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LIFE INSURANCE—INSURABLE INTEREST AND THE FREEDOM OF CONTRACT: WHY MEDICAID SETTLEMENT LEGISLATION CRACKS THE FOUNDATION OF THE LIFE INSURANCE INDUSTRY

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LIFE INSURANCE—INSURABLE INTEREST AND THE FREEDOM OF CONTRACT: WHY MEDICAID SETTLEMENT LEGISLATION CRACKS THE FOUNDATION OF THE LIFE INSURANCE INDUSTRY

Heather Harris *

Life insurance products must be distinguishable from financial instruments by including time-tested insurance safeguards. Congress should exercise its authority under the McCarran-Ferguson Act to permit insurance providers to offer and negotiate insurable interest as a contract term, and to price such policies accordingly.

State law mandates that a life insurance policy owner must have an insurable interest in the insured at the time of purchase. This does not apply to the transfer of ownership after the policy is in force. Life settlement companies purchase these policies for approximately one-third of the death benefit, becoming the owner and paying the remaining premiums. The company then receives the full death benefit when the insured dies.

Recent state legislation permits policy forfeiture in exchange for Medicaid benefits to the insured. The Medicaid applicant forfeits the life insurance policy in exchange for Medicaid qualification. Either the state or a third-party investor receives the death benefit when the insured dies, who may not be the policy owner.

Texas, Kentucky, Kansas, and Indiana have passed such legislation, and other states are actively considering proposals. At the time of contract formation, life insurers did not price these policies to cover payouts encouraged by this legislation. These financial losses will subsequently be passed to consumers,

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and jeopardize the future affordability of life insurance.

INTRODUCTION

> I am a committed defender of insurable interest. I consider a healthy concept of insurable interest to be essential to the effective functioning of the life insurance industry, and I view the mounting effort to erode that concept as the most dangerous development to the industry of the last generation.[1]

In the fictional story *The Hunger Games*, people—humans—are dropped into an arena to fight to the death.[2] Outsiders watch with substantial money at stake. The wagers are based on detailed information about each human "Tribute"; details that predict how much time each has left on this earth.

You abhor those who sent the humans to the arena for the violence they create. The spectators disgust you; the distaste in profiting from a human death stands independent of the distaste for violence and it shocks the conscience almost more than the violence itself. You are repulsed by them watching, that they are rooting for someone's demise. Strangers or not, there is something inherently wrong about the desire for death, something intrinsically menacing about profiting from a human passing. Wagering on human life turns the stomach, and violates a universal moral code.

Gambling on human life continues to encroach on the life insurance industry. Life insurance policies are sold to investors and valued based on how quickly the investor expects death; the shorter the life expectancy, the lower the financial risk, and the higher the bid.[3] As a gamble, the only loss is money. There is no sadness, no mourning, no bereavement attached to the bet.

The distinguishing feature between a life insurance policy sold to an investor and one retained by a loved one is the lack of insurable interest. An insurable interest is a benefit from the

1. Telephone Interview with Stephen C. Baker, Partner, Drinker Biddle & Reath (Sep. 10, 2014). Mr. Baker is a nationally known litigator, specializing in the defense of insurance companies in the secondary market of life insurance. Most notably for purposes of this Note, Mr. Baker defended Lincoln Life & Annuity Company of New York in the landmark case Kramer v. Phoenix Life Ins. Co., 940 N.E.2d 535 (N.Y. 2010). *Biography*, DRINKERBIDDLE, http://www.drinkerbiddle.com/people/attorneys/baker-stephen-c [https://perma.cc/97GU-JASQ] (last visited Feb. 22, 2016).

2. SUZANNE COLLINS, THE HUNGER GAMES (2008).

3. *Seniors Beware: What You Should Know About Life Settlements*, FINRA.ORG, http://www.finra.org/investors/alerts/seniors-beware-what-you-should-know-about-life-settlements [https://perma.cc/8BPB-YKQ6] (last visited Feb. 22, 2016) [hereinafter *Seniors Beware*].

"continued life of another."[4] According to the Supreme Court of the United States, "[a] man cannot take out insurance on the life of a total stranger, nor on that of one who is not so connected with him as to make the continuance of the life a matter of some real interest to him."[5]

Insurable interest is often referenced by the Supreme Court, which describes insurable interest as much by what the term attempts to prevent, wager policies, as by what is included: a man's own life, a family member's life and a creditor's relationship with a debtor.[6] The insurable interest requirement is in the interest of public policy.[7] Without insurable interest, "the [life insurance] contract does not have the same manifest utility and assumes more speculative characteristics which may subject it to the same general condemnation as wagers."[8] Insurance reduces risk, but wagers assume risk[9] and there is frankly "a sinister counter interest in having the life come to an end."[10]

In 1911, the Supreme Court held in *Grigsby v. Russell* that the insurable interest requirement of a life insurance contract[11] does not extend to the assignment of the policy once in force.[12] Therefore, after policy inception, the owner is free to assign[13] it to someone without an insurable interest.[14] Over the past century, this decision has turned the life insurance industry into an arena for investing and wagering on the lives of others.

The terrain now has a new player—states. In 2013, Texas became the first state to enact a life settlement program to fund

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

5. *Id.*

6. *Id.*; Grigsby v. Russell, 222 U.S. 149, 155–56 (1911) ("The very meaning of an insurable interest is an interest in having the life continue" and so "wagers came to be regarded as a mischievous kind of gaming.").

7. *Conn. Mut. Life Ins. Co.*, 94 U.S. at 460; Warnock v. Davis, 104 U.S. 775, 779 (1881) (reinforcing that wager policies are, "independently of any statute on the subject, condemned, as being against public policy.").

8. New England Mut. Life Ins. Co. v. Caruso, 73 N.Y.2d 74, 78 (1989).

9. Helvering v. Le Gierse, 312 U.S. 531, 539 (1941) ("Historically and commonly insurance involves risk-shifting and risk-distributing.").

10. *Grigsby*, 222 U.S. at 154.

11. At its root, a life insurance policy is a contract, and will be referred to as such when discussing the policy in the context of contract law. *Grigsby*, 222 U.S. 149, 155 ("[There is n]o question as to the character of that contract . . . before us.").

12. *Id.* at 149.

13. To consummate the sale of a life insurance policy, the rights of the policy are assigned to the purchaser. *Id.* at 149.

14. *Id.* at 157.

Medicaid;[15] other states are following suit.[16] States are diligently forming groups to study the financial impact of legislation, but the interests of insurers are mostly absent in these studies.[17]

A life settlement is the sale of a life insurance policy for value.[18] The life settlement market thwarts the basic tenet and purpose of life insurance—insurable interest.[19] "[L]ife insurance has become a major, if not the major, factor in the concern of men generally for the protection of their families and dependents."[20] The threat to the purpose, affordability, and sustainability of life insurance has escalated with the entrance of states in the life settlement market.[21] Congress should reestablish the role of insurable interest and, in response to current conditions, allow insurers the freedom to contract, thereby clarifying *Grigsby,* which is currently interpreted as enforcing a *right* to sell a life insurance policy, rather than enforcing a contract under its terms and applicable law.[22]

In order to allow insurers to respond to the new state legislation, Congress should enact federal legislation to permit insurers to offer and negotiate insurable interest as a contract term, and to price such policies accordingly. Allowing the life insurance industry to distinguish itself from the life settlement market will

15. TEX. HUM. RES. CODE ANN. § 32.02613 (West 2015).

16. *E.g.*, IND. CODE § 12-15-121.7 (2011); KAN. STAT. ANN. § 65-6233 (2015); KY. REV. STAT. ANN. § 205.631 (West 2014).

17. *E.g.*, COMM'N TO STUDY LONG-TERM CARE FACILITIES, FINAL REP., S. 126, 1st Sess., (Me. 2013), http://www.maine.gov/legis/opla/LTC2013reportpart1.pdf [https://perma.cc/6YRP-GWJ8].

18. *What is a Life Settlement?*, LIFE INS. SETTLEMENT ASS'N http://www.lisa.org/content/13/What-is-a-Life-Settlement.aspx [https://perma.cc/G74S-4Y9Q] (last visited Feb. 22, 2015); TEX. INS. CODE ANN. art. 1111A.002 (West 2011) (defining a life settlement contract as "a written agreement entered into between a provider and an owner establishing the terms under which compensation . . . will be paid . . . in return for the owner's assignment, transfer, sale, devise, or bequest of the death benefit.").

19. Helvering v. Le Gierse, 312 U.S. 531, 539 (1941) ("That life insurance is desirable from an economic and social standpoint as a device to shift and distribute risk of loss from premature death is unquestionable.").

20. Phoenix Mut. Life Ins. Co. v. Flynn, 171 F.2d 982, 985 (D.C. Cir. 1948).

21. Wm. Scott Page, *Texas Medicaid Law Could Transform Life Insurance Industry*, HUFFINGTON POST (Nov. 4, 2013, 5:12 AM), http://www.huffingtonpost .com/wm-scott-page/texas-medicaid-law-could_b_3837442.html [https://perma.cc/3D4X-AVK7]. ("The ramifications [of this legislation to life insurance companies] are enormous to say the least.").

22. Grigsby v. Russell, 222 U.S. 149, 157 (1911). The Court looked to the terms of the life insurance contract at issue, and "with no rule of law" requiring insurable interest, permitted the assignment. *Id.*

ensure the future viability of life insurance for the benefit of those who need it most.[23] Once federally authorized, insurers could offer two distinct life insurance policies: one with free assignability regardless of insurable interest at a higher premium, and one that is only assignable with insurable interest at the time of future sale at a reduced premium. Under this proposal, the insurance industry would bifurcate between the insurance product meant to financially protect those left behind after death—the classic life insurance product[24]—and a financial tool that enriches a stranger at the insured's death.[25]

This Note will trace the history of insurable interest beginning in England and continuing to its reception into the common law of the United States. It will then examine the Supreme Court's early perspective of insurable interest and the impact of these fundamental high-court decisions on the establishment of the secondary market. Next, this Note will compare the relationship that states have with insurable interest, and how states handle permutations of the secondary market.

Finally, this Note will argue that the most recent development in the evolution of insurable interest—i.e. states passing Medicaid settlement legislation in an attempt to defray state-funded healthcare costs for their respective residents—is contrary to the long-held support of insurable interest, and is dangerous to the solvency of the life insurance industry. This Note concludes with a federal call to action; a proposal to split the life insurance market from the life settlement market and allow the resulting insurance-product markets to determine the sustainability of the life settlement market when it cannot rely on insurance industry subsidization.

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23. A growing life settlement market threatens the life insurance industry. *See* U.S. SEC. AND EXCH. COMM'N, LIFE SETTLEMENTS TASK FORCE 20 (2010), http://www.sec.gov/news/studies/2010/lifesettlements-report.pdf [https://perma.cc/AH5F-VRSQ] ("While life settlements may impact insurer's profitability and financial condition[s] . . . the extent of this impact is likely to be small [due to] the very small percentage of [life insurance] policies that have been settled.").

24. *Id.* at V. ("[T]he historical social policy of insurance . . . is to protect families . . . from potential economic hardship caused by untimely death of the insured.") *Id.*

25. TEX. INS. CODE ANN. art. 1111A.002 (West 2011).

I. INSURABLE INTEREST

A. *Across the Ocean: The Birth of Insurable Interest*

Wager policies were outlawed in England by the Life Assurance Act of 1774[26] and this prohibition was integrated into the common law in the United States.[27] "[T]he concept [of insurable interest] is embedded"[28] in The Life Assurance Act of 1774 as a means to prevent wager policies.[29] This requirement of insurable interest in a life insurance contract was in response to historic wager policies that ended in the death of the insured.[30] In a wager, the beneficiary of life insurance has "no interest whatever"[31] in the insured remaining alive, yet does have an interest in the insured's death in the amount of the death benefit.[32] The dangers inherent in such fundamental conflicts of interest violate public policy.[33]

B. *Insurable Interest Historically in the United States*

As insurable interest "became firmly rooted in the common law of every state in the Union . . ."[34] the Supreme Court explored the lines that separated wager policies from those with insurable interest, defining and updating the concept along the way.[35] In 1876 the Supreme Court in *Schaefer* defined a wager policy as one in which the policy owner has "no interest whatever in the matter insured, but only an interest in its loss or destruction."[36] A wife purchased life insurance on her husband, but subsequent to the

26. Life Assurance Act, 14 Geo. 3 (1774) (U.K.), http://www.legislation.gov.uk/apgb/Geo3/14/48/section/1 [https://perma.cc/MK52-XGHY].

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

28. PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Trust ex rel. Christiana Bank & Trust Co., 28 A.3d 1059, 1069 (Del. 2011).

29. *Id.* ("Parliament enacted the Life Assurance Act of 1774 which prohibited the use of insurance as a wagering contract unlinked to a demonstrated economic risk.").

30. *Id.*

31. Campbell v. New England Mut. Life Ins. Co., 98 Mass. 381, 386 (1867).

32. *Id.*

33. *See*, *e.g.*, Wainwright v. Bland. (1865) 150 Eng. Rep. 334, https://archive.org/details/casesonlawofinsu00vanc [https://perma.cc/R49G-HVBG] (depicting Wainwright, an incorrigible criminal who poisoned Helen Abercromby with the deliberate purpose of obtaining the insurance money).

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

35. *See* Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457 (1876); Warnock v. Davis, 104 U.S. 775 (1881); Grigsby v. Russell, 222 U.S. 149 (1911).

36. *Conn. Mut. Life Ins. Co.*, 94 U.S. at 460.

purchase, the marriage ended and later still, the insured died.[37] No assignment took place. The purpose of life insurance, in the eyes of the Court, was the "well-grounded expectations of support" that would otherwise cease with the death of the insured.[38] Therefore, absent post-marital support obligations, the ex-wife no longer had an insurable interest in her former husband.[39] However, the Court held that the policy was not void for the former wife's cessation of insurable interest.[40] Citing English cases after the Life Assurance Act of 1774, the Court stated that while there must be an insurable interest at the effective date of life insurance, "it need not continue until death" and therefore, this was not a wager policy.[41]

Five years later the Supreme Court in *Warnock* again examined the insurable interest requirement after policy issuance.[42] This time, the policy owner sold the interest in a life insurance policy to a trust association with no insurable interest.[43] Here, the Court defined insurable interest as "a reasonable ground, founded upon the relations of the parties to each other, either pecuniary or of blood or affinity, to expect some benefit or advantage from the continuance of the life of the assured."[44] Without insurable interest, the policy becomes a wager because the owner "is interested in the death rather than the life of the party assured. The law ought to be, and we think it clearly is, opposed to such speculations in human life."[45] The Court limited the trust association's benefit to the amount the association had paid in premiums, with interest.[46]

The Court's remedy was similar to a collateral assignment. In a collateral assignment, there is a creditor-debtor relationship and therefore insurable interest because the creditor has an interest in the debtor surviving and paying the debt.[47] If the debtor dies before satisfying the debt, the creditor is entitled to the death benefit up to the amount of the existing debt.[48] Therefore, the

37. *Id.* at 457.
38. *Id.* at 461.
39. *Id.* at 462.
40. *Id.* In other words, there is no underlying legal or moral obligation.
41. *Id.*
42. Warnock v. Davis, 104 U.S. 775 (1881).
43. *Id.*
44. *Id.* at 779.
45. *Id.* at 780.
46. *Id.* at 781.
47. Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 460 (1876).
48. Luxton v. United States, 340 F.3d 659, 662 (8th Cir. 2003) ("Unlike an

creditor is made whole, but does not profit from the debtor's death.[49]

Warnock is valuable because the Court clarified that the insurable interest requirement extended beyond the inception of the policy.[50] The reason for requiring insurable interest at the purchase of the policy extends to assignment: "the same ground which invalidates the one should invalidate the other."[51] However, thirty years later the Supreme Court again addressed the issue.[52]

In 1911, the Supreme Court established the authority cited by the life settlement market as the basis for its very existence, *Grigsby v. Russell*.[53] In this seminal case, Mr. Burchard needed money for surgery.[54] As a way to fund the operation, Mr. Burchard sold his life insurance policy to Dr. Grigsby for one hundred dollars, and assigned the life insurance policy to Dr. Grigsby.[55] Mr. Burchard's death (about one year later)[56] was unrelated to the surgery.[57]

The Court reasoned that the sale between Mr. Burchard and Dr. Grigsby was "very different from granting such a general license, to allow [Mr. Burchard] to transfer it to one whom he, the party most concerned, is not afraid to trust."[58] This scenario lacked the "mischievous kind of gaming" objectionable since early English cases.[59] The Court in *Grigsby* distinguished itself from its holding in *Warnock* by stating that the policy in *Warnock* was purchased

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absolute assignment, which permanently transfers all rights in the policy to the assignee, a collateral assignment transfers only those rights necessary to secure the assignor's debt.").

49. *Id.*

50. *Warnock*, 104 U.S. at 779 ("The assignment of a policy to a party not having an insurable interest is as objectionable as the taking out of a policy in his name.").

51. *Id.* at 782.

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

53. *Id.*; *see Life Settlement Questions*, POLICY SETTLEMENT, http://policysettlement.com/q-and-a/ [https://perma.cc/J5EF-UNRK] (last visited Feb. 22, 2016) ("Life settlements were legalized in The United States in 1911 by [the] Supreme Court Decision [Grigsby v. Russell]."); *see also History of Life Settlements in the U.S.*, LIFE INS. SETTLEMENT ASS'N, http://www.lisa.org/content/51/life-settlement-history.aspx [https://perma.cc/T844-SRRL] (last visited Feb. 22, 2016) ("The legal basis for life settlements as a legitimate option for life insurance owners may be found in the *Grigsby v. Russell* decision from the U.S. Supreme Court.").

54. *Grigsby*, 222 U.S. at 154.

55. *Id.*

56. *History of Life Settlements in the U.S.*, *supra* note 53.

57. Russell v. Grigsby, 168 F. 577, 579 (6th Cir. 1909) *rev'd*, 222 U.S. 149 (1911).

58. Grigsby v. Russell, 222 U.S. 149, 155 (1911).

59. *Id.* at 156.

for the purpose of assignment.[60] However, a dying patient in need of surgery may have played on the *Grigsby* Court's sympathy causing it to grasp for a non-existent distinction because the *Warnock* Court made no such distinction.[61] *Grigsby* discussed the property rights often associated with life insurance policies, as well as the economic risk to the value of life insurance as an asset if these property rights were not upheld.[62] And thus came the secondary market for life insurance.

II. THE SECONDARY MARKET FOR LIFE INSURANCE

Despite the common law rule against wager policies, the practice of wagering still exists, continuously morphing in an attempt to overcome statutory or common law hurdles.[63] Today the life settlement industry and its permutations are taking the place of common law wager policies.[64] A life settlement is the sale of a life insurance policy for value.[65] The life settlement market has evolved from viatical settlements, to stranger originated life insurance, and most recently, to state enactment of Medicaid settlement legislation.[66]

A. *The Evolution of Insurable Interest in the United States:*

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60. *Id.*

61. Warnock v. Davis, 104 U.S. 775, 782 (1881) ("The same ground which invalidates the one [a policy at issuance] should invalidate the other [a subsequent assignment]—so far, at least, as to restrict the right of the assignee to the sums actually advanced by him.").

62. *Grigsby*, 222 U.S. at 156.

63. *See* Allison Schrager, *Investing in Other People's Life Insurance Makes a Comeback*, BLOOMBERG BUSINESS (July 30, 2014), http://www.bloomberg.com/news/articles/2014-07-30/life-settlements-investors-interest-in-life-insurance-grows [https://perma.cc/6NCL-XFUV] ("Life settlements were born of the related practice of buying the life insurance policies of those who are terminally ill," i.e., effecting viatical settlements.); *see also* Michael G. Koutnik, Comment, *Long Live Life Settlements: The Current Status and Proposed Direction of the Life Settlement Market*, 96 MARQ. L. REV. 913, 926 (2013) (Following viatical settlements, another "market, this time fraudulent, grew from the life settlement market: the STOLI policy market.").

64. *See Seniors Beware*, *supra* note 3 ("When you sell your life insurance policy, whoever buys it is acquiring a financial interest in your death.").

65. *What is a Life Settlement?*, *supra* note 18.

66. There are other forms of settlement in related industries, such as stranger originated annuity policies. Memorandum from the Nat'l Ass'n of Ins. Comm'r to All Insurers Selling Life Ins. or Annuities in the U.S. (2011), http://www.naic.org/documents/legal_bulletin_111018_stoa.pdf [https://perma.cc/B5F8-NH9T]; Elizabeth D. Festa, *NAIC Issues Bulletin Against Stranger-Originated Annuities*, LIFEHEALTHPRO (Oct. 12, 2011), http://www.lifehealthpro.com/2011/10/12/naic-issues-bulletin-against-stranger-originated-a [https://perma.cc/TKE8-FTLM]. Though there are many parallel concerns, these are beyond the scope of this Note.

Viatical Settlements

Modern life settlements originated in the 1980's as viatical settlements in response to the AIDS crisis.[67] A terminally ill person could sell an existing life insurance policy to a third-party that lacked an insurable interest in her life.[68] The investor paid the insured a lump sum in exchange for assignment of owner and beneficiary.[69] As treatment for AIDS improved, this market opened beyond the terminally ill and life settlement companies targeted seniors with Stranger Originated Life Insurance ("STOLI").[70]

B. *Stranger Originated Life Insurance*[71]

In a STOLI sale an investor solicits an elderly prospect and invites her to purchase a life insurance policy.[72] The investor pays the premiums, and after the contestability period,[73] the owner transfers ownership to this investor.[74] The investor pays a fee to the owner following the assignment,[75] and the owner gets free life

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67. Schrager, *supra* note 63.

68. James Vlahos, *Are You Worth More Dead Than Alive?*, N.Y. TIMES: SUNDAY MAGAZINE (Aug. 10, 2012), at MM30, http://www.nytimes.com/2012/08/12/magazine/are-you-worth-more-dead-than-alive.html.

69. *Id.*

70. Schrager, *supra* note 63.

71. Larry King, the well-known former talk show host, is one of the most prominent STOLI victims. Anita Huslin, *Wealthy Engage in Controversial Re-selling of Life Insurance Policies*, WASH. POST (Nov. 27, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/11/26/AR2007112602182.html. At the recommendation of his broker, King purchased $15 million in life insurance. *Id.* He then sold the policies for $1.4 million. Liam Pleven & Rachel Emma Silverman, *An Insurance Man Builds a Lively Business in Death*, WALL ST. J. (Nov. 26, 2007, 11:59 PM), http://online.wsj.com/articles/SB119604142916903531. King alleged that his broker did not review the tax implications of the transaction or the impact it would have on purchasing life insurance in the future, and was unhappy that he did not know the identity of those who would benefit from his death. Huslin, *supra*. He settled the dispute in 2008 without disclosing the terms. Mike Myers, *Larry King Settles Life Insurance Suit*, CONTINGENT FEE BUSINESS LITIGATION (Sept. 2, 2008), http://www.contingentfeeblog.com/2008/09/articles/life-insurance-1/larry-king-settles-life-insurance-suit/ [https://perma.cc/4MYN-YDYH].

72. Mary Ann Mancini & Caitlin L. Murphy, *The Elusive Insurable Interest Requirement: Are You Sure the Insured Is Insured?*, 46 REAL PROP. TR. & EST. L.J. 409, 439 (2012).

73. The contestability period is usually two years. *See, e.g.*, S.D. CODIFIED LAWS § 58-15-10 (2014) (After two years the policy is "incontestable, except for nonpayment of premiums or fraud on the part of the applicant or insured . . . .").

74. Mancini & Murphy, *supra* note 72.

75. *Id.*

insurance during the contestability period.[76] While *Grigsby* is cited to authorize the life settlement market,[77] by distinguishing *Warnock*, the Court explicitly denounced the STOLI market subset, taken out "for the purpose" of a stranger owning the policy where "a person having an interest lends himself to one without any, as a cloak to what is, in its inception, a wager . . . ."[78]

Life insurance policies have a limited contestability period, but in some states, fraud may be alleged outside the period.[79] When STOLI is litigated as the fraudulent purchase of a life insurance policy, an insurer must prove the intent of the purchaser at the inception of the contract.[80] The life insurance policy is "lawful only if . . . purchase[d] . . . with a good-faith intent to obtain insurance for the benefit of his family, loved one, or business; they are not lawful if . . . purchase[d] . . . with the intent to resell it to a stranger at the earliest possible moment."[81] Importantly, because litigation occurs after the third-party reports a death claim, it is often the deceased party whose intent is at issue.[82]

C. *State Action in STOLI*

In response to the negative effects of STOLI on consumers, many states have enacted legislation based on a hybrid of two model laws. First, the National Conference of Insurance Legislators ("NCOIL") proposed a model in 2007[83] with a waiting period of two years[84] between the purchase of a life insurance

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76. Vlahos, *supra* note 68; *see generally* Kramer v. Phoenix Life Ins. Co., 940 N.E.2d 535 (N.Y. 2010).

77. Whether *Grigsby* truly authorizes the life settlement market, or merely does not prohibit it will be discussed later in this Note. *See infra* Part V.C.

78. Grigsby v. Russell, 222 U.S. 149, 156 (1911).

79. *See* S.D. CODIFIED LAWS § 58-15-10 (2014) (After two years the policy "is incontestable, except for nonpayment of premiums or fraud on the part of the applicant or insured . . . ."). *But see* Protective Life Ins. Co. v. Sullivan, 682 N.E.2d 624, 625 (Mass. 1997) (holding that "insurer could not rescind policy for fraud after passage of two-year statutory contestability period").

80. Life Prod. Clearing, LLC v. Angel, 530 F. Supp. 2d 646, 648 (S.D.N.Y. 2008).

81. *Id.*

82. Until the obligations under the policy become due, the issue is not ripe for judicial review. *See* Order Granting Motion to Dismiss, Mosier v. Phoenix Life Ins. Co., 8:12-cv-00227-PSG-E (C.D. Cal. Aug. 7, 2012) ("[I]n so far as the Receiver's claims are based on the assertion the [sic] Phoenix [the insurer] plans to deny coverage under the Policies if and when they become due, absent an unequivocal statement by Phoenix to this effect, such allegations are not ripe for review.").

83. NCOIL LIFE SETTLEMENTS MODEL ACT (NAT'L CONFERENCE OF INS. LEGISLATORS 2007), http://www.insurereinsure.com/files/upload/2005368I.pdf.

84. This time period matches the contestability period in most states. *See, e.g.*, S.D. CODIFIED LAWS § 58-15-10 (2014). However, the contestability period refers to

policy and when it may be sold to a party lacking insurable interest;[85] the model explicitly defines and prohibits STOLI.[86] Second, in 2009, the National Association of Insurance Commissioners ("NAIC") proposed its own model act that expands the waiting period on life settlements to five years[87] but lacks recourse for premium financing, one of the techniques to fund STOLI.[88] Many state laws reflect these models,[89] actively working to prevent STOLI because it is dangerous to allow investments that thwart the purpose of purchasing life insurance.[90] New York and California are examples of states that did not adopt either model.

In New York,[91] the intent of the original purchaser of a life insurance policy does not matter, as decided in *Kramer v. Phoenix Life Insurance Company*.[92] The New York Court of Appeals held that New York law incorporates the common law understanding that a policy "valid at the time of procurement" may be assigned to a party not having an insurable interest, as long as the policy was "'valid in its inception.'"[93] The decision to purchase the life

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the time period when an insurer may challenge the contract (for a reason besides fraud or unpaid premiums). The waiting period in this NCOIL model prevents an owner from selling the policy during that time. NCOIL LIFE SETTLEMENTS MODEL ACT (NAT'L CONFERENCE OF INS. LEGISLATORS 2007), http://www.insurereinsure.com/files/upload/2005368I.pdf. Although the time periods align, the two laws address two unique issues.

85. *See, e.g.*, MASS. GEN. LAWS ch. 175, § 223A (2014). Massachusetts has adopted the NCOIL model, requiring a two-year waiting period for settlement following issuance, with certain exceptions. *Id.*

86. NCOIL LIFE SETTLEMENTS MODEL ACT (NAT'L CONFERENCE OF INS. LEGISLATORS 2007), http://www.insurereinsure.com/files/upload/2005368I.pdf.

87. NAIC VIATICAL SETTLEMENTS MODEL ACT § 11(a) (NAT'L ASS'N OF INS. COMM'RS 2009), http://www.naic.org/store/free/MDL-697.pdf.

88. *Id.* Premium financing is an arrangement where the premium is paid as a loan, and the life insurance policy itself serves as collateral for the loan. It is an indicator of STOLI, but there are legitimate premium finance arrangements. U.S. SEC. AND EXCH. COMM'N, *supra* note 23, at 11.

89. *See* Mary Jo Hudson, Baily Cavalieri LLC, Life Settlements & STOLI A Case Law Update, Presentation at the NAIC CLE 15 (2013), http://baileycavalieri.com/165-Life%20Settlements%20and%20STOLI.pdf [https://perma.cc/P5M8-P8E8]. As of 2013 nine states had a five year waiting period, one state had a four year waiting period, and twenty one states had a two year waiting period before a life insurance policy may be sold. The other nineteen states did not incorporate either model into their insurable interest laws. *Id.*

90. NCOIL LIFE SETTLEMENTS MODEL ACT (NAT'L CONFERENCE OF INS. LEGISLATORS 2007) 1, http://www.insurereinsure.com/files/upload/2005368I.pdf.

91. Similar to New York, New Jersey does not prohibit STOLI. Donna Horowitz, *2013 saw end of market's decline*, THE DEAL PIPELINE (June 19, 2014), (Special Report) at 1, http://www.thedeal.com/pdf/2013LSSpecialReport.pdf [https://perma.cc/KZL7-BGK5].

92. 940 N.E.2d 535, 536–537 (N.Y. 2010).

93. *Id.* at 541.

insurance policy must be "free from nefarious influence or coercion," but, absent this, the intent to immediately sell the policy after purchase is irrelevant.[94] While reaching a decision so contrary to the majority of states, the court recognized that there is "tension between the law's distaste for wager policies" and the court's holding, but reiterates that this "is not [the court's] role" as it simply interprets the law.[95] The court found that New York law does not prevent STOLI if the purchaser had an insurable interest at that moment, regardless of an intent to sell.[96]

California's law is a stark contrast to New York's. California recognized that its insurable interest law could not combat STOLI as it evolved, despite the best attempts of insurers.[97] Investors create new ways to skirt the law: for example, purchasers would create a "shell third-party entity"—like a trust—to mask STOLI and allow truthful responses on the life insurance application meant to prevent STOLI.[98] In response to STOLI's persistence, California law now addresses the issue of the *straw man*,[99] stating that "[a]ny device, scheme, or artifice designed to give the appearance of an insurable interest where there is no legitimate insurable interest violates the insurable interest laws."[100]

D. *The "Legitimate" Secondary Market for Life Insurance: Life Settlements*

Though STOLI is illegal in most states, it is merely a subset of a much larger life settlement market.[101] While most states have

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94. *Id.*

95. *Id.* at 542.

96. *Id.* ("It is not our role, however, to engraft an intent or good faith requirement onto a statute that so manifestly permits an insured to immediately and freely assign such a policy.").

97. Lincoln Nat'l Life Ins. Co. v. Gordon R.A. Fishman Irrevocable Life Trust, 638 F. Supp. 2d 1170, 1179 (Cal. 2009) ("[T]he [California] law as it presently exists allows this kind of insurance arrangement to be valid. . . . [I]t is perhaps best to follow the wisdom expressed long ago by President Ulysses S. Grant, who said that 'the best way to get rid of a bad law is to enforce it.'").

98. Am. Gen. Life Ins. v. Goldstein, 741 F. Supp. 2d 604, 608 (D. Del. 2010) ("In order to conceal the nature of [STOLI] policies, the insured individual will often designate the policyholder and/or beneficiary of the proceeds to be a shell third-party entity such as a trust, and then transfer the beneficiary interest [in the trust, rather than the life insurance policy] to a STOLI entity after obtaining the policy."). This way, there is no beneficiary change through the insurer to raise suspicions. *Id.*

99. CAL. INS. CODE § 10110.1 (West 2010).

100. *Id.*

101. JOSEPH E. LASKA, THE LATEST DEVELOPMENTS IN STOLI AND OTHER SCHEMES 53 (2012), http://online.fliphtml5.com/gxrx/hmch/#p=1 [https://perma.cc/

enacted legislation to prevent STOLI (i.e. life insurance originated by, and purchased on behalf of, a stranger, third-party investor), this state action is not meant to eliminate life settlement transactions as a whole.[102] It is legal to sell a life insurance policy that was purchased in good faith and with insurable interest.[103]

1. The Life Settlement Market by the Numbers

There are two payouts in a life settlement. First, the investor pays the current owner a settlement price at the time of settlement, i.e., assignment.[104] Second, the new owner as beneficiary collects the death benefit at the insured's death.[105] The policy's face value along with other factors, such as the insured's age, medical history, and life expectancy, determine the settlement price.[106]

The life settlement market is a small fraction of the whole life insurance industry. The aggregate face value of life insurance in the United States in 2010 was $18 trillion.[107] By comparison, in 2014 the aggregate face value of policies in the life settlement market totaled only $32 billion.[108] The life insurance industry wrote $130 billion in new premiums in 2012.[109] In 2013 only $2.57 billion (in face value) of life insurance policies were sold in the secondary

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842Q-6TPE] ("Currently 39 states have either banned STOLI or have introduced legislation to do so.").

102. CAL. INS. CODE § 10110.1 (West 2010) (While an "insurable interest shall . . . exist at the time the contract of life . . . insurance becomes effective, [it] need not exist at the time the loss occurs.").

103. *See Life Settlement Questions*, *supra* note 53.

104. Pleven & Silverman, *supra* note 71.

105. *Id.*

106. *Seniors Beware*, *supra* note 3 ("When you sell your life insurance policy, whoever buys it is acquiring a financial interest in your death."). It is, thus, a legal forum to wager on another person's life (where the person has already validly procured life insurance and is now willing to sell such coverage). James Vlahos, *Are You Worth More Dead Than Alive?*, N.Y. TIMES: SUNDAY MAGAZINE (Aug. 10, 2012), at MM30, http://www.nytimes.com/2012/08/12/magazine/are-you-worth-more-dead-than-alive.html. ("For all the advancements that aim to make life-expectancy science more precise, death remains one of the most uncertain certainties around. When you invest in an individual life settlement, you are placing a bet.").

107. EY, CONTRIBUTIONS OF THE LIFE INSURANCE INDUSTRY TO THE US ECONOMY 3 (2014), https://www.acli.com/Issues/Taxes/Documents/EY_ACLI-Life-Insurance-Industry-Contributions.pdf [https://perma.cc/6UMU-ZR7U].

108. Press Release, Conning, Life Settlements and Secondary Market Annuities: Opportunities and Challenges (Oct. 14, 2015) https://www.conning.com/pressrelease-detail.aspx?id=12916 [https://perma.cc/BN9L-KEMY].

109. FED. INS. OFFICE, U.S. DEP'T OF THE TREASURY, ANNUAL REPORT ON THE INSURANCE INDUSTRY 14 (June 2013), http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/FIO%20Annual%20Report%202013.pdf [https://perma.cc/2F38-79XW].

market.[110] Fifteen life settlement companies dominate the industry, controlling almost 87% of the market and generating 1,281 settlements in 2013.[111] These policies had a face value of $2.23 billion and settled for $362 million, an average settlement payout of 16.2%.[112]

Even though the life settlement market is small in proportion to the life insurance industry, it is growing.[113] The life settlement market grew by over 20% from 2012 to 2013,[114] and is estimated to grow from $35 billion in 2013[115] to $150 billion within ten years.[116]

2. Lapse Rates in the Life Insurance Industry

Not all life insurance policies are in force at the time of the insurable event—the insured's death—a significant number lapse.[117] This is a factor for life insurance companies in setting policy premiums.[118] General life insurance lapse rates are reported at 85%,[119] or even 88%, though not disclosed by insurance companies.[120] The lapse rate for the population targeted by the life settlement industry, those over sixty-five years old, is near 35%.[121]

3. State Regulation of Life Settlements

Some state laws regulate contact between the owner of the life

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110. Horowitz, *supra* note 91, at 1.

111. *Id.* at 4. The fifteen top life settlement companies in 2013 include the following: Coventry First, Magna Life Settlements Inc., Settlement Group Inc., Life Equity LLC, Abacus Settlements LLC, Legacy Benefits LLC, Berkshire Settlements Inc., CMG Life Services, FairMarket Life Settlements Corp., Institutional Life Services LLC, GWG Life Settlements, Habersham Funding LLC, Maple Life Financial Inc., RiverRock Partners LLC, Montage Financial Group Inc. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. Laura Davison, *Pay for Death-Bet Middlemen Fuels Risk, Conning Says*, BUS. WK. (Sept. 29, 2014, 6:51 PM) http://swissinfo.ch/eng/compensation-for-death-bet-middlemen-fuels-risk--conning-says/40806762 [https://perma.cc/96NB-LFVC].

116. Huslin, *supra* note 71.

117. DELOITTE CONSULTING LLP & THE UNIVERSITY OF CONNECTICUT, THE LIFE SETTLEMENTS MARKET: AN ACTUARIAL PERSPECTIVE ON CONSUMER ECONOMIC VALUE 12 (2005), http://www.quatloos.com/uconn_deloitte_life_settlements.pdf [https://perma.cc/NM2L-Z5HE].

118. *Id.*

119. *See* Huslin, *supra* note 71.

120. DELOITTE CONSULTING LLP, *supra* note 117, at 12.

121. *Id.* Perhaps as people age, mortality is easier to accept and the value of the death benefit significantly outweighs the premiums due. In addition, the longer a person has owned a life insurance policy, the more they have invested in it.

insurance and the insured.[122] For example, the owner-investor may only contact a healthy insured once every three months to verify her health status—if she is still living, but may contact an unhealthy insured, someone with a life expectancy of less than one year, once every thirty days.[123] States also regulate the disclosures required prior to the life settlement—a free-look provision,[124] and privacy requirements regarding the medical information are submitted to determine the value of the policy.[125]

4. Tax: the Transfer for Value Rule

While many states regulate the practice of a life settlement transaction, it is the Internal Revenue Service ("IRS") that regulates the proceeds.[126] The IRS treats the proceeds of a life settlement differently than the death benefit of a policy.[127] Life insurance, the "favored child of the Internal Revenue Code,"[128] has unique tax privileges.[129] Generally, a life insurance death benefit is not taxed as gross income under the Internal Revenue Code ("Code").[130] One exception to this special treatment is a life insurance policy that is transferred for valuable consideration.[131] Under the transfer for value rule, a death benefit paid in a life settlement exceeding the consideration and premiums paid for the

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122. *E.g.*, CONN. GEN. STAT. § 38a-465 (2015); MASS. GEN. LAWS ch. 175 § 220 (2015); N.Y. INS. LAW § 7811 (McKinney 2009); OR. REV. STAT. § 744.364 (2014); UTAH CODE ANN. § 31A-36-109 (West 2015).

123. OR. REV. STAT. § 744.364 (2015). The owner-investor may be tempted to have more frequent contact in order to file death claims as soon as possible and receive the death benefit.

124. A free-look provision is a period of time, often ten days, in which a purchaser of life insurance may renege the contract without penalty. *See, e.g.*, S.D. CODIFIED LAWS § 58-15-8.1 (2015).

> [A person may] return the policy . . . within ten days [and] have the premium paid refunded if, after examination of the policy, the purchaser is not satisfied . . . for any reason . . . . [I]t is void from the beginning and the parties are in the same position as if no policy had been issued.

Id.

125. *E.g.*, MASS. GEN. LAWS ch. 175, § 220 (2015).

126. I.R.C. § 101 (2013).

127. *Id.*

128. Donald O. Jansen & Lawrence Brody, *The Often Overlooked Income Tax Rules of Life Insurance Policies*, TAX'N PLAN. AND COMPLIANCE INSIGHTS, Autumn 2013, at 56, http://www.willamette.com/insights_journal/13/autumn_2013_6.pdf [https://perma.cc/Y65S-LYLP].

129. I.R.C. § 101 (2013).

130. I.R.C. § 101(a)(1) (2013).

131. I.R.C. § 101(a)(2) (2013).

assignment is taxable as gross income.[132]

There are two related exceptions to the taxation of life insurance benefits. First, accelerated death benefits of a life insurance policy are not taxed under the Code.[133] An accelerated death benefit is an additional, negotiable term of a life insurance contract whereby the insured may receive a portion of the death benefit early if she is terminally or chronically ill.[134] Not all life insurance policies carry this feature since it is an optional term of the contract.

Second, the Code also makes an exception for viatical settlements.[135] A viatical settlement is the same as a life settlement, except that the seller must be terminally or chronically ill to qualify for the settlement.[136] If a terminally or chronically ill person does not have an accelerated death benefits rider on her policy, she may still sell the policy to a qualified viatical settlement company.[137] Under these circumstances, the IRS treats the amount paid to the insured by the viatical settlement company as a death benefit, and not taxed.[138]

These two exceptions to the transfer for value rule created confusion about how to tax a life settlement. In response, the IRS issued two revenue rulings in 2009.[139] The first of these revenue rulings demonstrated that in a life settlement, the amount realized by the seller of the policy is income under the Code.[140] The second revenue ruling clarified that the profit incurred from a death benefit following a transfer for valuable consideration is taxed as gross income.[141] With these clarifications, the IRS was unambiguous that the life settlement market is not entitled to the tax benefits of life insurance.[142]

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132. *Id.*

133. I.R.C. § 101(g) (2013).

134. *Id.*

135. This exception was implemented with the passage of HIPAA in 1996. Gary J. Gasper, *New Tax-Free Treatment of Viatical Settlements*, THE CPA J., May 1997.

136. Terminal illness is an illness with a life expectancy under twenty-four months. NAIC Viatical Settlements Model Act, *supra* note 87, at 697–5. A chronic illness is when the person is unable to perform two activities of daily living (specified in the Act), requires substantial supervision, and has a level of disability comparable to the definition provided by the Secretary of Health and Human Services. *Id.* at 697–2.

137. Gasper, *supra* note 135.

138. I.R.C. § 101(g)(2)(A) (2013).

139. Rev. Rul. 2009-13 I.R.B.; Rev. Rul. 2009-14 I.R.B.

140. Rev. Rul. 2009-13 I.R.B (Situation 2).

141. Rev. Rul. 2009-14 I.R.B.

142. Jansen & Brody, *supra* note 128, at 56.

5. The Life Settlement Market Abroad

The life settlement market attracts investors beyond the United States.[143] The United States is the largest secondary market for life insurance, followed by Japan and the United Kingdom;[144] Germany most recently joined the market in 1999.[145]

Although life settlements have been legal in the United Kingdom since 1844,[146] they are disfavored in the retail market by financial regulators.[147] In 2012 the Financial Services Authority ("FSA")[148] called traded life policy investments ("TLPIs") "toxic."[149] The Financial Conduct Authority ("FCA")[150] calls them "death bonds," and explains that the insured's are "typically . . . US citizens."[151] These "schemes" are "high–risk," additionally they are "offshore and so outside of [its] regulatory scope."[152]

Canadian law restricts trafficking life insurance policies.[153] In

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143. *The Secondary Markets for Life Insurance*, BVZL INT'L SECONDARY MKTS. FOR LIFE INS., http://www.bvzl.de/index.php?language=en&main_id=15&sub_id=57 [https://perma.cc/H9GK-Z2P6] (last visited Feb. 22, 2016).

144. *The UK Secondary Market*, BVZL INT'L SECONDARY MKTS. FOR LIFE INS., http://www.bvzl.de/index.php?language=en&main_id=15&sub_id=59 [https://perma.cc/6LZL-K56G] (last visited Feb. 22, 2016).

145. *The Secondary Markets for Life Insurance*, *supra* note 143.

146. *Id.*

147. *Traded life policy investments*, FIN. CONDUCT AUTHORITY, http://www.fca.org.uk/consumers/financial-services-products/investments/types-of-investment/traded-life-policy-investments [https://perma.cc/2JNU-7XBM] (modified Feb. 14, 2014).

148. This regulatory authority has since been split in two, the Financial Conduct Authority and the Prudential Regulation Authority. FSA, http://www.fsa.gov.uk [https://perma.cc/BHV3-4PB9] (last visited Nov. 30, 2015).

149. Natalie Holt, *Consumers Hit Out at FSA Over Life Settlements*, MONEY MARKETING (Aug. 16, 2012, 8:00 AM), http://www.moneymarketing.co.uk/consumers-hit-out-at-fsa-over-life-settlements/1056262.article [https://perma.cc/26AN-VTHL].

150. *How We Operate*, FIN. CONDUCT AUTHORITY, http://www.fca.org.uk/about/governance [https://perma.cc/KN4P-MWLN] (last visited Feb. 22, 2016) (The FCA is "accountable to the Treasury and, through them, to Parliament.").

151. *Id.*; *Traded life policy investments*, FIN. CONDUCT AUTHORITY, http://www.fca.org.uk/consumers/financial-services-products/investments/types-of-investment/traded-life-policy-investments [https://perma.cc/2JNU-7XBM] (last modified Feb. 14, 2014).

152. *Traded life policy investments*, FIN. CONDUCT AUTHORITY, http://www.fca.org.uk/consumers/financial-services-products/investments/types-of-investment/traded-life-policy-investments [https://perma.cc/2JNU-7XBM] (last modified Feb. 14, 2014).

153. Insurance Act, R.S.O. 1990, ch. I.8, § 115 (Can.) ("Any person . . . who trafficks or trades in life insurance policies for the purpose of procuring the sale, surrender, transfer, assignment, pledge or hypothecation thereof to himself, herself or itself or any other person, is guilty of an offence.").

Ontario, however, the Financial Services Tribunal determined that this restriction is limited to Canadian life insurance policies.[154] And thus, Canadian investors actively participate in the US life settlement market.[155]

The US life settlement market is attractive to foreign investors for many reasons. First, unlike the term[156] and endowment[157] products primarily offered to the secondary markets in the United Kingdom and Germany, the US life settlement market is largely made up of permanent policies[158] (whole life and universal life).[159] Second, in countries such as Canada, life settlements are largely banned within the provinces, so investors cross the border to participate.[160] Third, if premiums are paid, there is a guaranteed payout because death is a certainty—the only unknown is when. Therefore, the life settlement market attracts investors beyond US borders, but the lives being gambled on are largely those of US citizens.

154. *Trading in life insurance policies*, FIN. POST, http://www.financialpost.com/story.html?id=8a7866a1-f652-434a-a18d-1eb4c301b38e [https://perma.cc/7KT8-YXC5] (last visited Feb. 22, 2016).

155. Tara Perkins, *Manulife unit battles U.S. 'life settlements' industry*, THE GLOBE AND MAIL (Aug. 23, 2012, 4:56 PM), http://www.theglobeandmail.com/globe-investor/manulife-unit-battles-us-life-settlements-industry/article573948/ [https://perma.cc/8CCR-JUSY].

156. Term life insurance provides coverage for a certain period of time, normally between one and thirty years. *Life Insurance Basics*, INS. INFO. INST., http://www.iii.org/article/life-insurance-basics [https://perma.cc/S7RH-7BH3] (last visited Feb. 22, 2016).

157. An endowment policy is an investment tool that also includes term life insurance. If the insured dies during the term, a death benefit is paid. Amy Fontinelle, *The Pros Of An Endowment Life Insurance Policy*, INVESTOPEDIA, http://www.investopedia.com/articles/pf/12/endowment_life_insurance.asp (last visited Feb. 22, 2016).

158. Permanent life insurance remains in force until the insured's death if all premiums are paid. *Life Insurance Basics*, *supra* note 156.

159. *The Secondary Markets for Life Insurance*, *supra* note 143. Both whole life and universal life insurance is a type of permanent policy, but with universal life insurance the premiums are more flexible. *Life Insurance Basics*, *supra* note 156. As cash value accumulates in the policy, the policy owner has the option to reduce the premium payments as long as the interest earned on the cash value is sufficient. *Id.*

160. Perkins, *supra* note 155.

III. STATE PARTICIPATION IN THE LIFE SETTLEMENT MARKET: MEDICAID SETTLEMENTS[161]

The US life settlement market has not only attracted global players, but also the attention of state governments struggling to reduce deficits.[162] In 2013 Texas became the first state to enact Medicaid settlement legislation, in which Medicaid candidates could sell their life insurance policy to an investor and use the settlement funds to finance long-term care.[163] Medicaid normally has a five-year look-back period where transfers of assets are evaluated for qualification.[164] Under Medicaid settlement legislation, the policy that is subject to the settlement is not considered an asset despite the transaction occurring within five years of the application.[165] In exchange for waiving the look-back, this financing technique delays the implementation of tax-funded Medicaid benefits for the candidate, saving the state significant money.[166] Other states are now following.[167]

Medicaid settlement legislation has two forms: the private option and the public option.[168] States such as Kentucky and Texas adopted the private option, while other states such as Florida and Louisiana propose making both options available.[169] Kansas and

161. The term "Medicaid Settlements" is the phrase used by the American Council of Life Insurers (ACLI) to describe the legislation discussed in this Note. Presentation given by The Honorable Robert Damron, et al. on Medicaid Settlements to the 2013 ACLI Annual Conference, 2 (Oct. 2013) (on file with author). Recognizing the influence of the ACLI, and the likelihood that this phrase will be commonly used in the future, this Note adopts the ACLI term.

162. *E.g.*, ST. OF ME. FINAL REP. OF THE COMM'N TO STUDY LONG-TERM CARE FACILITIES LEGIS. 126 (2013).

163. TEX. HUM. RES. CODE ANN. § 32.02613 (West 2015).

164. *Glossary*, LONGTERMCARE.GOV, http://longtermcare.gov/the-basics/glossary/#Look_Back_Period (last visited Feb. 22, 2016).

165. TEX. HUM. RES. CODE ANN. § 32.02613 (West 2015).

166. ADVISORY WORK GROUP REP. OF S. CON. RES. 104, at 4 (La. 2013) http://www.ldi.la.gov/docs/default-source/documents/publicaffairs/annualreports/scr-104.pdf?sfvrsn=4 [https://perma.cc/GR44-CD7M]; FLA. AGENCY FOR HEALTH CARE ADMIN., ACCELERATED LIFE BENEFITS TECHNICAL ADVISORY WORKGROUP 7 (Jan. 15, 2013) http://www.lifecarefunding.com/pdfs/florida-medicaid-legislative-report.pdf?file=2013/1/Florida+Medicaid+Legislative+Report+and+Bill+Policy+Conversions+to+Long+Term+Care+2013.pdf [https://perma.cc/BG6Q-7QP2] [hereinafter "Accelerated Life Benefits Tech. Advs'y Workgroup"].

167. *E.g.*, IND. CODE § 12-151-21.7 (2015); KAN. STAT. ANN. § 65-6233 (2015); KY. REV. STAT. ANN. § 205.631 (West 2014).

168. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 8.

169. KY. REV. STAT. ANN. § 205.631 (West 2014); TEX. HUM. RES. CODE ANN. § 32.02613 (West 2015); Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 7; ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166.

Indiana passed legislation for the public option.[170] A New Jersey bill creating the public option is currently pending after a similar bill did not pass during the 2012–13 legislative session.[171]

A. *The Medicaid Program*

Medicaid is a joint state and federal program that "finances health care for the poor."[172] However, with the cost of long-term care, "[t]hose who have been solidly middle class or more for their entire adult lives are forced to rely on Medicaid . . . ."[173] The "gray tsunami" of baby boomers are reaching the age where they may need long-term care, and the Medicaid system cannot handle the influx.[174] States finance their portion through "permissible taxes" and "legislative appropriations."[175]

To qualify for Medicaid, a candidate must have limited assets and income.[176] Privately held life insurance policies can disqualify a candidate for Medicaid coverage.[177] As a result, Medicaid candidates often forfeit life insurance in order to "spend down" their assets.[178] Medicaid settlement legislation proposes two alternatives to the current forfeiture options.[179]

B. *The Private Option*

A Medicaid settlement through the private option is very similar to a private life settlement as is currently practiced in the secondary market.[180] A Medicaid candidate finds a life settlement

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170. IND. CODE § 12-15-2-17 (2015); KAN. STAT. ANN. § 65-6233 (2015).

171. LA. DEP'T OF INS., HCR 210 OF THE 2014 REGULAR SESSION: USE OF VIATICAL SETTLEMENT FOR LONG-TERM CARE OF MEDICAID APPLICANTS 3–4 (2014), http://www.ldi.louisiana.gov/docs/default-source/documents/legaldocs/hcr-210-14.pdf?sfvrsn=10 [https://perma.cc/P8TJ-GD7V].

172. BARRY R. FURROW ET AL., HEALTH LAW 585 (2nd ed. 2000).

173. Public Hearing on LD 1092 Before the Joint Standing Committee on Insurance and Financial Services, 2013 Leg., 126th Sess. (Me. 2013) (statement of Richard A. Erb, President and CEO Maine Health Care Association) http://www.mainelegislature.org/legis/bills/getTestimonyDoc.asp?id=9065 [https://perma.cc/A8NR-FEEK].

174. *Id.*

175. *Financing & Reimbursement*, MEDICAID.GOV, http://www.medicaid.gov/medicaid-chip-program-information/by-topics/financing-and-reimbursement/financing-and-reimbursement.html [https://perma.cc/T6T4-TRU3] (last visited Feb. 22, 2016).

176. ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 2.

177. *Id.*

178. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 7; Page, *supra* note 21.

179. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 9.

180. *Id.* at 8–10. If the life settlement company is aware of the pending Medicaid

company willing to purchase her life insurance policy and transfers ownership to the investor.[181] The difference between the Medicaid settlement through the private option and a normal life settlement is that, under the state Medicaid settlement legislation, the proceeds from the settlement go to an irrevocable bank account, and the funds may only be used for long-term care.[182] Following this transaction, the settlement funds will not disqualify a candidate for Medicaid.[183] Current information available on this legislation does not state whether the settlement proceeds are taxed as income.[184]

C. *The Public Option*

The public option bypasses the third-party investor.[185] Instead, the state acts as a fiduciary in the life insurance transaction.[186] Under this option, the Medicaid applicant irrevocably assigns the state as the primary beneficiary of her policy.[187] In return, the state takes over paying the premiums and makes periodic payments to the applicant to reimburse the cost of long-term care.[188] Current state agencies would administer the process.[189]

The public option is considered a collateral assignment, and when the insured dies the state is reimbursed for the cost of paying the Medicaid benefits and premiums.[190] Any remaining funds are paid to the "named beneficiaries of the policy."[191] The Florida legislation does not address that the insured and the policy owner need not be the same person, in other words, the owner of the asset

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denial, the bargaining power will significantly swing to their favor. *See supra* Part II.D.

181. *See* TEX. INS. CODE ANN. art. 1111A.002 (22) (West 2011).

182. S.B. 794, 2013 Leg., 115th Reg. Sess. (Fla. 2013), Bill Analysis and Fiscal Impact Statement, at 6, http://www.flsenate.gov/Session/Bill/2013/0794/Analyses/2013s0794.cf.PDF [https://perma.cc/ED2X-DFFB].

183. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 10. Medicaid typically has a "[f]ive-year period prior to a person's application for Medicaid payment of long-term care services [where the] agency determines if any transfers of assets have taken place during that period that would disqualify the applicant from receiving Medicaid benefits for a period of time called the penalty period." *Glossary*, *supra* note 164.

184. *E.g.*, Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166.

185. *Id.* at 9–10.

186. *Id.* at 10.

187. *Id.* at 9.

188. *Id.* at 10.

189. *Id.* at 9.

190. S.B. 794, 2013 Leg., 115th Reg. Sess. (Fla. 2013), Bill Analysis and Fiscal Impact Statement, *supra* note 182 at 7.

191. *Id.*

might not be the insured.[192]

D. *The Cost of Medicaid and the Savings of Medicaid Settlements*

Medicaid is the third largest government program, having a budget of $265 billion per year.[193] In the next ten years, annual federal Medicaid funding is expected to reach $554 billion.[194] The states pay an additional $160 billion a year for Medicaid.[195] It is "estimated that 70 percent of Americans who reach the age of 65 will need some kind of long-term care for at least three years during their lifetime."[196] These long-term care costs, if not privately funded, are covered by Medicaid even for those over 65 because Medicare does not cover long-term care.[197] Long-term care ranges from a private nursing home room with a national average annual cost exceeding $90,000 in 2012 to a home health aide for $21,000 a year.[198]

Florida studied the cost savings of the proposed Medicaid settlement legislation through the Center for Economic Forecasting and Analysis.[199] The Center's report on the financial impact of the proposed Medicaid settlement legislation in Florida concluded that "allowing these conversions would benefit elders . . . in Florida who become self-care limited by approximately $138–157 million (net) annually."[200] Other states rely on this Florida study to estimate their own economic savings.[201]

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192. *Id.*

193. Michael D. Tanner, *ObamaCare created a Medicaid time bomb*, N.Y. POST, (Dec. 7, 2013, 9:15 PM), http://nypost.com/2013/12/07/the-medicaid-time-bomb/.

194. *Id.*

195. *Id.*

196. Betty Ann Bowser, *Why Long-Term Care for U.S. Seniors is Headed for 'Crisis'*, PBS (Mar. 20, 2013, 11:50 AM) http://www.pbs.org/newshour/rundown/ americas-looming-long-term-care-crisis-and-what-can-be-done/ [https://perma.cc/HXN3-NUK6]. *See also*, *How Much Care Will You Need?*, LONGTERMCARE.GOV, http://longtermcare.gov/the-basics/how-much-care-will-you-need/ [https://perma.cc/MR2R-GYGN] (last visited Feb. 22, 2016) ("Someone turning age 65 today has almost a 70% chance of needing some type of long-term care services and supports in their remaining years.").

197. *What's not covered by Part A & Part B?*, MEDICARE.GOV, http://www. medicare.gov/what-medicare-covers/not-covered/item-and-services-not-covered-by-part-a-and-b.html [https://perma.cc/L94H-5NCW](last visited Feb. 22, 2016).

198. ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 2.

199. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 8.

200. *Id.*

201. Public Hearings on H.R. 3174 Before the Joint Standing Committee on Insurance and Financial Services, 2013 Leg., 126th Sess. (Me. 2013) (statement of Senator Margaret Craven) http://www.mainelegislature.org/legis/bills/getTestimonyDoc

IV. THE RISK OF MEDICAID SETTLEMENTS

> Mandating the insertion of a settlement feature into life insurance policies could raise the cost of life insurance policies by an undetermined amount and make life insurance less affordable, causing an undetermined number of [people] to forego the purchase of life insurance and leave their families more financially at risk upon their demise.[202]

This conclusion by the Louisiana Advisory Work Group is a grim warning. The rapidly growing life settlement market poses a significant danger to the life insurance industry,[203] and Medicaid settlement legislation only exacerbates the problem.[204] The appeal of the immediate cost savings can be analogized to a pay-day loan—immediately richer, but ultimately worse off.

A. *The Problem with Life Settlements*

Many participants in a life settlement are harmed, from the insured, to the policy owner, to the original beneficiary, to the insurance company, to anyone who may purchase life insurance in the future. To begin with, the insured is harmed. The financial value of a life limits the insurance available to cover that person.[205] When an insured sells her life insurance policy, the policy is still in force and can reduce or eliminate the amount of personal life insurance that the insured is eligible to purchase in the future.[206]

There are also tax implications to life settlements that may impact policy owners, as the Financial Industry Regulatory Authority ("FINRA") warns.[207] By selling a policy, the policy owner forgoes the favorable tax treatment intended for the product.[208] "[P]ublic policy should encourage families to protect themselves financially from the unexpected loss of a provider," but

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.asp?id=9064 [https://perma.cc/6QND-C8R8].

202. ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 4.

203. As an example, a book of policies with $100,000,000 in face value and a 50% lapse rate is converted through settlements from a $50,000,000 future payout liability to a 0%zero percent lapse rate and $100,000,000 future payout liability because death is a certainty, not a risk.

204. *See* TEX. HUM. RES. CODE ANN. § 32.02613(l) (West 2015) (requiring the department to proactively advertise and raise awareness about the life settlement option); *see also* ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 6 ("To supplement private marketing efforts, the legislature could direct education initiatives by state government.").

205. *Seniors Beware*, *supra* note 3.

206. *Id.*

207. *Id.*; *What is a Life Settlement?*, *supra* note 18.

208. I.R.C. § 101 (2013).

this public policy does not extend to the sale of life insurance and neither do the tax benefits.[209] Despite the states' legislative silence on the tax treatment of Medicaid settlements, the IRS is explicit that life settlements do not receive the benefit of the tax treatment of life insurance.[210]

Beyond these tax concerns, a life settlement is financially imprudent for policy owners. An economic study performed by Deloitte Consulting and the University of Connecticut concluded that a "policyholder with impaired health could maximize her estate value if other assets are liquidated and the life insurance policy is maintained until death."[211] This study was completed before Medicaid settlement legislation developed, but the principle remains: the amount received by the policy owner in a life settlement, 16.2% in 2013,[212] is not a good deal, and it is unconscionable to intimate that losing 83.8%[213] of a guaranteed death benefit is prudent.[214]

When a permanent policy lapses, the owner is not walking away empty-handed.[215] The policy owner had a period of life insurance where the death benefit would have been paid if the insured died, similar to a term policy. However, this person purchased a permanent policy with the option to retain the policy beyond a fixed term.[216] The fact that it lapsed does not mean the

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209. *Tax Expenditure of the Week: Tax-Free "Inside Buildup" of Life Insurance*, CENTER FOR AMERICAN PROGRESS, http://www.americanprogress.org/issues/open-government/news/2011/03/30/9220/tax-expenditure-of-the-week-tax-free-inside-buildup-of-life-insurance [https://perma.cc/D6GG-HREE] (last visited Feb. 22, 2016).

210. I.R.C. § 101 (2013); Rev. Rul. 2009-13 I.R.B.; Rev. Rul. 2009-14 I.R.B.

211. DELOITTE CONSULTING LLP, *supra* note 117, at 13.

212. Horowitz, *supra* note 91, at 4 (dividing the total paid: 362,169,970, by the total face value: 2,231,933,404, to calculate the percentage of the guaranteed death benefit that is received).

213. This is not even calculating the tax incurred through the settlement.

214. *Seniors Beware*, *supra* note 3 ("Life settlements can have high transaction costs and unintended consequences. And even if you decide a life settlement is generally right for you, it can be hard to tell whether you are getting a fair price.").

215. As long as premiums are paid, with a permanent policy the termination of the policy is the decision of the policy owner. *See generally Life Insurance Basics*, INS. INFO. INST. http://www.iii.org/article/life-insurance-basics [https://perma.cc/S7RH-7BH3] (last visited Feb. 22, 2016). With a term policy, the termination of coverage is a term of the contract. *Id.* Therefore, if a ten year term policy terminated after year ten, or a policy owner allowed a permanent policy to lapse after year ten, the permanent policy still had a feature that was not part of the term policy—the right of continuance. If the insured is diagnosed with cancer in year ten, the permanent policy is much more valuable in comparison to the term policy. *Id.*

216. Permanent life insurance remains in force until the insured's death if all premiums are paid. *Id.*

policy was a waste; the protection was provided and the right to continue the policy existed.[217] The owner purchased a feature, permanence, at her option, which she did not exercise.[218]

In addition to the harm and risks to the insured and policy owner, the original beneficiary loses. In a life settlement, whether or not part of a Medicaid settlement, the original beneficiary loses the expected death benefit.[219] It was the policy owner's original desire for the benefit to go to the named beneficiary. Situations and relationships change, but especially in the circumstances surrounding a Medicaid life settlement, the desire to leave a legacy may not have vanished. Nonetheless, bureaucratic rules on retained assets mandate the assignment to the state. The desire to leave a legacy, to leave the next generation better off than the current, actually harms the intended beneficiaries left behind.[220]

Insurers also suffer losses in a life settlement. Insurers rely on many factors when pricing a life insurance policy, including mortality, persistency, lapse rates,[221] expected profits, and the impact of technology in improving health.[222] Insurers experience economic gains when a life insurance policy lapses because they have collected premiums on a policy that will not pay a death benefit.[223] This economic gain is used to subsidize remaining in force policies and price new policies.[224] Therefore, if policies that would otherwise lapse are now sold to investors, the insurer is less profitable.[225]

There are now professional investors in a private market and "[t]he ramifications . . . are enormous to say the least."[226] State involvement to keep many more policies in force raises the

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217. *Id.*

218. *Id.*

219. *E.g.*, TEX. HUM. RES. CODE ANN. § 32.02613 (West 2015).

220. While the loss of choice is not a legal harm, there is a notable emotional benefit to the policy owner (or insured) to have the death benefit go to the beneficiary of her choosing. *See* Huslin, *supra* note 71.

221. Some recognition must be given to the argument that healthy lives lapse while unhealthy lives persist, or keep their life insurance policy in force. DELOITTE CONSULTING LLP, *supra* note 117, at 2. However, this argument fails to recognize that a life settlement is more often related to the financial condition of the policy owner than the physical health of the insured. And, even someone with impaired health faces a better return on her investment by retaining the policy than selling it. *Id.*

222. U.S. SEC. AND EXCH. COMM'N, *supra* note 23, at 19.

223. *Id.*

224. *Id.*

225. *Id.*

226. Page, *supra* note 21.

financial obligations of insurance companies in unexpected ways.[227] But not all view these ramifications as a problem. Chris Ortesis, Chief Executive Officer of the life settlement company Life Care Funding, testified before the Maine Senate Committee on Insurance and Financial Services that there are "clear winners with Life Insurance Policy Conversions[.]"[228] They are "[t]he policy owner and their family . . . . [t]he provider of long term care services . . . . [t]he state of Maine's Medicaid program and the taxpayers."[229] When it comes to making large profits, where there are clear winners there are also clear losers. While the state and the provider of long-term care services win, not mentioned are the profits for life settlement companies.[230] Unacknowledged losers are life insurance companies and the policyholders that will be held accountable to cover the higher payments.[231]

In the future, the life settlement market may have no winners. The 2010 Security and Exchange Commission ("SEC") Task Force found that "[w]hile life settlements may impact an insurer's profitability and financial condition[s] . . . the extent of this impact is likely to be small."[232] This small impact projection relies on "the very small percentage" of life insurance policies that have been sold.[233] However, laws must be enacted with the future in mind. Medicaid settlement legislation has the potential to increase the size of the life settlement market significantly.[234] Although the life

227. Warren S. Hersch, *Texas Law Promoting Life Settlements is Bad News*, LIFEHEALTHPRO (June 21, 2013) http://www.lifehealthpro.com/2013/06/21/texas-law-promoting-life-settlements-is-bad-news [https://perma.cc/SZ94-JV2J].

228. Public Hearings on L.D. 1092 Before the Joint Standing Committee on Insurance and Financial Services, 2013 Leg., 126th Sess. (Me. 2013) (statement of Chris Ortesis, CEO of Life Care Funding) http://www.mainelegislature.org/legis/bills/get TestimonyDoc.asp?id=9066[https://perma.cc/A8NR-FEEK].

229. *Id.*

230. *Id.* Mr. Ortesis stated that his company, Life Care Funding, "aims to make about 10 percent on each purchased policy." Darren Fishell, *Former Insurance Lobbyist Teaches Seniors How to Avoid Medicaid for End-of-Life Care*, BANGOR DAILY NEWS (Sept. 12, 2014, 8:17 AM), http://bangordailynews.com/2014/09/12/ business/former-insurance-lobbyist-educates-seniors-on-how-to-avoid-medicaid-for-end-of-life-care/.

231. Public Hearings on L.D. 1092 Before the Joint Standing Committee on Insurance and Financial Services, 2013 Leg., 126th Sess. (Me. 2013) (statement of Chris Ortesis, CEO, Life Care Funding) http://www.mainelegislature.org/legis/bills/get TestimonyDoc.asp?id=9066 [https://perma.cc/A8NR-FEEK].

232. U.S. SEC. AND EXCH. COMM'N, *supra* note 23, at 20.

233. *Id.*

234. *E.g.*, Texas requires the department to proactively advertise and raise awareness about the life settlement option. TEX. HUM. RES. CODE ANN. § 32.02613(*l*) (West 2015) ("The department shall educate applicants for long-term care services . . .

insurance industry may not suffer in the short term, the future of the industry is at risk now with the enactment of Medicaid settlement legislation. These expansions will propel the life settlement market to a point where it is no longer a "very small percentage" of the industry.[235]

Insurance contracts from this point forward will be priced with Medicaid settlement law in mind.[236] The additional expense will be passed to future policy owners,[237] and the cost of life insurance will increase. This cost will be spread throughout new policy owners, because insurers will recover costs and have no way to distinguish those who are purchasing the policy as an investment to sell in a future market with those who are purchasing the policy to invest in their family and protect their family for conventional purposes. With only one product to sell, the first will purchase a policy that is cheaper than actuarially priced, and the second will be compelled to cover the difference.

B. *The Problem with the Public Option*

The public option recommended in Florida[238] and enacted in Kansas and Indiana presents additional unique concerns.[239] The public option is a collateral assignment.[240] This means that the state pays the policy premiums, is assigned the irrevocable beneficiary, and makes periodic payments to the policy owner to reimburse the

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about options for life insurance policies, including options that do not allow a life insurance policy to be considered as an asset or resource in determining eligibility for medical assistance.").

235. U.S. SEC. AND EXCH. COMM'N, *supra* note 23, at 20.

236. *Id.* at 13 ("Insurers base their premium rates on certain assumptions, including assumptions of policy lapse rates."); DELOITTE CONSULTING LLP, *supra* note 117, at 12. ("One of the key actuarial assumptions used in pricing a life insurance contract is the anticipation of lapse rates.").

237. Future policy owners will bear the additional expense because the cost of life insurance is determined at time of contract; it is locked in. *Why I Purchased Life Insurance at 23*, NEW YORK LIFE, http://www.newyorklife.com/learn-and-plan/why-purchased-life-insurance-at-23 [https://perma.cc/LGK3-54WJ] (last visited Feb. 22, 2016). Some term life insurance has increasing premiums as a product feature (part of the original policy terms), but these products are not the target of the life settlement market. *Life Insurance - Top Ten Questions*, DEP'T OF FIN. SERVS. http://www.dfs.ny.gov/consumer/que_top10/que_life.htm [https://perma.cc/E8AV-WN4P] (last visited Feb. 22, 2016).

238. This bill did not pass in Florida. *CS/SB 794: Medicaid Eligibility*, FLA. SENATE, http://www.flsenate.gov/Session/Bill/2013/0794 [https://perma.cc/795H-9CYY] (last visited Feb. 22, 2016).

239. IND. CODE § 12-15-1-21.7 (2015); KAN. STAT. ANN. § 65-6233 (2014); Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166 at 10.

240. IND. CODE § 12-15-1-21.7 (2015); KAN. STAT. ANN. § 65-6233 (2014).

cost of long-term care incurred by the policy owner.[241] At an insured's death, the state retains the portion of the death benefit that reimburses the state for the cost of Medicaid and the life insurance premiums paid.[242] Any death benefit beyond that amount is awarded to the original beneficiary.[243]

1. Medicaid Settlements are not a Collateral Assignment

First, in this public option arrangement, the state has a perverse interest in the early death of the assignor.[244] If the assignor outlives the death benefit of her life insurance policy,[245] then the state becomes responsible for the extended portion of her long-term Medicaid care.[246] While it is true of Medicaid in general that the longer a person lives the higher the expense for the state, this relationship removes any notion of an insurable interest—any interest in the "continued life" of the assignor[247]—for the assignee, the state.[248]

Second, by labeling the settlement a loan,[249] the state has statutorily created an insurable interest that is contrary to the long-

241. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 9–10.

242. IND. CODE § 12-15-1-21.7 (2015); KAN. STAT. ANN. § 65-6233 (2014). It is not clear whether the state recoups all the long-term costs, or only the costs financed by the state (as opposed to the federal contribution).

243. IND. CODE § 12-15-1-21.7 (2015); KAN. STAT. ANN. § 65-6233 (2014).

244. While this is true for the Medicaid program in general, it is not a characteristic of traditional collateral assignments. *See* In re Taslis, 41 B.R. 47, 49 (Bankr. D. Mass. 1984) ("Generally, a collateral assignment of an interest in property is a secured transaction whereby a borrower assigns his interest in property to a lender to secure performance of an obligation. The assignee for security (the secured party) has the right to collect the assigned claim and apply the proceeds in satisfaction of the secured debt; any surplus belongs to the assignor (the borrower)." (citations omitted)).

245. The death benefit has been pre-spent via assignment to the state. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166 at 10. "The state acts as a fiduciary intermediary converting assets held in a life insurance contract to periodic payments offsetting the cost of long-term care confinement." *Id.*

246. KY. REV. STAT. ANN. § 205.631(2) (West 2014) ("Medicaid . . . shall begin on the day following exhaustion of the life settlement proceeds . . . .").

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

248. Medicaid, and the elderly in general, carry financial burdens for the state outside the Medicaid settlement legislation. *See supra* Part III.D. However, the scope of this argument is limited to say that the state has no insurable interest in the life of the insured (who may, or may not be the Medicaid recipient). *See generally Conn. Mut. Life Ins. Co.*, 94 U.S. at 460. Without this insurable interest, it is inaccurate to classify the relationship established in a Medicaid settlement as a collateral assignment. *Id.* Without insurable interest, the relationship established by a Medicaid settlement falls within the boundaries of the proposal of this Note. *See infra* Part V.

249. Luxton v. United States, 340 F.3d 659, 662 (8th Cir. 2003) ("[A] collateral assignment transfers only those rights necessary to secure the assignor's debt.").

held definition by the Supreme Court.[250] As a loan, the state creates an artificial insurable interest by establishing a debtor-creditor relationship with the Medicaid recipient.[251] However, Medicaid is a government program that is funded through taxes.[252]

Third, in a collateral assignment, the indebtedness to the creditor shrinks with each payment. However, with Medicaid settlements, the debt to the assignor increases daily.[253] This is the opposite of a collateral assignment, and should not be erroneously labeled as such, because to do so implies that the state has an insurable interest that simply is not present.

Without insurable interest, there is no collateral assignment and the assignment is therefore subject to the distinction set forth in this Note's proposal. Medicaid settlements should only be available to life insurance policy owners who choose to purchase the specific endorsement proposed in this Note.

2. Taxpayers with a Life Insurance Policy are Paying for Medicaid Twice

A taxpayer who also has a life insurance policy that is assigned to the state pays twice for the long-term care: once through taxes,[254] and once through insurance premiums. In this program the taxpayer is penalized for purchasing life insurance, even though the Supreme Court and the IRS have both recognized and preserved the classic form of life insurance.[255]

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250. *Conn. Mut. Life Ins. Co.*, 94 U.S. at 460 (stating that an insurable interest is a benefit from the "continued life of another").

251. *Id.* ("It is well settled that a man has an insurable interest in his own life . . . and the creditor in the life of his debtor.").

252. *Financing & Reimbursement*, *supra* note 175. States must recoup some of the costs of Medicaid through the Medicaid Estate Recovery Program. 42 U.S.C. § 1396p (2015). However, the total recovered is miniscule, 0.13% of the total amount spent on Medicaid in 2005. *Medicaid Estate Recovery Program*, FACTCHECK.ORG, http://www.factcheck.org/2014/01/medicaid-estate-recovery-program/ [https://perma.cc/Q5G5-3WG5]. "Given the small amounts recovered compared to total Medicaid spending, it is reasonable to surmise that Medicaid estate recovery is a relatively infrequent occurrence." U.S. Dep't of Health & Human Services, *Medicaid Estate Recovery Collections*, ASPE, https://aspe.hhs.gov/legacy-page/medicaid-estate-recovery-collections-143701 [https://perma.cc/T9JE-CRRE] (last visited Feb. 22, 2016).

253. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 3. "Upon the death of the Medicaid recipient, the state would recoup its costs of providing Medicaid benefits and . . . paying premium from the death benefit." ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 4.

254. *Financing & Reimbursement*, *supra* note 175.

255. I.R.C. § 101 (2013); *Conn. Mut. Life Ins. Co.*, 94 U.S. at 460 ("[I]n life insurance the loss can seldom be measured by pecuniary values. Still, an interest of some sort in the insured life must exist.").

Thus there results a significant detrimental impact to a policy owner for purchasing life insurance early; she is essentially voluntarily paying for long-term care at an earlier point in her life. This creates an incentive to not purchase life insurance. For a candidate with a life insurance policy, Medicaid is a loan program. For everyone else, it is government provided assistance. This discrepancy may be justifiable, but, in the very least, must be acknowledged.

C. *Unanswered Questions*

In large part because these laws are new, and in many states not yet passed, many questions linger about the programs.

1. How is the Life Settlement Payout Taxed?

A life settlement executed outside the scope of Medicaid settlement legislation is taxed as income under the Internal Revenue Code.[256] Under the private option, it is unclear whether the settlement is taxed in the same way. The settlement is performed in the exact manner as a non-Medicaid life settlement.[257] The only difference is that the funds are held irrevocably in a state-controlled bank account, and not considered an asset for Medicaid qualification purposes.[258]

If the settlement proceeds are taxed as income, the Medicaid applicant must be warned. A person applying to Medicaid is not in the financial position to handle a substantial tax bill.[259] If the settlement proceeds are not taxed, then by foregoing the tax, the federal government is endorsing the legislation.[260] In addition, if not taxed, then the states are acting contrary to the two Revenue Rulings in 2009 which unquestionably removed the favorable tax treatment of life settlements intended for the conventional life

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256. *Id.*

257. *See Seniors Beware*, *supra* note 3.

258. S.B. 794, 2013 Leg., 115th Reg. Sess. (Fla. 2013), Bill Analysis and Fiscal Impact Statement, *supra* note 182.

259. Most states limit countable assets to $2,000. U.S. Dep't of Health & Human Services, *Financial Requirements - Assets*, LONGTERMCARE.GOV, http://longtermcare.gov/medicare-medicaid-more/medicaid/medicaid-eligibility/financial-requirements-assets (last visited Feb. 22, 2016).

260. This is comparable to municipal bonds that do not pay a federal tax, by not collecting the tax the federal government is considered to be providing a form of "federal aid." *The Tax Break-Down: Municipal Bonds*, THE COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET (Sept. 13, 2013), http://crfb.org/blogs/tax-break-down-municipal-bonds [https://perma.cc/84K4-8SAW].

insurance market.[261] Either way, the tax implications to the legislation must be clarified.

2. What Rate is Charged to Life Settlement Funds for Long-Term Care?

The government pays a lower rate to long-term care providers under Medicaid than private payers.[262] Under the public option, where Medicaid candidates are reimbursed for their long-term care expenses,[263] are these candidates paying the private rate, or the government rate? If it is the government rate, then this legislation further discourages the use of private long-term care insurance, or adding a long-term care rider to a life insurance policy because neither of these two private remedies allow the lower, government rate. If they pay the private rate, then life insurance companies are legislatively forced to fund Medicaid at a rate even higher than the government's funding of its own program.

3. Does this Legislation Apply to Existing Contracts?

Texas Medicaid settlement law does not specify whether the legislation applies to life insurance policies issued prior to the June 14, 2013 enactment.[264] The law states that the new law applies to Medicaid eligibility determinations made after January 1, 2014, and any determination before that date is governed by the former law.[265] In the Louisiana study, the work group found that "[i]nsurance companies reserves are based on the exposure created by their existing contract language. Statutorily imposing language or conditions that alter existing contracts will affect insurer solvency."[266] This conclusion reiterates that this Louisiana proposal only impacts "new life insurance policies containing [the Medicaid settlement] benefit."[267] The law protects the "settled expectations" of a party, and the insurer had no reason to anticipate this additional financial burden.[268]

261. Rev. Rul. 2009-13 I.R.B.; Rev. Rul. 2009-14 I.R.B.; *see supra*, Part II.D.4.

262. Kevin D. Dayaratna, *Studies Show: Medicaid Patients Have Worse Access and Outcomes than the Private Insured*, HERITAGE FOUNDATION, (Nov. 9, 2012), http://thf_media.s3.amazonaws.com/2012/pdf/bg2740.pdf. ("Medicaid typically pays physicians 56 percent of the amount that private insurers pay.").

263. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 10.

264. TEX. HUM. RES. CODE ANN. § 32.02613 (West 2015).

265. *Id.*

266. ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 4.

267. *Id.* at 7.

268. Landgraf v. USI Film Products, 511 U.S. 244, 265 (1994) ("Elementary

To apply this law to in force life insurance policies violates the United States Constitution. "No State shall . . . pass any . . . Law impairing the Obligation of Contracts."[269] These laws will impair the solvency of life insurance companies to meet the obligations of in force contracts, the ability to pay all death claims as promised. The law must respect the Constitution and the "[e]lementary considerations of fairness."[270]

4. What if a Medicaid Applicant is the Policy Owner but not the Insured?

Often, the policy owner and the insured are not the same person. For example, a grandparent may purchase life insurance on a grandchild.[271] If this grandparent applies for Medicaid and collaterally assigns the policy to the state, the asset, the life insurance policy, will not—hopefully—reimburse the state for the Medicaid loan for a very long time. This is a *major* oversight in the law.[272]

This mistake leads to further questions about whether the economic savings of this program are correct. In the public option, the state is ignoring a pivotal step in determining the profitability of the transaction: the life expectancy of the insured.[273] Is the state truly willing to take on all risk, or should it be as selective as the rest of the secondary market? States supporting the public option fail to address these underwriting concerns.[274]

5. Is Medicaid Settlement Legislation Really the Answer?

Louisiana revisited the proposed legislation, and the Louisiana Department of Insurance ("LDI") updated the 2013 study.[275] Between April 1, 2012, and March 31, 2013, the Louisiana Department of Health and Hospitals ("DHH") received

considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted.").

269. U.S. CONST. art. I, § 10, cl. 1.

270. *Landgraf*, 511 U.S. at 265.

271. *E.g.*, LA. REV. STAT. ANN. § 22:901C (2012) (With "individuals related closely by blood or by law, a substantial interest [is] engendered by love and affection.").

272. S.B. 794, 2013 Leg., 115th Reg. Sess. (Fla. 2013), Bill Analysis and Fiscal Impact Statement, *supra* note 182.

273. *See* Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166.

274. *See id.*

275. *See* LA. DEP'T OF INS., *supra* note 171, at 4; *see generally* ADVISORY WORK GROUP REP. OF S. CON. RES. 104, *supra* note 166, at 1.

approximately 12,000 applications for Medicaid, of which 423 were denied.[276] However, of these 423 only eighty owned life insurance policies, and only twenty-two were denied Medicaid coverage based on the life insurance.[277] Only two of the twenty-two life insurance policies valued in excess of $50,000.[278]

Two states, Kansas and Indiana, have enacted the public option.[279] Since 2012, only one person in Kansas has used the option, assigning the benefits of a life insurance policy to the state.[280] This is attributed to the legislation being unknown, and not desired.[281] Indiana passed the legislation in 2011, but has yet to implement the public option.[282] Florida determined that Medicaid settlement legislation would save Florida "approximately $138–157 million (net) annually."[283] It is to be seen whether this will cure the Medicaid financial crises, or whether the cost-saving projections are inflated. Six states failed to pass similar Medicaid settlement bills in 2014. [284]

There are additional concerns with how Medicaid settlement legislation complies with federal Medicaid law. For example, the Indiana statute limits the assignment, stating that "[t]he office may receive funds under this subsection only to the extent permitted by 42 U.S.C. § 1396p."[285] Federal Medicaid law limits what may be recovered following the death of a Medicaid recipient.[286] A state must obtain "federal waivers or authorizations for [a] state-based variation on Medicaid eligibility requirements" which are set by the federal government.[287] The compatibility of this state legislation and federal Medicaid law is unknown.[288]

276. *Id.*

277. *Id.* at 2 ("[V]iatical brokers purchase only policies with face value of $50,000 or more.").

278. *Id.* at 1.

279. *Id.* at 2.

280. LA. DEP'T OF INS., *supra* note 171.

281. *Id.* at 1.

282. *Id.* at 2.

283. Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 8.

284. California, Maine, Maryland, Massachusetts, New York, and Pennsylvania. Massachusetts has decided to perform a study on the proposal. LA. DEP'T OF INS., *supra* note 171, at 3.

285. IND. CODE § 12-15-2-17(d)(2015).

286. 42 U.S.C. § 1396p (2013). Kentucky also "acknowledges that implementation may be limited by federal law." LA. DEP'T OF INS., *supra* note 171, at 2.

287. LA. DEP'T OF INS., *supra* note 171, at 3.

288. Even with the federal authority to deny the variation (thus, effectively prohibit state Medicaid settlements), the proposal of this Note is still needed. The

D. *The Conflict of Interest*

States must always perform a regulatory balancing act. But now as a market participant, states face a dangerous conflict of interest. A state must protect the people of the state, reduce its own deficit, and keep insurers solvent so that death claims are paid as promised.[289] These are competing interests, as demonstrated by existing and proposed Medicaid settlement legislation.

While advocates of Medicaid settlement legislation argue that this is a consumer first approach, on more careful examination, it is not. Instead, this is a Medicaid-funding approach that first and foremost provides revenue to the state, with state consumer's interests pushed to the background.[290] If the primary motivation behind this legislation is to protect consumers, states should pass legislation that considers a life insurance policy a protected asset that does not restrict eligibility for Medicaid, similar to a primary home or motor vehicle.[291] While there is concern for access to the cash build up in some life insurance products, legislation to restrict access to these funds (which is common in divorce situations) is available.[292] States are empowered to amend their current Medicaid qualifications to treat life insurance in a more favorable way.[293]

In addition to ways that state governments could simultaneously protect life insurance policies and long-term care, the life insurance industry provides its own options. Some insurers

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proposal set forth infra creates a market-based solution to the issue that one (the current) market for life insurance is asked to inefficiently handle two distinguishable economic uses of life insurance. Further, unilateral refusal to allow states to pass Medicaid legislation would, in effect, legislatively abolish a new segment of the secondary market for life insurance, whereas this Note's proposal would allow the new segment but price it according to policy features.

289. *The United States Insurance Financial Solvency Framework*, NAIC (2010) http://www.naic.org/documents/committees_e_us_solvency_framework.pdf [https://perma.cc/RE9Q-GCFJ].

290. *See* Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 8.

291. U.S. Dep't of Human & Human Services, *supra* note 259.

292. In a divorce, a court may issue a Qualified Domestic Relations Order that removes some rights of a life insurance policy owner. *E.g.*, Lessard v. Lessard, No. FA97–0343326S, 1998 WL 525533, at *2 (Conn. Super. Ct. Aug. 14, 1998) ("Husband shall name the Wife beneficiary on $150,000 of life insurance insuring his life until he no longer has any financial responsibility to her for the payment of alimony. The Husband shall also name each minor child beneficiary on $50,000 of life insurance insuring his life.").

293. States determine financial eligibility for Medicaid. U.S. Dep't of Health & Human Services, *supra* note 259.

offer life insurance with a long-term care rider, or accelerated death benefit rider.[294] These riders come at an additional premium[295] and with unique features, but generally allow for a part of the death benefit to be used for long-term care if needed.[296]

V. THE PROPOSAL: A FEDERAL RESPONSE

As demonstrated by this Note up to this point, the states have now entered the life insurance market in a way that is in direct contradiction to the purpose of life insurance as held by the Supreme Court.[297]

A. *The McCarran-Ferguson Act of 1945 Authorizes Federal Intervention*

Under the McCarran-Ferguson Act of 1945, a federal statute preempts a state statute regarding the "business of insurance" when the federal statute is deliberate in the regulation of the insurance industry.[298] The McCarran-Ferguson Act is restricted to an Act of Congress which "shall be construed to invalidate, impair, or supersede" any state law that regulates the business of insurance.[299] The Act sanctioned the Health Insurance Portability and Accountability Act of 1996 (HIPAA)[300] and the Patient Protection and Affordable Care Act[301] among others. It must now address the secondary market of life insurance.

294. Elizabeth O'Brien, *Hedging your bets on long-term care*, MARKETWATCH (Nov. 6, 2013, 6:15 AM), http://www.marketwatch.com/story/hedging-your-bets-on-long-term-care-2013-11-06. *See supra* Part II.D.4.

295. The additional cost of the long-term care rider serves as further proof that current life insurance policies, or policies without this endorsement, are not priced to accommodate Medicaid settlements. *See, e.g.*, *Life Insurance with Additional Care Benefit*, Northwestern Mutual, https://www.northwesternmutual.com/products-and-services/life-insurance/state/accelerated-care-benefits-state [https://perma.cc/SS6G-WVXS] (last visited Feb. 22, 2016).

296. O'Brien, *supra* note 294.

297. Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 461 (1876) (stating that the "real purpose" of the life insurance policy must not be a wager, "but to secure such advantages, supposed to depend on the life of another . . . to prevent . . . a mere wager"); Warnock v. Davis, 104 U.S. 775, 780 (1881) (The law is "opposed" to policy owners having an "interest[] in the death rather than the life of the party assured.").

298. 15 U.S.C. §§ 1011–1015 (2014).

299. *Id.*

300. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat 1936 (1996).

301. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

B. *Proposed Federal Intervention: Turn Insurable Interest into a Negotiable Term of a Life Insurance Contract*

The federal government should exercise its power under the McCarran-Ferguson Act to permit life insurance companies to offer and negotiate an insurable interest requirement that applies subsequent to contract formation as a contract term, and for the entire duration of the contract, and to price such policies accordingly. This federal statute would allow a life insurance purchaser the freedom to pay for the features of the policy that she values without the obligation to subsidize more. In essence, the current life insurance market should be allowed to offer two options: a life insurance product that is only assignable with insurable interest, and a life insurance product equivalent to today's products that are freely assignable. The premiums would correlate with the contract terms, with the free assignability option being more expensive.

The scope of this proposal must be federal as it must be uniform across states that currently have divergent assignability laws. Most states currently enforce assignment of a life insurance policy to the extent that the terms of the contract allow.[302] This also means that these states would presently enforce a non-assignability clause in a policy. However, ten states—California, Connecticut, Maryland, Michigan, Nebraska, Nevada, New York, North Dakota, Utah, and Wisconsin—expressly prohibit an insurer from restricting assignment of a life insurance policy.[303] With profitable Medicaid settlement legislation spreading throughout the states, there is little motivation for these states to now give life insurance companies more contracting power.[304]

In addition to these ten states, three more have conflicts within their own statutes. Kentucky allows the assignment of a life insurance policy "as provided by [the] terms of the contract,"[305] but also prohibits insurers from "restrict[ing], limit[ing], or impair[ing] in any way the lawful transfer of ownership, change of beneficiary,

302. *E.g.*, MASS. GEN. LAWS ch. 175, § 119A (2014).

303. CAL. INS. CODE § 10130 (West 2014); CONN. GEN. STAT. § 38a–465 (2014); MD. CODE ANN., INS. § 16-111 (West 2014); MICH. COMP. LAWS § 500.2207 (2014); NEB. REV. STAT. § 44-704 (2014); NEV. REV. STAT. § 687B.200 (2015); N.Y. INS. LAW § 3212 (McKinney 2009); N.D. CENT. CODE § 26.1-33-33 (2014); UTAH CODE ANN. § 31A-22-412 (West 2014); WIS. STAT. § 632.47 (2014).

304. *See* Accelerated Life Benefits Tech. Advs'y Workgroup, *supra* note 166, at 8.

305. KY. REV. STAT. ANN. § 304.14-250(1) (West 2014).

or assignment of a policy."[306] Maine[307] and Washington[308] have similar conflicts.

These thirteen states pose a problem for insurers wishing to issue state specific life insurance policies in permissive states having non-assignment clauses. With the mobility of policy owners, a life insurance policy that is issued in a state that enforces a non-assignability clause may subsequently "relocate" with its owner to a restrictive state, resulting in an unenforceable contract clause at the time of assignment.[309] Therefore, with these conflicts of laws, a prudent insurer contracts considering the most restrictive states, in this case with free assignability (with resultant higher premiums) mandated by these thirteen states.

Without a contract term restricting policy assignment, courts rely on state law to determine the validity of the assignment. With most states requiring insurable interest for the first two or five years of a policy, after this time period the lack of restriction is interpreted as acceptance of free assignability by the insurer.[310] Therefore, without the proposed federal intervention, these state laws on insurable interest impliedly restrict life insurers to provide multiple insurance policies through unique contract terms regarding their assignability.

As an example, in *Grigsby* a contract clause stated any claim to the policy was "subject to proof on interest."[311] The Court determined that without a rule of law supporting the contract term, it was unenforceable and "[did] not diminish the rights" of the third-party purchaser.[312] As such, absent collective state

306. KY. REV. STAT. ANN. § 304.15-717(1)(p)(3) (West 2014).

307. *See* ME. REV. STAT. ANN. TIT. 24-A, § 2420 (2014). *But see* ME. REV. STAT. ANN. TIT. 24-A, § 6812-A (2009).

308. *See* WASH. REV. CODE § 48.18.360 (2014). *But see* WASH. REV. CODE § 48.102.130 (2014).

309. *See* Clay v. Sun Ins. Office, Ltd., 377 U.S. 179 (1964) (holding that an insurance policy purchased by an Illinois resident and citizen in Illinois who later moved to Florida and became a resident and citizen of Florida was governed by Florida law); *see also* Watson v. Employers Liab. Assurance Corp., 348 U.S. 66 (1954) (allowing suit in Louisiana under Louisiana law for an insurance policy that was negotiated for and issued in Massachusetts, delivered in Massachusetts and Illinois, even though under Louisiana law one of the contract clauses was unenforceable).

310. *Cf.* Nw. Mut. Life Ins. Co. v. Johnson, 254 U.S. 96, 102 (1920) (interpreting a two-year suicide exclusion in a life insurance policy as an "inverted expression" that after that time, it is not a defense).

311. Grigsby v. Russell, 222 U.S. 149, 157 (1911).

312. *Id.* ("[A] 'claim against the company, arising under any assignment of the policy, shall be subject to proof on interest.' But [with] no rule of law to that effect, and the company saw fit to pay, the clause did not diminish the rights of Grigsby, as against

cooperation, this proposal requires a federal law.

C. Grigsby v. Russell *not at Conflict*

Grigsby v. Russell, the 1911 decision that is consistently recognized as providing Supreme Court acquiescence to the life settlement market,[313] is not in conflict with this proposal. In *Grigsby*, the Supreme Court held that there need not be an inherent insurable interest requirement in the transfer of ownership after the life insurance policy is purchased.[314] Therefore, under the terms of Mr. Burchard's contract,[315] without a challenge by the insurance company, and with "no rule of law" requiring insurable interest, the Court permitted the assignment.[316]

Under this construct, *Grigsby* does not contradict a federal mandate that insurable interest at assignment be a negotiable term of the life insurance contract. This proposal creates a law consistent with *Grigsby*, and therefore contracts that include the term would be enforceable under *Grigsby*. According to *Grigsby*, contracts that exclude the insurable interest at assignment term *still* lack an inherent insurable interest requirement at inception, and would still be freely assignable.[317]

With this proposal, *Grisby* remains the authority for the life settlement market.[318] While the Court found no inherent insurable interest requirement in the *Grigsby* contract,[319] this proposal will allow for an explicit contract term, fully consistent with *Grigsby*. This federally sanctioned freedom of contract would give purchasers of life insurance the ability to purchase exactly the features of life insurance which they value, without an unwanted mandate to purchase the equivalent of a compulsory assignability

the administrators of Burchard's estate."). *Id.*

313. *See Life Settlement Questions*, *supra* note 53; s*ee also History of Life Settlements in the U.S.*, *supra* note 53.

314. Grigsby v. Russell, 222 U.S. 149, 155 (1911).

315. *Id.* Mr. Burchard was the original policy owner and insured, who sold the life insurance policy to Dr. Grigsby. *Id.*

316. *Id.* at 157.

317. *Id.*

318. *Id.* The language in this Supreme Court decision suggests that the Court did not anticipate the reach of this case. *See id.* The Court saw the facts before it as "a very different . . . thing from granting such a general license, to allow [Mr. Burchard] to transfer it to one whom he, the party most concerned, is not afraid to trust." *Id.* at 155. These facts were very different from the "mischievous kind of gaming" objectionable since early English cases. *Id.* at 156. This language by the Court implies a limitation that falls short of today's life settlement market. *See id.*

319. *Id.* at 157.

endorsement.

D. *Concerns with the Proposal*

The Supreme Court recognized in *Grigsby v. Russell* that life insurance has long been characterized as property, "[s]o far as reasonable safety permits."[320] Indeed, viewing a life insurance policy as an asset is what causes an issue for Medicaid qualification.[321] The *Grigsby* Court found that "[t]o deny the right to sell except to persons [with insurable interest would] diminish appreciably the value of the contract . . . ."[322] This remains true: the value of a life insurance policy will vary based on the contract terms, specifically the free assignability of the policy. However, the premium will correlate to the value of the policy, removing the risk of harm to the owner that the Court feared.[323] With the freedom to purchase either a fully liquid policy or one that is only transferrable to one with an insurable interest, the property rights are part of the initial contract, allowing contract negotiation in good faith with supporting commensurate pricing.

Additionally, the states' responses to STOLI, most requiring two or five year waiting periods before the sale of a policy absent an insurable interest, show that these property rights are not guaranteed. States are willing to delay assignability of *all* life insurance policies in a protective effort that delays property rights.[324] Contracting property rights at the outset of the policy purchase is not an injustice.

Further, the global life settlement market shows that there is not a universal right to sell a life insurance policy as property.[325] This, along with the life insurance products in the US market, is why the policies involved in the "world" market are in fact US policies, with foreigners gambling on the lives of Americans.[326] As

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320. *Id.*

321. *See* U.S. Dep't of Health & Human Services, *supra* note 259.

322. *Grigsby*, 222 U.S. at 156.

323. *Id.* The risk of harm is the "diminish[ed] value" of the policy. *Id.*

324. *See, e.g.*, MASS. GEN. LAWS ch. 175, § 223A (2014). Massachusetts requires a two-year waiting period. Therefore, for the first two years following the purchase of life insurance in Massachusetts, the property rights of that policy are diminished. *Id.*

325. Ontario, Canada is one example of a place where it is illegal to sell a life insurance policy. Insurance Act, R.S.O. 1990, c. I.8, s. 115 (Can.) ("Any person . . . who trafficks or trades in life insurance policies for the purpose of procuring the sale, surrender, transfer, assignment, pledge or hypothecation thereof to himself, herself or itself or any other person, is guilty of an offence.").

326. *The Secondary Markets for Life Insurance*, *supra* note 143.

the life settlement market develops, there is a potential concern that foreigners have a financial interest in the early demise of US insureds.[327]

Finally, the risk to the life insurance industry and the viability of insurers to remain solvent within the existing and proposed life settlement practices makes it the duty of the federal government and states to protect this very asset, otherwise the reasonable safety of these assets will be jeopardized.[328] Additionally, this proposal is narrow and only regulates the insurable interest requirement, while leaving the states free to continue to regulate the life insurance industry.

E. *The True Cost: the Risk of Status Quo*

Life insurance is not only for the wealthy.[329] It is meant as a feasible option for those who want to protect their loved ones and make death a simple mourning process without a simultaneous devastating financial collapse.[330] It is in society's best interest to encourage private life insurance and to reward those who financially protect their family.[331] The harm to the life insurance industry will not manifest itself immediately; it has too much momentum for immediate impact.[332] But inevitably the life

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327. This is admittedly conspiratorial, but nonetheless worth mentioning.

328. *See, e.g.* 31 U.S.C. § 313 (2013) (The Federal Insurance Office "monitor[s] all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system."); *Massachusetts Division of Insurance*, MASS.GOV, http://www.mass.gov/ocabr/government/oca-agencies/doi-lp/mass-div-of-insurance.html [https://perma.cc/7ECK-8YA6] (last visited Feb. 22, 2016) ("The DOI monitors financial solvency [of] insurance companies.").

329. *When Should You Buy Life Insurance?*, KIPLINGER, (Jan. 2015), http://www.kiplinger.com/article/insurance/T034-C000-S001-when-should-you-buy.html [https://perma.cc/3HTN-HKRA] (explaining that single income families with children, single parents, and those caring for elderly parents are all high-need situations for life insurance).

330. *See* Helvering v. Le Gierse, 312 U.S. 531, 540 (1941) ("[U]sually insurance payable to specific beneficiaries is designed to shift . . . the risk of premature death of the one upon whom the beneficiaries are dependent for support. Indeed, the . . . protection of contracts and their proceeds intended to guard against just such a risk."); *see also* Conn. Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 461 (1876) (stating that the "real purpose" of the life insurance policy must not be a wager, "but to secure such advantages, supposed to depend on the life of another . . . to prevent . . . a mere wager").

331. *Helvering*, 312 U.S. at 539.

332. U.S. SEC. AND EXCH. COMM'N, *supra* note 23, at 20. The life insurance industry is so large that a small life settlement market has a negligible impact, but an impact will be felt as it grows. *Id.* ("Industry observers have predicted that life settlements will have an insignificant impact on the insurance industry . . . given the

settlement market will reach the size where it irreparably harms the industry. While the current concerns with how to fix and fund Medicaid seem insurmountable, these fears pale in comparison to the gradual destruction of the life insurance industry.[333] Medicaid is funded through taxes;[334] insurance companies paid $18.1 billion in taxes in 2014.[335] The industry has $3.6 trillion of invested assets, and over 2.5 million employees.[336] The size of the industry does not make it too big to fail; the size makes it too big to arbitrarily risk, a dangerous status quo.

CONCLUSION

A prescient Supreme Court in *Warnock* viewed the assignment of a life insurance policy after its commencement as "contrary to the general policy of the law respecting insurance, in that it might lead to gambling or speculative contracts upon the chances of human life."[337] Almost 135 years later, it seems the Court's concerns were well warranted as the free assignability of life insurance policies has single-handedly created an entire, rapidly growing settlement industry in which both private and public players gamble—on aggregate, billions of dollars—on the life spans of total strangers.

Wager policies are "independently of any statute on the subject, condemned, as being against public policy."[338] They have been condemned, and any conflicting statute diverges from the long-standing principles of this country, and others.[339] A life settlement transaction is, in every sense of the word, a wager.[340] With free assignability, a life insurance policy can become a wager policy after purchase. While the intent of the original purchaser

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very small percentage of in-force policies that have been settled.").

333. *The Financial Services Industry in the United States*, SELECTUSA, http://selectusa.commerce.gov/industry-snapshots/financial-services-industry-united-states [https://perma.cc/4UY3-SQEF] (last visited Feb. 22, 2016) ("In 2014, finance and insurance represented 7.92 percent (or $1.26 trillion) of U.S. gross domestic product.").

334. *Financing & Reimbursement*, *supra* note 175.

335. *Insurance Industry at a Glance*, INSURANCE INFORMATION INSTITUTE, http://www.iii.org/fact-statistic/industry-overview (last visited Feb. 22, 2016).

336. *Id.*

337. Warnock v. Davis, 104 U.S. 775, 780 (1881).

338. *Id.* at 779.

339. *Id.*; Helvering v. Le Gierse, 312 U.S. 531, 539 (1941) ("That life insurance is desirable from an economic and social standpoint as a device to shift and distribute risk of loss from premature death is unquestionable.").

340. *Warnock*, 104 U.S. at 780 (A wager is when the owner "is interested in the death rather than the life of the party assured.").

was genuine, the investor purchasing the existing insurance at a later date is purchasing a policy in the same way as an original owner; there is nothing substantial to differentiate the original purchase from the subsequent purchase as pertaining to the definition of a wager—a financial gain at the death of a stranger. Therefore, to require a good faith intent at the first purchase, but not the second is contrary to the condemnation of wager policies dating back to the Life Assurance Act of 1774.[341]

The life settlement market should not have life insurance premiums, payments, and resulting payouts and profits subsidized by policies purchased and retained for genuine insurance purposes. In an effort to preserve the financial viability of the personal life insurance industry, Congress should allow insurers to offer and negotiate an insurable interest requirement subsequent to contract formation and at the time of assignment as a contract term, and should price such policies accordingly. Life insurance companies undertake the risk of others every day. Every policy sold is more financial exposure to the insurer. Insurers take on the unknown of one and spread it among many. With the many variables and risks for which an insurer must account, the life settlement market is beyond a reasonable scope of future contingencies. The solvency of life insurance companies hinges on pricing risk, and with the combination of two separate and unique markets—life insurance for protection, and life insurance as an investment tool—insurers will be forced to raise the premiums on the former in order to subsidize the risk of the latter. The victims bearing the economic cost of wagers in the market are not the insurance companies, but ultimately policy owners.

The Robin Hood[342] appeal to Medicaid settlement legislation is tempting, but to steal from the rich—the insurance companies—to provide for the poor—Medicaid—is to gamble with the entire US life insurance industry. The Robin Hood fantasy must remain in English folklore. Laws as dangerous as Medicaid settlements, and an industry as important as insurance, calls for the hue and cry, so let it be heard.

341. Life Assurance Act, 14 Geo. 3 c. 48 (U.K.).

342. *Robin Hood*, *Who Was Robin Hood*, NOTTINGHAM CASTLE MUSEUM AND ART GALLERY, http://www.nottinghamcastle.org.uk/explore/robin-hood [https://perma.cc/E8YW-9J6T] (last visited Feb. 22, 2016) ("Robin Hood . . . is a heroic outlaw in English folklore, a highly skilled archer and swordsman. He has become known for 'robbing from the rich and giving to the poor', [sic] assisted by a group of outlaws known as his 'Merry Men' [sic]. The origin of the legend is claimed by some to have stemmed from actual outlaws, but some say it is only from ballad and story.").