracts did not explicitly refer to the statutes passed by the English Parliament. Lord v. Dall, 12 Mass. (1 Tyng) 115, 117–18 (1815). Instead, the Massachusetts Supreme Judiciary Court in that case looked to the insurable interest requirement that was customarily required in marine insurance. *Id.* at 118. The court held that the primary prerequisite for insurable interest in life insurance was a pecuniary interest in the person whose life was insured. *Id.* The English statutes requiring an insurable interest, however, undoubtedly influenced the customs prevalent among merchants, sailors, and the common law in the United States.

35. Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 460 (1876); Swisher, *supra* note 18, at 482–83; *see, e.g.*, ALASKA STAT. § 21.42.020 (2006); ARIZ. REV. STAT. ANN. § 20-1104 (2007); ARK. CODE ANN. § 23-79-103 (2004).

36. 3 COUCH ON INSURANCE, *supra* note 33, § 41.1, at 41-3 to -4.

37. Warnock v. Davis, 104 U.S. 775, 779 (1881). The Supreme Court recognized that providing a precise definition of insurable interest that would clearly delineate what was insurance and what was a mere wager would be difficult. *Id.* The definition the Court did provide, however, underscores the primary elements that are essential: (1) a particular relationship between the parties, and (2) some type of interest in the continuance of the insured person's life. *Id.*

38. Rubenstein v. Mut. Life Ins. Co. of N.Y., 584 F. Supp. 272, 278 (E.D. La. 1984).

marriage,[39] although the language that is used to describe insurable interest is often broad and left to judicial interpretation.[40] Insurable interest is therefore based on the relationship between the parties—not on whether someone pays the premiums of the policy.[41]

The insurable interest requirement provides a two-fold public policy purpose for life insurance: (1) to prevent people from wagering on human lives, and (2) to "eliminate an incentive for the beneficiary of a life insurance policy to hasten the demise of the insured."[42] Although the English Parliament originally passed the insurable interest statutes in a concerted effort to eliminate gambling from legitimate insurance contracts,[43] modern emphasis on the requirement attempts to reduce moral hazard[44]—life insurance policies are not meant to serve as an inducement to murder.[45] In the United States, therefore, in order to obtain a life insurance policy, there must be an insurable interest in the life that is to be insured,[46] otherwise the contract violates public policy and is considered null and void.[47]

39. *Warnock*, 104 U.S. at 779; Guardian Nat'l Life Ins. Co. v. Eddens, 13 N.W.2d 418, 419–20 (Neb. 1944).

40. *See* Swisher, *supra* note 18, at 497; Edwin A. Patterson, *Insurable Interest in Life*, 18 COLUM. L. REV. 381, 381–82 (1918).

41. W. & S. Life Ins. Co. v. Webster, 189 S.W. 429, 430–31 (Ky. 1916).

42. John M. Limbaugh, Note, *Life Insurance as Security for a Debt and the Applicability of the Rule Against Wager Contracts*, 64 MO. L. REV. 693, 695 (1999).

43. Jacob Loshin, Note, *Insurance Law's Hapless Busybody: A Case Against the Insurable Interest Requirement*, 117 YALE L.J. 474, 479–81 (2007).

44. Lynn A. Stout, *Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives*, 48 DUKE L.J. 701, 725–26 (1999). For an example of why the insurable interest requirement remains relevant in an attempt to prevent moral hazard in connection with life insurance, see Cindy Chang, *2 Charged in Insurance Scams Are Now Charged in Killings*, N.Y. TIMES, Aug. 2, 2006, at A14. Two women obtained life insurance policies with large death benefits on two homeless men and later collected the proceeds on the insurance policies when the men died. *Id.* The women were charged, however, with murdering the homeless men based on evidence that they had run them over with cars. *Id.*

45. 28 BERTRAM HARNETT & IRVING I. LESNICK, APPLEMAN ON INSURANCE 2D § 174.01, at 60 (2006) [hereinafter APPLEMAN ON INSURANCE].

46. Every state requires that an insurable interest exist at the time the contract is entered. MEYER, *supra* note 24, § 4.1, at 87–88. New Jersey only recently passed a statute requiring that an insurable interest exist at the inception of the contract:

> No person shall procure or cause to be procured any insurance contract upon the life, health or bodily safety of another individual unless the benefits under that contract are payable to the individual insured or his personal representative, or to a person having, at the time when that contract was made, an insurable interest in the individual insured.

N.J. STAT. ANN. § 17B:24-1.1(b) (West 2006).

47. Swisher, *supra* note 18, at 479.

With regard to the insurable interest requirement, there exist two categories of life insurance policies: (1) policies procured by people insuring their own lives, and (2) policies procured on the lives of others.[48] Concerning the first category of life insurance policies, an established principle recognizes that every person has an insurable interest in his own life.[49] This principle logically follows from the idea that each person possesses an interest in the continuation of his own life and knows who would benefit from his existence and who would suffer loss from his death. Therefore, insurance companies typically permit a person who takes out a policy on his own life to name any beneficiary on the policy.[50]

The ability of a person to procure a life insurance policy on himself and designate any desired beneficiary is nevertheless restricted. Courts have held that there must be "good faith" on the part of the person seeking insurance when entering into the life insurance contract, such that the policy is not a cover for a wager.[51] Thus, a person is not permitted to seek insurance on himself based on collusion with others when really the transaction is a mere disguise for a wagering contract.[52] In other words, a person seeking insurance on himself "must really, not just nominally, be the person who contracts with the insurance company."[53] Occasionally, the person seeking insurance is not the true applicant. A "question sometimes arises as to who in fact and in legal contemplation made the contract of insurance with the insurer."[54] Although the insured signs the application, someone else may have been the true cause of initiating the

48. *Id.* at 484–85.

49. MEYER, *supra* note 24, § 4:3, at 90.

50. 3 COUCH ON INSURANCE, *supra* note 33, § 41:19, at 41-37 to -38. In part, latitude is given to people seeking an insurance policy on their own lives and naming any beneficiary they desire because it is logical to assume that nobody would designate a beneficiary that would likely murder the insured. 28 APPLEMAN ON INSURANCE, *supra* note 45, § 174.05, at 79. Even if a beneficiary does in fact kill the insured in order to obtain the insurance proceeds, state common law or "slayer" statutes prevent the beneficiary from receiving the death benefit amount of the policy. Swisher, *supra* note 18, at 488–89.

51. *See, e.g.*, Grigsby v. Russell, 222 U.S. 149, 156 (1911); Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 460 (1876); Bankers' Reserve Life Co. v. Matthews, 39 F.2d 528, 529 (8th Cir. 1930); Finnie v. Walker, 257 F. 698, 700 (2d Cir. 1919); Mechs.' Nat'l Bank v. Comins, 55 A. 191, 193 (N.H. 1903). This good faith requirement was reaffirmed as recently as January 22, 2008. Life Prod. Clearing, LLC v. Angel, 530 F. Supp. 2d 646, 653–56 (S.D.N.Y. 2008).

52. 3 COUCH ON INSURANCE, *supra* note 33, § 41:19, at 41-37.

53. 28 APPLEMAN ON INSURANCE, *supra* note 45, § 174.05, at 79.

54. 3 COUCH ON INSURANCE, *supra* note 33, § 41:21, at 41-40.

application and paid for the policy.[55] Therefore, "[m]ere signing of an application for life insurance does not amount to 'taking out' the policy within the meaning of the rule that a person may take out a policy on his or her own life payable to whom he or she desires."[56] If the insured is not the "true" applicant, the policy may be considered void in certain instances,[57] namely, if the applicant lacks "good faith" through fraud, collusion, or intent to enter into a policy that is a mere wager.[58]

While some criticize this notion of "good faith" on the part of the person seeking insurance,[59] the vagueness of the phrase does not render it meaningless. Good faith within the context of life insurance is reflective of the *nature* and *purpose* of life insurance: there must be a risk being transferred from the person seeking insurance to the insurance company.[60] In other words, the *intent* of the person entering into the life insurance contract is not to achieve monetary gain for the sake of profit, but for the sake of protecting against some loss. The good faith test, therefore, points to a legitimate distinction between a life insurance contract and a wager or investment contract that even the government has implicitly recognized—because the government wants to encourage private risk spreading among citizens, it provides favorable tax treatment on life insurance

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55. *Id.* As one court stated:

> [O]ne may not insure his own life for the benefit of another who has no insurable interest therein if the beneficiary assumes payment of the premiums or otherwise participates in or induces the transaction. Such insurance contracts are regarded as in the nature of wagering or gambling transactions and are universally condemned as being in contravention of public policy.

Penn Mut. Life Ins. Co. v. Slade, 47 F. Supp. 219, 221 (E.D. Ky. 1942).

56. 3 COUCH ON INSURANCE, *supra* note 33, § 41:21, at 41-40 to -41.

57. *Id.* § 41:20, at 41-40; *see also* 28 APPLEMAN ON INSURANCE, *supra* note 45, § 174.05, at 79 & n.92 (indicating that an "insured does not become the true owner of the policy merely by participating in the application process when someone else in fact procured the insurance"; such a situation subjects the policy to being considered void).

58. Johnny C. Parker, *Does Lack of an Insurable Interest Preclude an Insurance Agent from Taking an Absolute Assignment of His Client's Life Policy?*, 31 U. RICH. L. REV. 71, 79 (1997).

59. *See, e.g.*, Kreitner, *supra* note 29, at 1125–27 (arguing that courts have interpreted "good faith" in different ways, and in the end, it is nearly impossible to determine whether someone obtained a policy in good faith); *cf.* Loshin, *supra* note 43, at 477 (advocating for an abolition of the insurable interest requirement).

60. *See supra* notes 12–15 and accompanying text; Jordan v. Group Health Ass'n, 107 F.2d 239, 248 (D.C. Cir. 1939) (indicating that insurance turns on whether insurance risk is involved and is the principal object and purpose of the contract).

proceeds, generally exempting life insurance proceeds from all federal income tax.[61]

The second category of life insurance policies is when a third party procures a policy on the life of another. Various states hold different understandings of what constitutes a valid insurable interest between someone seeking insurance and the life of the person to be insured.[62] Although the Supreme Court has recognized both family relationships and pecuniary ties as satisfying the insurable interest requirement,[63] some legislatures have determined that family relationships alone without pecuniary estimation are insufficient.[64] Among the states that do include family relationships within their insurable interest common law or statutory definition, it is not always clear which family relationships are considered sufficient.[65] Sufficient relationships generally include spouses, parents, children, siblings, and grandparents.[66] The underlying principle, however, that is consistent among all the states is that there must be "a reasonable ground, founded upon the relations of the parties to each other, . . . to expect some benefit or advantage from the continuance of the life of the [in]sured."[67] If no such relationship or pecuniary interest exists, "the contract is a mere wager, by which the party taking the policy is directly interested in the early death of the [in]sured."[68] In addition to requiring that a particular relationship exist, some jurisdictions require the person whose life is to be insured to consent to the insurance company issuing the policy.[69]

61. *See* 26 U.S.C. § 101(a) (2000); David S. Miller, *Distinguishing Risk: The Disparate Tax Treatment of Insurance and Financial Contracts in a Converging Marketplace*, 55 TAX LAW. 481, 486, 504 (2002).

62. Franklin L. Best, Jr., *Defining Insurable Interests in Lives*, 22 TORT & INS. L.J. 104, 106 (1986).

63. Warnock v. Davis, 104 U.S. 775, 779 (1881).

64. *See, e.g.*, CAL. INS. CODE § 10110 (West 2007).

65. Best, *supra* note 62, at 108.

66. *See* 28 APPLEMAN ON INSURANCE, *supra* note 45, § 174.06, at 87–105 (outlining the various familial relationships and the historical understanding of whether they satisfy the insurable interest requirement).

67. *Warnock*, 104 U.S. at 779.

68. *Id.*

69. 3 COUCH ON INSURANCE, *supra* note 33, § 41:22, at 41-42. Certain exceptions to this requirement of consent from the insured may exist, such as situations involving group insurance, a spouse procuring insurance on another spouse, or a parent obtaining insurance on a child. *Id.* § 41:22, at 41-43. The State of Texas allows a broad understanding of insurable interest by allowing the consent of the insured to act not only as evidence of, but even as a substitute for insurable interest where one would not otherwise exist. *See* TEX. INS. CODE ANN. § 1103.056 (Vernon 2008).

A valid insurable interest is something that must exist at the inception of the life insurance contract.[70] If an insurable interest exists when the contract is made, whether it remains present at the moment of the insured's death is usually irrelevant.[71] The focus, therefore, is on the time when the contract was made. Even if the insurable interest requirement appears to have been objectively met due to a particular relation between the parties causing the insurance company to issue a policy, there is still a *subjective* component to the insurable interest requirement that must be present.[72] As the good faith test discussed above indicated, this subjective component pertains to the intent of the person seeking the insurance.[73] If a person seeks life insurance primarily for a reason other than to shift risk to an insurance company and fails the good faith test, courts will not recognize the policy as a valid insurance contract.[74] For example, when a husband procures an insurance policy on the life of his wife with the intent to kill her and obtain the death benefit amount, the life insurance policy is void ab initio.[75] A second example is the good faith requirement that prevents the person seeking insurance from being a nominal party only—one that seeks only to sell or assign the policy for profit shortly after the policy takes effect.[76] In general, the "test seems to be the intention of the parties at the time of procurement of the policy."[77] A valid insurance contract, therefore, requires both an objective relationship in which there is inherent risk

70. 28 APPLEMAN ON INSURANCE, *supra* note 45, § 174.04, at 71.

71. *Id.* § 174.04, at 72.

72. *See infra* notes 73–78 and accompanying text.

73. Bankers' Reserve Life Co. v. Matthews, 39 F.2d 528, 529 (8th Cir. 1930).

> In short, the test is the good faith in taking out the policy for the benefit of one having an insurable interest. The crux is whether the policy was a wagering contract at the time it became effective as a contract. If, at that time, [an] assignment [of the policy] was contemplated by the insured, it is a wagering contract, otherwise it is not.

Id.

74. *See, e.g.*, Elmore v. Life Ins. Co. of Va., 198 S.E. 5, 6–7 (S.C. 1938).

75. The common law rule that courts have applied to find life insurance policies procured with the intent to kill the insured person void ab initio is known as the "Null Rule." Ben Kingree & Louise Tanner, *Life Insurance as Motive for Murder*, 29 TORT & INS. L.J. 761, 763 (1994).

76. In a situation "where the insured is merely a nominal party whose life and name are used to cover a scheme to obtain speculative insurance, the courts will invalidate the life insurance policy as violative of public policy." 1 WARREN FREEDMAN, RICHARDS ON THE LAW OF INSURANCE § 92, at 381 (5th ed. 1952).

77. 7 RICHARD A. LORD, WILLISTON ON CONTRACTS § 17:5, at 582 (4th ed. 1997) [hereinafter WILLISTON ON CONTRACTS].

that can be transferred and a legally valid subjective intent of the party seeking the insurance.[78]

III. THE NATURE AND PURPOSE OF LIFE INSURANCE

Life insurance[79] is "a contractual arrangement under which one party, an insurer, contracts with another, the insured, to pay money to the insured or a designated beneficiary on the fortuitous happening of stipulated contingencies of harm to the person . . . insured . . . [where] the basic adverse contingency is the death of the insured."[80] Although this definition and other commonly accepted definitions provide a rudimentary outline of life insurance,[81] it is easy to overlook the uniqueness of this contractual arrangement.

The nature of life insurance is different from other forms of insurance because of two things: (1) the subject that is insured—a human life; and (2) the condition precedent—the death of a human being.[82] Because the value of a human life and the loss resulting from death are incapable of being measured purely in monetary terms, a life insurance policy is not ordinarily a pure indemnification contract like fire and casualty insurance.[83]

Thus, from the perspective of the policy owner, the primary purpose of life insurance is to provide against an unexpected loss resulting from the insured's death and help prevent economic hardship for those who have an insurable interest in the insured's

78. Warnock v. Davis, 104 U.S. 775, 779 (1881); Parker, *supra* note 58, at 79. The requirement that there be a legally valid subjective intent does not overlook the fact that people often act with mixed intentions. The thrust of the requirement is that the person seeking insurance acts with the primary intention for which insurance is designed—transfer of risk—not primarily or simply for profit.

79. There are a number of different forms of life insurance, including but not limited to: term life insurance, whole life insurance, variable life insurance, ordinary life insurance, universal life insurance, group life insurance, endowment life insurance, and credit life insurance. *See* 28 APPLEMAN ON INSURANCE, *supra* note 45, § 173.05, at 13–29 (explaining different forms of life insurance). It is beyond the scope of this Note to provide a detailed account of the various forms of life insurance. Accordingly, the various forms will collectively be referred to as "life insurance" unless otherwise specified.

80. *Id.* § 173.01, at 3.

81. *See, e.g.*, DOBBYN, *supra* note 11, at 7 ("Life insurance is essentially a contract to make specific payments upon the death of the person whose life is insured.").

82. *See* 28 APPLEMAN ON INSURANCE, *supra* note 45, § 173.01, at 3.

83. MEYER, *supra* note 24, § 4:2, at 88; 1 COUCH ON INSURANCE, *supra* note 33, § 1:39, at 1-58. A possible exception to this would be credit life insurance because the amount that the debtor owes to the creditor is easily ascertainable and subject to precise calculation.

life.[84] That is, there is an inherent *risk* of loss that may occur if the insured person dies, and it is this risk that is shifted from the person seeking insurance to the life insurance company. This inherent risk is directly related to the insurable interest requirement.[85] The insurable interest requirement in life insurance is qualitatively different than in other forms of insurance; it is based on relations between persons, not relations between persons and things. Therefore, "[l]ife insurance is important. Among its purposes are to protect the families of breadwinners, create estates, preserve estates, and fund business continuation arrangements."[86] Indeed, it is "unquestionable" "[t]hat life insurance is desirable from an economic and social standpoint as a device to shift and distribute risk of loss from premature death."[87]

IV. THE SPIN ON SPIN-LIFE POLICIES

With the introduction of the AIDS epidemic in the United States during the 1980s, life insurance policies were used in a new manner; people who had life insurance policies in force, but who later acquired a life-threatening disease or were terminally ill, began selling their life insurance policies to various companies at a discounted price.[88] Because a life insurance policy is considered personal property of the policy owner,[89] the policy owner has a limited right to assign ownership of the policy to a different person or to change beneficiaries.[90] This ability to assign ownership of the

84. *See* Jerry, *supra* note 5, at 305.

85. *See supra* Part II.

86. Belth, *supra* note 4, para. 2. Some groups describe this as the "social purpose" of life insurance. *STOLI Alert* (Ass'n for Advanced Life Underwriting, Falls Church, Va., Am. Council of Life Insurers, Washington, D.C., & Nat'l Ass'n of Ins. and Fin. Advisors, Falls Church, Va.), Mar. 2007, at 1, *available at* http://www.naifa.org/advocacy/stolialert/pdf/stoli_march07.pdf [hereinafter *STOLI Alert*, March]. The social purpose of life insurance is indicative of the *nature* of the contractual agreement because it shows the type of risk that is transferred from the person seeking insurance to the insurance company.

87. Comm'r v. Le Gierse, 312 U.S. 531, 539 (1941).

88. Terry M. Magady, *Selling Life Insurance on the Secondary Market*, L.A. LAW., July–Aug. 2006, at 14, 14.

89. Life insurance policies after they are put in force have "the ordinary characteristics of property." Grigsby v. Russell, 222 U.S. 149, 156 (1911).

90. Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 457 (1876) ("Any person has a right to procure an insurance on his own life, and assign it to another, provided it be not done by way of cover for a wager policy."); *see also* Nathaniel S. Shapo, *Life Settlements and Investor-Owned Life Insurance*, 2007 A.L.I.-A.B.A. COURSE OF STUDY 339, 341, *available at* WL SM085 A.L.I.-A.B.A. *339, *341 (describing life insurance policy owners as having a bundle of property rights with respect to the policy).

policy and determine who should receive the death benefit turned into the secondary market for life insurance.[91] The selling of a life insurance policy by a terminally ill policyholder on the secondary market became known as a "viatical settlement."[92] Viatical settlement transactions, however, are not insurance contracts, and as such, are not part of the "business of insurance."[93] For the purposes of the Securities Act, the Securities and Exchange Act, and federal securities regulation, viatical settlements in certain instances qualify as investment contracts, and therefore as securities.[94]

By 1998, the secondary market had expanded to include the selling of policies on people who were neither terminally nor chronically ill.[95] These types of transactions are called "life settlements" and involve situations in which the person seeking life insurance generally does so initially to protect against a loss that would result upon death, not for the sake of selling the policies later to investors.[96] Life settlements and viaticals can be useful tools for people struggling with expensive illnesses or tragedies insofar as they allow people to obtain money by selling preexisting policies that they no longer need. States have attempted to pass statutes to regulate the secondary market, but a problem arises insofar as viatical and life settlements on the secondary market are not considered "insurance."[97] While Congress granted the states authority to regulate the insurance

91. Shapo, *supra* note 90, at 341.

92. *Id.* "Viaticus" is a Latin adjective denoting something in relation to a journey. CASSELL'S NEW LATIN DICTIONARY 604 (1959).

93. SEC v. Life Partners, Inc., 87 F.3d 536, 542 (D.C. Cir. 1996).

94. Something qualifies as an "investment contract" if there is: (1) an investment of money in (2) a common enterprise in which (3) the profits are to be derived from the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946). For examples of courts classifying viatical settlements as investment contracts (i.e., securities), see *SEC v. Mut. Benefits Corp.*, 408 F.3d 737, 745 (11th Cir. 2005), and *Wuliger v. Eberle*, 414 F. Supp. 2d 814, 824 (N.D. Ohio 2006). *But see Life Partners, Inc.*, 87 F.3d at 549 (holding that fractional interests in viatical settlements where the viatical company provided pre-purchase services and post-purchase ministerial services are not securities since such an arrangement fails the third prong of the *Howey* test).

95. Belth, *supra* note 4, para. 4.

96. *See* J. Alan Jensen & Stephan R. Leimberg, *Stranger-Owned Life Insurance: A Point/Counterpoint Discussion*, 33 ACTEC J. 110, 110 (2007) (distinguishing between SPIN-Life policies and life settlements insofar as life settlements involve the acquisition of a preexisting policy from an insured who no longer needs it); Joseph M. Belth, *Viatical and Life Settlement Transactions*, CONTINGENCIES, Mar.–Apr. 2002, at 22, *available at* http://www.contingencies.org/marapr02/viatical.pdf (describing the secondary market as involving people selling policies that they already own).

97. *Life Partners, Inc.*, 87 F.3d at 542; Belth, *supra* note 4, para. 21.

business in 1945 with the McCarran-Ferguson Act,[98] the authority of the states to regulate the secondary market is unclear.[99] Therefore, it is incumbent upon Congress to determine who should regulate the secondary market and how it should be done since these transactions often qualify as securities and should be subject to federal securities regulation.[100]

The success of the secondary market eventually led to hedge funds and institutional investors partnering with agents and brokers to solicit wealthy elderly people, usually seventy years and older,[101] to obtain life insurance purely to make a profit by later selling the policies to speculators.[102] These policies entered into by wealthy elderly people (with a net worth of at least $1 million)[103] upon the inducement of

98. *See* McCarran-Ferguson Act, 15 U.S.C. § 1012 (2006). The McCarran-Ferguson Act, however, does not eliminate all involvement of insurance and insurance companies from federal regulation. 28 APPLEMAN ON INSURANCE, *supra* note 45, § 173.03, at 5. The non-insurance business activities of insurance companies are still subject to general federal statutes. *Id.* Although the McCarran-Ferguson Act currently provides for state regulation of the insurance industry and a limited antitrust exemption for the industry, there have been repeated attempts to modify or repeal the Act, and consideration of federal regulation of insurance. *See, e.g.*, Insurance Industry Competition Act of 2007, S. 618, 110th Cong. (2007); H.R. 1081, 110th Cong. (2007).

99. Belth, *supra* note 4, paras. 21–22. Although viatical and life settlements are not insurance contracts, the Fourth Circuit recently held that viatical settlements affect the business of insurance, and therefore, the Virginia Viatical Settlements Act "relates to" the business of insurance in such a way that it qualifies under the McCarran-Ferguson Act as subject to state regulation. Life Partners, Inc. v. Morrison, 484 F.3d 284, 287 (4th Cir. 2007), *cert. denied*, 128 S. Ct. 708 (2007).

100. Belth, *supra* note 4, paras. 22–23; *see supra* note 94.

101. Rachel Emma Silverman, *Letting an Investor Bet on When You'll Die: New Insurance Deals Aimed at Wealthy Raise Concerns; Surviving a Two-Year Window*, WALL ST. J., May 26, 2005, at D1. The secondary market has for the most part been an economic success. In 2006, an estimated $15 billion in transactions was done; it is now possible to purchase "death bonds" on Wall Street which consist of life insurance contracts sold on the secondary market in a fashion similar to the way that mortgages are bundled together. Matthew Goldstein, *Profiting from Mortality: Death Bonds May Be the Most Macabre Investment Scheme Ever Devised by Wall Street*, BUS. WK., July 30, 2007, at 44, 44–46. It is predicted that the death bond market could realistically reach $160 billion in transactions in the proximate future. *Id.* at 46. In fact, twenty German funds have already been set up to invest in the death benefits of Americans. Holman W. Jenkins, Jr., *Life Insurers Face the Future, Grudgingly*, WALL ST. J., Aug. 9, 2006, at A11. Even such financial institutions as Credit Suisse, Deutsche Bank, Goldman Sachs, and Lehman Brothers have invested in the secondary market, along with investors such as Warren Buffett. Matthew Goldstein, *Why Death Bonds Look So Frail*, BUS. WK., Feb. 25, 2008, at 40, 40; Charles Duhigg, *Late in Life, Finding a Bonanza in Life Insurance*, N.Y. TIMES, Dec. 17, 2006, at 1.

102. Belth, *supra* note 4, para. 4. SPIN-Life policies often involve universal life insurance coverage or other coverage where premiums are underpriced. *Id.* para. 27.

103. *STOLI Alert*, March, *supra* note 86, at 2. *But see* R. Marshall Jones et al., *'Free' Life Insurance: Risks and Costs of Non-Recourse Premium Financing*, EST. PLAN., July 2006, at 3, 4 (2006) (placing the minimum net worth of targeted individuals at a higher level—$5 million).

investors are known as speculator-initiated life insurance, or SPIN-Life insurance policies.[104] Investors target wealthy elderly people that have "excess insurability"—people who have a high net worth, but who have life insurance that covers only a small percentage of that net worth (e.g., $1 million of in-force life insurance coverage when a person's net worth is $10 million).[105]

People who have excess insurability are those who "do not want or feel they have a need to purchase any additional life insurance as part of their personal, business, or estate planning."[106] Because a person with only $1 million in life insurance coverage who has a net worth of $10 million appears to have a need for additional coverage, an insurance company would generally be willing to issue a policy for the remainder of the person's net worth: $9 million (net worth less existing life insurance in force). It appears to the company that the person merely wants to protect those assets. Investors in SPIN-Life policies, however, not only look for wealthy elderly people with excess insurability, but also for people who have minor health problems yet still qualify for standard or preferred rates in order to maximize the investors' return.[107] Investors prefer that these elderly people have certain small health problems to increase their mortality rate without increasing premiums (again, to maximize profit on the person's death).[108]

Although different forms of SPIN-Life exist, a common scenario is the following: in a typical situation, investors, agents, or brokers approach or solicit a qualified elderly person.[109] They inform the elderly applicant that he can receive a large sum of money at the end of two years by being the "owner" of *free, no risk* life insurance.[110] In certain instances, the investors give the applicant a cash advance or a new car as an added enticement for the applicant to go along with the scheme.[111]

104. See *supra* note 3 for the various other names of SPIN-Life insurance. For more information on SPIN-Life policies, visit http://www.spinlifeins.com/Home_Page.php.

105. Jones et al., *supra* note 103, at 4 n.7.

106. *Id.*

107. *Id.* at 4.

108. *Id.*

109. *STOLI Alert*, March, *supra* note 86, at 2. For a discussion of SPIN-Life policies utilizing trusts, see Jones et al., *supra* note 103, at 4–5.

110. *STOLI Alert*, March, *supra* note 86, at 1–2; Belth, *supra* note 4, para. 34. Depending on the incontestability period, *see infra* notes 114–16 and accompanying text, the elderly person may have to hold the policy for more than two years.

111. Jones et al., *supra* note 103, at 4; Silverman, *supra* note 101, at D2.

The investors explain that there is no risk and no cost to the applicant because they provide a loan in addition to the cash advance in order to pay for the annual premiums for the first two years.[112] This type of loan does not require collateral or a personal guarantee on the part of the applicant and is a non-recourse loan which allows for premium financing.[113] State statutes and certain contractual provisions do not allow insurance companies to deny liability on a contract due to a material misrepresentation after a certain period of time has passed; this is called the "incontestability provision."[114] The investors provide the loan to the applicant for two years due to the contestability period of the policy[115] and because states typically do not allow a policy owner to sell a life insurance policy on the secondary market for at least two years.[116] If the applicant dies during the contestability period (usually the first twenty-four months after the policy is put in force), the death benefit will be paid to the insured's beneficiaries, but the beneficiaries are obligated to pay back the loan to the investors.[117] If the applicant does not die during the contestability period, the applicant's health is reevaluated and institutional investors make offers to purchase the policy from the applicant.[118]

Although the applicant has the option of keeping the policy, he would be required to repay the premium loan, plus interest and any charges imposed by the investors.[119] Typically the loan amount, interest, and fees imposed by the investors are high enough that the applicant is forced to accept the offers made by the investors and transfer ownership of the policy.[120] Investors generally offer 10–15% of the death benefit amount of the policy,[121] although if the applicant

112. *STOLI Alert*, March, *supra* note 86, at 2. Some SPIN-Life arrangements do not include transfer of ownership after two years; instead, a trust representing the investors is established from the inception of the policy to hide the lack of insurable interest and true purpose of the policy. *STOLI Alert* (Am. Council of Life Insurers, Washington, D.C., & Nat'l Ass'n of Ins. and Fin. Advisors, Falls Church, Va.), Nov. 2007, at 1, *available at* http://www.acli.com/NR/rdonlyres/6E625C8B-4FCE-4598-9AE3-4EF3DD0C501F/11922/Stoli_Alert_Nov_07_web1.pdf.

113. Belth, *supra* note 4, Exhibit B.

114. 17 COUCH ON INSURANCE, *supra* note 33, § 240:5, at 240-13.

115. *STOLI Alert*, March, *supra* note 86, at 2.

116. *See* Jones et al., *supra* note 103, at 4–5.

117. *STOLI Alert*, March, *supra* note 86, at 2.

118. Belth, *supra* note 4, Exhibit B.

119. *STOLI Alert*, March, *supra* note 86, at 2.

120. *Id.*

121. Belth, *supra* note 4, Exhibit B.

experiences new health risks during the two-year contestability period, the policy is more attractive to investors.[122] After the applicant transfers ownership of the policy and receives the proceeds from selling it, he must repay the premium loan amount, plus the interest and fees.[123] Any profit that the applicant receives from selling the policy to the investors is taxed at 15% as a long-term capital gain.[124]

After the applicant transfers ownership of the policy to the investors, the investors continue to pay the premium on the policy until the person dies and they receive the death benefit (after changing the designated beneficiaries to themselves), or they in turn sell the policy to another group of investors.[125] The investors are betting that the applicant will live longer than two years, and they structure the arrangement such that the applicant will inevitably transfer ownership to them.[126] At the same time, however, the investors hope that the applicant will die within a relatively short amount of time afterward, thereby minimizing continued premium payments and maximizing profit.[127]

A brief hypothetical helps illustrate the structure of SPIN-Life transactions. Applicant *X* has a net worth of $11 million, but in-force life insurance coverage for only $1 million. Agent *A*, working on behalf of Investor *Y*, convinces Applicant *X* (who is slightly overweight and has high cholesterol) to apply for a life insurance policy with Insurance Company *Z* for $10 million on January 1, 2009, with a loan from Investor *Y* to pay the annual premium of $500,000. If Applicant *X* dies on January 1, 2010, Applicant *X*'s beneficiaries would receive $10 million, but would be required to pay Investor *Y* the 2009 premium of $500,000, plus interest and fees. If Applicant *X* lives until January 1, 2011 (the end of the contestability period), he will be offered $1.5 million by Investor *Y* to assign ownership of the policy to the Investor, and must pay Investor *Y* $1 million (for the premium loan) plus interest and fees from the non-recourse premium loan. Interest and fees on the loan equal $100,000. Therefore,

122. Magady, *supra* note 88, at 15.

123. Jones et al., *supra* note 103, at 4–5.

124. *Id.* at 12; Belth, *supra* note 4, Exhibit B.

125. *See* Jones et al., *supra* note 103, at 13 (noting that investors often resell SPIN-Life policies to other investors); *STOLI Alert*, March, *supra* note 86, at 1–2 (indicating that investors pay the premiums during the life of the contract until they receive the policy proceeds).

126. *STOLI Alert*, March, *supra* note 86, at 2.

127. *See* Duhigg, *supra* note 101, at 1.

Applicant *X* realizes a $400,000 gain. This is taxed at 15%, leaving him with a $340,000 net profit from the arrangement. Investor *Y* changes the beneficiary to itself, and continues to pay the premium for each year Applicant *X* lives. If Applicant *X* dies on January 1, 2012, Investor *Y* will receive the $10 million death benefit, but having already paid Applicant *X* $1.5 million and one annual premium of $500,000, he realizes a net profit of approximately $8 million.[128] If, however, Applicant *X* lives for seventeen years after the policy is transferred to Investor *Y*, Investor *Y* will break even. After that, Investor *Y* would incur a net loss of $500,000 for each additional year that Applicant *X* lives. Investor *Y* essentially wagers that Applicant *X* will die sometime between years two and nineteen from the policy's inception.

Although agents, brokers, and investors market SPIN-Life policies as no-risk and free for the applicant,[129] there are a number of things wrong with such transactions. First, agents and brokers often do not advise applicants that after entering into SPIN-Life transactions, it will be difficult for them to obtain additional life insurance because they are using up their excess insurability.[130] Such an opportunity cost certainly cannot be considered "free" since the applicants are in effect selling their capacity to obtain life insurance, which they will not be able to recover.[131] In addition, the "free" loan to the applicant and funded by the lender or investors is subject to taxation.[132] There is

128. Depending on how the SPIN-Life policy was structured, the investors could incur tax consequences as well. Silverman, *supra* note 101, at D2.

129. *STOLI Alert*, March, *supra* note 86, at 1–2; Belth, *supra* note 4, Exhibit B.

130. See text accompanying note 105 for an explanation of excess insurability. The problem of agents and brokers not conveying adequate information is highlighted by a lawsuit filed by CNN talk show host Larry King against a broker concerning two SPIN-Life policies. The broker allegedly failed to disclose tax implications, fees, payments, commissions, and did not advise him on whether he should keep the new policies. *See* Anita Huslin, *The Wealthy are Selling Their Life Insurance Policies for Profit, Raising Ethical and Financial Concerns and . . . Insuring a Controversy*, WASH. POST, Nov. 27, 2007, at D1.

131. Jensen & Leimberg, *supra* note 96, at 113, 115–16.

> [An] insured under [a SPIN-Life] policy uses up some of his insurability by the amount of the death benefit. Insurers will insure any individual only for so much coverage. Consequently, [SPIN-Life] policies can dramatically reduce potential permanent coverage for the insured. [A SPIN-Life] policy in most instances never lapses. Therefore, it will reduce the ability of the insured to buy additional coverage throughout his life . . . .

Id. at 113.

132. *See* Jones et al., *supra* note 103, at 12.

also no guarantee that the insured will be able to sell the policy on the secondary market if investors lose their interest.[133]

Other complications involve standard indemnification provisions in the premium financing agreements for SPIN-Life policies in which the applicant or applicant's family is required to indemnify the investors for any loss that is caused by a material misrepresentation or omission connected with applying for insurance coverage.[134] Life insurance applications often ask if the applicant intends to sell the policy.[135] Misrepresentation with respect to this question or other material questions concerning health history give an insurance company a right to rescind the policy; if the misrepresentation is intentional, the company could rescind the policy even after the person dies.[136] Such a situation creates significant liability for the applicant and potentially his family, even after death.[137] Liability for such actions is not limited to money alone; the applicant (and investors, agents, and brokers) can be charged with insurance fraud, which is a felony.[138]

Misrepresentations on applications are quite common in the SPIN-Life context since those involved are trying to hide the true nature of the transactions;[139] such misrepresentations do not go unnoticed. In fact, the Securities and Exchange Commission recently filed a lawsuit against a hedge fund company involved with material misrepresentations on a large number of SPIN-Life policy applications.[140] Besides suspect misrepresentations, any cash incentives or gifts could be considered a rebate as an inducement to purchase insurance, which is illegal in most states.[141]

133. Jensen & Leimberg, *supra* note 96, at 127.

134. Jones et al., *supra* note 103, at 6, 8.

135. *Id.* at 8.

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.*; *see, e.g.*, Am. Gen. Life Ins. Co. v. Schoenthal Family, LLC, 248 F.R.D. 298, 301–02 (N.D. Ga. 2008) (indicating that an eighty-two year old man stated on an application that his net worth was $10.7 million when it was in fact $160,000, and that his annual income was $160,000 when it was $7200, in order to induce American General to issue a policy with a death benefit of $7 million as part of a SPIN-Life transaction).

140. SEC v. Lydia Capital, LLC, No. 07-10712-RGS, 2008 WL 509136, at *1 (D. Mass. Feb. 21, 2008); *STOLI Alert* (Am. Council of Life Insurers, Washington, D.C., & Nat'l Ass'n of Ins. and Fin. Advisors, Falls Church, Va.), June 2007, at 3, *available at* http://www.naifa.org/advocacy/stolialert/pdf/stoli_june07.pdf [hereinafter *STOLI Alert*, June].

141. Jones et al., *supra* note 103, at 8–9.

Further, SPIN-Life policies "turn the purpose of life insurance on its head."[142] Life insurance is designed to provide long-term financial protection for families, businesses, and those with a particular relation to the insured person who are exposed to risks associated with the insured's death.[143] It therefore has an inherently social function.[144] SPIN-Life policies do not serve the same social function as life insurance. Instead of safeguarding against fortuitous risk, the value of a human life in SPIN-Life transactions "is reduced to a commodity that is auctioned off in the futures market to the highest bidder."[145] By recognizing that the continuation of human life is valuable, and that with death comes loss, life insurance promotes the dignity and sanctity of life; it is not meant to "sanction speculative risks on human life, and encourage the evils for which wager policies are condemned."[146] SPIN-Life transactions subvert the dignity of human life by using a person exclusively in "a way for speculators to make a quick buck."[147]

In addition to the aforesaid problems, SPIN-Life transactions threaten to bring about the death of life insurance by changing the traditional understanding of what life insurance is and by attacking the elements necessary for a valid life insurance contract. SPIN-Life policies should not be considered life insurance for contractual *and* public policy reasons, and a clear distinction between the two types of contracts should be made. The federal government leaves it to the states to define and regulate insurance.[148] As a result, states have the ability to define what qualifies as an *insurance* contract.[149] One of the requirements that states impose on any contract in order for it to be considered *insurance* is the insurable interest requirement.[150] As noted above, an insurance contract is one whereby risk is shifted from

142. *STOLI Alert*, March, *supra* note 86, at 1.

143. *Id.*

144. *Id.*

145. *STOLI Alert*, June, *supra* note 140, at 4 (internal quotation marks omitted) (quoting Frank Keating, President, American Council of Life Insurers). One commentator has referred to this process of SPIN-Life reducing a human person into an economic commodity as "commodification" and "economic reductivism." Jensen & Leimberg, *supra* note 96, at 119 (internal quotation marks omitted).

146. Warnock v. Davis, 104 U.S. 775, 781 (1881).

147. *STOLI Alert*, June, *supra* note 140, at 4 (internal quotation marks omitted) (quoting David F. Woods, Chief Executive Officer, National Association of Insurance and Financial Advisors).

148. *See* 15 U.S.C. § 1012 (2006); *see also id.* § 6712(c)(2).

149. *See* 15 U.S.C. § 1012 (2006); *see also id.* § 6712(c)(2).

150. *See supra* notes 34–36 and accompanying text.

someone exposed to a fortuitous future event that could result in loss to himself and instead is transferred to the insurance company.[151] To briefly summarize again, this inherent risk is based on two components: (1) an objective relation between the person seeking insurance and the person whose life is insured (e.g., a husband procures insurance on his wife),[152] and (2) a good-faith subjective intent of the person seeking insurance (e.g., the person is entering the contract for the purpose of obtaining insurance, and not with a murderous intent or as a nominal party in order to immediately sell the policy for the sake of profit).[153] If the insurable interest requirement (and its objective and subjective elements) is not met, the agreement is not a valid insurance contract.[154] It may be an investment contract or a wager, but it would not be a contract that is subject to state insurance regulation—insurance companies do not have the authority to enter into such agreements under the designation of "life insurance."[155]

SPIN-Life policies do not have the necessary components to be considered life insurance. Although it appears that these policies have the necessary objective component of the insurable interest requirement (a person takes out a policy on himself), the subjective intent is lacking. At the time of the policy's inception, it is contemplated that the policy will be resold or irrevocably assigned to someone that does not have a proper insurable interest in the insured. The good faith intent is absent because the applicant is a nominal party for the purposes of monetary gain, and is not seeking the policy in order to transfer risk to the insurance company.[156] Because no insurance risk is being transferred to the insurance company, the transaction is not an *insurance* contract.[157] Although viatical settlements and other life settlements are distinguishable from SPIN-Life policies insofar as the underlying life insurance contracts for viatical and life settlements were originally entered into without the

151. *See supra* note 12 and accompanying text.

152. Warnock v. Davis, 104 U.S. 775, 779 (1881).

153. Parker, *supra* note 58, at 79.

154. *See supra* notes 70–78 and accompanying text.

155. Without a valid insurable interest, "the insurance company has no legal right to issue a policy." 7 WILLISTON ON CONTRACTS, *supra* note 77, § 17:5, at 593.

156. *See supra* notes 51–58 and accompanying text (describing the good faith intent requirement in the purchase of a life insurance policy); *see also* Jensen & Leimberg, *supra* note 96, at 110 (noting that SPIN-Life policies involve an "anticipated sale").

157. *See supra* notes 12–15 and accompanying text (discussing the elements necessary for an insurance contract).

contemplation of a future sale of the policies,[158] they are similar to SPIN-Life in that they are both investments and not insurance, properly speaking.[159]

Instead of being classified as insurance contracts, SPIN-Life policies are, in substance, investment contracts, which are subject to federal securities regulation.[160] SPIN-Life policies meet the requirements for an investment contract proposed by the Supreme Court: (1) an investment of money, (2) in a common enterprise, (3) in which the expectation of profits is derived from the efforts of others.[161] Although SPIN-Life policies are disguised as life insurance policies, the Court indicates that in determining whether something is a "security," substance is more important than form and emphasis should be on economic reality.[162] As such, SPIN-Life policies should be subject to federal and state *securities* regulation, not state *insurance* regulation. This poses a large problem to investors, applicants, and insurance companies insofar as each of these parties is associated with the potentially illegal solicitation, sale, or issuance of an unregistered security.[163]

Even if the aforesaid argument is rejected (i.e., that SPIN-Life policies are not insurance contracts), nevertheless SPIN-Life policies should be considered void ab initio because they are "not consistent with the intended purposes of the insurable interest statutes."[164] The insurable interest requirement originated for a two-fold public policy purpose: (1) to prevent wagering on human lives, and (2) to mitigate

158. *See* Magady, *supra* note 88, at 14.

159. See *SEC v. Mut. Benefits Corp.*, 408 F.3d 737, 741–45 (11th Cir. 2005), and *Wuliger v. Eberle*, 414 F. Supp. 2d 814, 824 (N.D. Ohio 2006), for an explanation on why viatical settlements should be classified as investments. This Note does not question the legitimacy of viatical or life settlements that applicants procure with the intention of obtaining life insurance, not primarily as an investment and something to later be sold.

160. *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(1) (2006) (including investment contracts within the definition of a "security").

161. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

162. Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

163. Jones et al., *supra* note 103, at 10.

164. David F. Woods, CEO, Nat'l Ass'n of Ins. and Fin. Advisors, Statement to the National Association of Insurance Commissioners Life Insurance and Annuities (A) Committee Interim Meeting and Public Hearing on Premium Financing, Life Settlements and the Relationship with State Insurable Interest Laws, on behalf of the Nat'l Ass'n of Ins. and Fin. Advisors, the Ass'n for Advanced Life Underwriting, and the Nat'l Ass'n of Indep. Life Brokerage Agencies, (May 3, 2006), *available at* http://www.naifa.org/newsevents/documents/20060503_NAIC _testimony.pdf.

the incentive to murder someone whose life was insured.[165] SPIN-Life policies are contrary to both of these purposes. SPIN-Life policies are problematic in this respect for several reasons:

> (1) a policy is issued to an insured or someone with an insurable interest in the insured who neither provides nor incurs significant liability with respect to the resources with which the policy is acquired;
>
> (2) the resources to acquire the policy are provided or guaranteed by a person who does not possess an insurable interest in the insured; and
>
> (3) it is contemplated at the time of policy inception that sometime after two years from the policy's issuance, it is likely to be resold or will primarily benefit a person who lacks an insurable interest in the insured.[166]

Thus, SPIN-Life policies lack a legally cognizable insurable interest and violate public policy against wagers, because the applicant is merely a nominal party when the transaction is entered into with the insurance company. There is collusion between the applicant, the agent or broker, and the investment company providing the loan to procure the policy purely for purposes of speculating on the life of the applicant, thereby failing the good faith aspect of the insurable interest requirement.[167] Because the "public interest is of paramount importance," insurance companies should be permitted to void SPIN-Life policies ab initio for lacking sufficient insurable interest even if the contestability period has passed, and the equitable doctrines of waiver and estoppel should not apply.[168]

165. Limbaugh, *supra* note 42, at 695. The two-fold public policy reasons for the insurable interest requirement are intertwined: "[t]he primary purpose of the rule against wager contracts is to prevent speculation and attendant moral hazard." *Id.* at 696.

166. Woods, *supra* note 164.

167. *See supra* notes 101–02.

168. Beard v. Am. Agency Life Ins. Co., 550 A.2d 677, 688 (Md. 1988). Rescission of a life insurance policy is a powerful tool that should not be taken lightly; insurance companies should not seek rescission in order to avoid their obligation to pay the death benefits on legitimate policies. Because proving that a policy is a SPIN-Life policy might be difficult to do on a case-by-case basis, rescission should be invoked only when it is clear that the policy was a cover for a wager or an investment to be sold. Rescission should be permitted to insurance companies in such transactions, however, because the underlying policy is not a true insurance contract, and would likely not have been entered into by the insurance company.

Further, the insurable interest requirement is also based on the premise that there is a risk of loss due to the insured person's death.[169] SPIN-Life policies are contrary to life insurance and this insurable interest requirement; the initiator of the policy (the investor) is at risk not if the person dies, but if the person continues to *live*.[170] Because large sums of money are involved in these transactions with a potential risk of significant losses to investors, SPIN-Life policies provide an unusually large incentive to kill the insured person in order to ensure that the transaction is profitable.[171] To compound the problem of potential incentive for murder, there is no guarantee that the applicant's personal information will be kept confidential from investors, nor are there any adequate safeguards to prevent the eventual resale of the policy to people with nefarious inclinations.[172] After the applicant sells the policy to investors, the beneficiaries who will receive the proceeds of the policy are unknown to the applicant; not knowing who has a significant monetary interest in one's own death is unsettling, even to former SPIN-Life policyholders such as CNN talk show host Larry King.[173] Therefore, SPIN-Life policies violate the insurable interest rule because "[t]he rule is designed to protect human life. Policies in violation of the insurable interest rule are not dangerous because they are illegal; they are illegal because they are dangerous."[174]

Several state insurance departments have already indicated that SPIN-Life policies violate insurable interest laws. For example, the New York Insurance Department's Office of General Counsel released an opinion on December 19, 2005, stating that SPIN-Life transactions do not conform to New York's insurance laws because there is no valid insurable interest since they are a "speculative investment for

169. Rubenstein v. Mut. Life Ins. Co. of N.Y., 584 F. Supp. 272, 278 (E.D. La. 1984).

170. *See* Jensen & Leimberg, *supra* note 96, at 110 (indicating that investors enter into these transactions because they believe that the cost of paying continued premiums on SPIN-Life policies will be *less* than the death benefits of the policies, resulting in a gain, based on the life expectancy of the insured); *id.* at 117 ("The successful outcome of the investors' bet depends on someone's death.").

171. Belth, *supra* note 96, at 22.

172. Jones et al., *supra* note 103, at 13.

173. *See* Liam Pleven & Rachel Emma Silverman, *Cashing in: An Insurance Man Builds a Lively Business in Death: As Life Settlements Boom, Banks, Regulators Circle; Betting on Larry King*, WALL ST. J., Nov. 26, 2007, at A1 (indicating that one of the complaints in Larry King's lawsuit against a Maryland insurance brokerage is that he does not know who has a financial interest in his death after selling two SPIN-Life policies).

174. Liberty Nat'l Life Ins. Co. v. Weldon, 100 So. 2d 696, 708 (Ala. 1957).

the ultimate benefit of a disinterested third party."[175] The State of Utah Insurance Department issued a bulletin indicating that a SPIN-Life policy in which a third party initiates the transaction and expects to receive the proceeds of the policy does not satisfy the insurable interest requirement.[176] The bulletin indicated that it was impossible for a valid insurable interest to exist because there is no interest by the third party (i.e., investors) in having the insured person continue to live, but rather a substantial interest in not having the person continue living.[177] The Arkansas Insurance Department issued a similar statement refusing to recognize a valid insurable interest in SPIN-Life transactions.[178] The state insurance departments in Alabama and Idaho issued statements cautioning agents and those soliciting SPIN-Life policies to refrain from entering such transactions and advising them that the insurance departments of the respective states review such transactions for validity.[179] The Pennsylvania Insurance Department also recently issued a bulletin stating that it does not approve or sanction SPIN-Life policies, and it advised consumers to avoid participating in such transactions.[180] The Louisiana Department of Insurance issued a bulletin indicating that SPIN-Life policies may violate many of the Louisiana Insurance Code provisions, including insurable interest, the prohibition against wager policies, the prohibition on "wet ink" life settlements, premium finance, and usury.[181] Therefore, it is clear that SPIN-Life policies constitute a problem, but the question remains on what should be done about them.

V. PROPOSED ACTIONS CONCERNING SPIN-LIFE POLICIES

Because SPIN-Life policies are potentially profitable to investors, they are not likely to go away in the proximate future. There is sufficient evidence to question their validity as insurance contracts under state insurance laws, however, and a solution, therefore, is

175. *STOLI Alert*, March, *supra* note 86, at 3.

176. Utah Dep't of Ins. Directive No. 2006-3 (July 10, 2006).

177. *Id.*

178. Ark. Dep't of Ins. Directive No. 1-2005 (Mar. 28, 2005).

179. Ala. Dep't of Ins., Bulletin of June 26, 2007; Ala. Dep't of Ins., Bulletin of June 22, 2007; Idaho Dep't of Ins. Bulletin No. 07-3 (Apr. 2, 2007).

180. Pa. Ins. Dep't, STOLI Notice: Beware of Unusual Life Insurance Transactions (May 5, 2008).

181. L.A. Dep't of Ins. Bulletin No. 06-05 (Sept. 5, 2006).

needed. Currently, there are three primary approaches that states have considered in addressing SPIN-Life. The first approach attempts to prevent SPIN-Life transactions by requiring life insurance policy owners to wait five years before they can sell policies in the secondary market. Nebraska and North Dakota have passed legislation adopting this approach.[182] Iowa and West Virginia recently enacted similar legislation that prohibits a person from selling a policy within five years of its issuance, but that also requires viatical companies and brokers to disclose information to insurers if a policy is sold within five years of issuance, and classifies SPIN-Life policies as fraudulent viatical settlement acts.[183] Kansas enacted similar legislation.[184] Some groups such as the National Association of Insurance Commissioners ("NAIC") are also discouraging SPIN-Life policies by supporting the five-year prohibition on the selling of life insurance policies that are purchased with the intent to sell them on the secondary market.[185] The NAIC softens the blanket five-year prohibition on the settlement of SPIN-Life policies by allowing for exceptions involving terminal or chronic illness, divorce, death of a spouse, retirement, physical or mental disability preventing full-time employment, and bankruptcy.[186]

Although the above approach has the desirable effect of chilling the economic incentive to enter a SPIN-Life transaction by forcing policy owners and investors to wait five years before they can make a profit, it does not address the inherent problem that SPIN-Life transactions represent. SPIN-Life policies erode the distinction between an insurance contract and a wager or an investment. By merely prohibiting the sale of life insurance policies in the secondary market for a certain length of time after they are procured, insurance companies might still unknowingly enter into contracts (SPIN-Life policies) which they may not be authorized to enter in the first place since they are unregistered investment contracts, and arguably not true insurance contracts. If SPIN-Life policies are investment

182. N.D. CENT. CODE § 26.1-33.3-10 (Repl. Vol. 2007); NEB. REV. STAT. § 44-1110(1) (2008).

183. IOWA CODE ANN. § 508E.6 (2008); W. VA. CODE ANN. § 33-13C-2, -11 (2008).

184. KAN. STAT. ANN. § 40-5006 (2008). It should be noted that the Kansas statute recognizes that SPIN-Life policies violate the insurable interest requirement and are essentially wagers on human lives. *Id.* § 40-5002(*l*).

185. *STOLI Alert*, March, *supra* note 86, at 2.

186. *Id.* at 3. In addition to the exceptions to the five-year moratorium on the settlement of policies, the proposal allows for the selling of policies after two years if the insured paid the premium, if there was no agreement or intention to sell the policy at the inception of the contract, or the insured was not evaluated for settlement of the policy. *Id.*

contracts, they would be subject to federal securities regulation.[187] As such, it is proper for insurance companies to lobby Congress and state legislatures to pass legislation concerning SPIN-Life contracts and to treat them as distinct from insurance and even viatical or life settlements. If the distinction between investments such as SPIN-Life policies and true insurance contracts is not recognized and is ultimately lost, the favored federal tax exempt status of life insurance proceeds in general may be put in jeopardy.[188]

Certain states have taken a slightly different approach to SPIN-Life policies. Indiana recently enacted a statute to prohibit the sale of SPIN-Life policies entirely, classifying SPIN-Life policies as unfair and deceptive acts, but allowing policies to be sold after two years of being in force instead of requiring a five-year waiting period.[189] Hawaii and Kentucky have passed similar legislation.[190] The legislation in Kentucky, however, goes one step further and specifically allows insurers both to ask on life insurance applications whether the owner intends to use premium financing to pay for the policy, and to require the owner to certify that he is not entering the agreement in order to sell the policy later.[191]

The third and most aggressive approach to SPIN-Life policies, however, is the one adopted by Ohio. Every year, any insurer issuing life insurance policies in Ohio must have one of its officers file with the Ohio Insurance Department a description of the measures the insurer has taken to detect and prevent SPIN-Life policies.[192] In contrast to the proposed legislation in Kentucky that merely permits an insurance company to ask questions on life insurance applications to detect whether the transaction is a SPIN-Life situation, Ohio now *requires* insurance companies to ask questions on the application "that are reasonably structured to identify and prevent stranger-originated life insurance [(SPIN-Life)]."[193] In further distinction to any other state legislature's approach, Ohio considers "[a]ny contract,

187. *See supra* note 94 and accompanying text.

188. *See* Miller, *supra* note 61, at 509 (stating that the Internal Revenue Service considers the treatment of insurance under securities law as "relevant for federal income tax purposes").

189. IND. CODE ANN. §§ 27-8-19.8-20.1(a)–(b), 27-8-19.8-9.2 (LexisNexis 2008). Nevertheless, Indiana does not permit an insurer to deny payment or rescind a SPIN-Life policy if it has been in effect for more than two years. *Id.* § 27-1-12-44(b).

190. HAW. REV. STAT. § 431E-41 (2008); KY. REV. STAT. ANN. § 304.15-020(7)(a)(1)(k) (West 2008).

191. KY. REV. STAT. ANN. § 304.15-702(1) (West 2008).

192. OHIO REV. CODE ANN. § 3911.021 (West 2008).

193. *Id.* § 3916.05(B).

agreement, arrangement, or transaction . . . entered into for the furtherance or aid of a stranger-originated life insurance act, practice, arrangement, or agreement" to be "void and unenforceable."[194] In addition, Ohio requires life insurance companies to report to the state superintendent of insurance any person they suspect of engaging or having engaged in a SPIN-Life arrangement.[195]

Among the three approaches mentioned above, state legislatures would do well to follow elements of each. The Ohio stance of considering SPIN-Life policies void and unenforceable should be adopted because it reinforces the traditional distinction between true life insurance and transactions that are not essentially *insurance*, but are in fact wagers. In addition, state legislatures should require life insurance companies to create policies and procedures for detecting and preventing SPIN-Life policies, but forcing them to file such policies and procedures each year is an unnecessary burden once they are in place. State legislatures should also consider a statute similar to Kentucky's proposed legislation which allows companies to ask questions on applications to detect SPIN-Life transactions, and which requires owners to certify that they are not purchasing the policy in order to sell it later. States should also consider requiring a five-year waiting period on selling life insurance policies in the secondary market in order to reduce the economic incentive for SPIN-Life speculators. Classifying SPIN-Life policies as fraudulent, unfair, and deceptive actions with substantial fines would likely further deter people from entering such transactions. State legislatures should also refine what constitutes a valid insurable interest, making reference to the objective relationship required, and the subjective intent required.

Besides state legislatures passing new state statutes, a possible course of action is for state insurance departments to issue bulletins similar to those of Alabama, Arkansas, Idaho, Louisiana, Pennsylvania, and Utah and remind those interested in SPIN-Life policies that it is illegal for a person to procure or cause to be procured any policy that does not meet the insurable interest requirement. In addition, state insurance departments should encourage insurance companies and applicants to report the names of agents and brokers in order to create a list of those that have been involved with SPIN-Life policies. The state insurance departments should make such a list available to all insurance companies

194. *Id.* § 3916.172.
195. *Id.* § 3916.18(C)(3).

conducting business within state boundaries so that companies can be aware of such individuals.

With respect to insurance companies, a potential remedy is to add questions on life insurance applications regarding the applicant's purpose in seeking insurance, and specifically ask whether the applicant has plans to sell the policy on the secondary market. Although this would force many insurance companies to refile applications with the state insurance department in each state where they conduct business in order to have the application forms re-approved, it would provide an explicit way for companies to know if the transaction involves a SPIN-Life policy. This course of action helps insurance companies fulfill their "duty to use reasonable care not to create a situation which may prove to be a stimulus for murder."[196] It would also help them avoid any liability or penalties stemming from issuing something that may be an unregistered security.

Instead of altering life insurance applications, some companies have taken a different plan of action for discouraging SPIN-Life policies: raising premiums for elderly applicants.[197] Although actuarial calculations of pricing on certain products and age groups should be reevaluated, adjustments should not be applied in a blanket fashion to all products where premium amounts are not already underpriced. Such a plan would adversely affect elderly applicants who seek life insurance for legitimate reasons. In addition, raising premiums only on policies for elderly applicants does nothing in the long run to prevent similar SPIN-Life schemes involving younger applicants. Besides considering recalculation of premiums, insurance companies should at the very least notify agents and brokers that they refuse to enter into SPIN-Life arrangements.[198] Possible sanctions imposed by insurance companies on agents and brokers could include termination of continued business relations or deprivation of any commission on such policies.

196. Liberty Nat'l Life Ins. Co. v. Weldon, 100 So. 2d 696, 708 (Ala. 1957). For a discussion of a cause of action against insurance companies for the negligent issuance of life insurance policies, see Scott LeRoy Terry, Case Note, *Liability for Negligent Issuance of Life Insurance:* Bajwa v. Metropolitan Life Insurance Company, *804 N.E.2d 519 (Ill. 2004)*, 29 S. ILL. U. L.J. 379 (2005).

197. Duhigg, *supra* note 101, at 46.

198. Several companies have already issued such statements to agents and brokers. Silverman, *supra* note 101, at D1.

CONCLUSION

Contrary to what certain agents, brokers, and investors claim, SPIN-Life policies are not "free" and involve substantial risks to applicants, investors, agents, insurance companies, and the life insurance industry in general. Awareness of SPIN-Life policies has only recently been raised, and it is necessary to develop a unified understanding and solution to their introduction into the market. Underlying any solution should be the realization that a life insurance contract has certain requirements and that the insurance industry and private individuals have an interest in retaining a distinction between insurance, wagers, and investments. The insurable interest requirement and insurance risk have defined the insurance industry for centuries and remain relevant today. Congress, state legislatures, state insurance departments, and insurance companies should take measures to make SPIN-Life policies clearly distinct from insurance contracts, thereby preventing the death of life insurance by preserving its traditional definition and requirements.