No. 141

Court of Appeals

STATE OF NEW YORK

ALICE KRAMER,

Plaintiff-Respondent,

against

PHOENIX LIFE INSURANCE CO., LINCOLN LIFE & ANNUITY CO. OF NEW YORK,

Defendants-Respondents,

LIFEMARK S.A.,

Intervenor-Appellant.

ON A QUESTION CERTIFIED BY THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, U.S.C.A. NO. 09-3903

BRIEF OF THE INSTITUTIONAL LIFE MARKETS ASSOCIATION AS *AMICUS CURIAE*

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Court of Appeals Rule 500.1(f), The Institutional Life Markets Association states that it is a not-for-profit trade association with no parent corporation, subsidiaries or affiliates.

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U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-775, LIFE INSURANCE SETTLEMENTS: REGULATORY INCONSISTENCIES MAY POSE A NUMBER OF CHALLENGES (JULY 2010)..2, 8, 9, 10

The Second Circuit has asked this Court to clarify New York Insurance Law § 3205(b) as it applies to the sale of a life insurance policy by an insured to an investor (a "life settlement"). Specifically, the Second Circuit has asked:

> Does New York Insurance Law §§ 3205(b)(1) and (b)(2) prohibit an insured from procuring a policy on his own life and immediately transferring the policy to a person without an insurable interest in the insured's life, if the insured did not ever intend to provide insurance protection for a person with an insurable interest in the insured's life?

The Institutional Life Markets Association ("ILMA") respectfully submits the following *amicus curiae* brief, due to the importance of the certified question to New York's life settlement industry, and urges the Court to answer the certified question "no" for the reasons discussed herein.

PRELIMINARY STATEMENT

ILMA promotes best practices in the life settlement market and seeks clear, transparent rules of conduct that are predictable and certain. ILMA has an interest in the question before this Court because its members are some of the world's leading investors in the life settlement market.

Life settlements involve the purchase of existing in-force life insurance policies by investors. This multi-billion dollar market provides consumers with valuable options to maximize the value of life insurance policies they no longer need or want or can no longer afford. Insurance consumers can sell their unwanted policies on the secondary market and receive substantial and fair market value for

their property, instead of being forced to lapse or surrender their unwanted policies to the insurers for little or no cash surrender value. The life settlement market enhances the value of the property interests the insurance consumer obtained. As was recognized by the recent Report to the Special Committee on Aging of the United States Senate by The United States Government Accountability Office ("GAO")[1], the life settlement market provides important benefits to elderly Americans. (Failla Aff. Ex. 1: GAO Report, at Letter, Page 1.)

ILMA members do not participate in the type of practice the Insurers alleged to have occurred in this case – investors agreeing in advance to purchase a policy before it has been procured – and ILMA has successfully lobbied together with the insurance industry for life settlement laws that prevent such transactions. These life settlement laws, including New York's recently adopted Life Settlement Act, subject persons who violate the law to regulatory, civil and/or criminal penalties. The laws do not, however, provide insurers with the expansive right to challenge policies that the Insurers argue for in this case. The legal issues raised in this case have ramifications far beyond the practices the Insurers complain about in their briefs and will impact responsible investors in the life settlement market and

[1] This past month, the GAO issued a Report, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-775, LIFE INSURANCE SETTLEMENTS: REGULATORY INCONSISTENCIES MAY POSE A NUMBER OF CHALLENGES (July 2010) (the "GAO Report") which includes a comprehensive overview of the life settlement market, and is included for the Court's reference as Exhibit 1 to the Affirmation of John E. Failla ("Failla Aff.") filed in support of ILMA's motion for leave to file this brief.

ultimately consumers who no longer want or need their insurance policies. ILMA has a strong interest in ensuring that the legal rules that govern the secondary market are clear, transparent, certain and predictable for investors who in good faith purchase policies trading in the markets.

If the certified question is answered in the affirmative, and life insurance policies can be challenged by insurers based solely on a retrospective examination of the insured's subjective intentions in procuring the policy (often after the insured has died and all that remains is inconclusive circumstantial evidence), the property rights of New York consumers will be substantially diminished, and the secondary market for life insurance policies in New York will be subjected to significant uncertainty. Indeed, coupled with the Insurers' argument that insurable interest challenges should be permitted after the contestability period, a rule permitting insurers to seek rescission based on the insured's intent when procuring the policy would leave all legitimate life settlements open to challenge indefinitely based on an unclear standard that would be entirely unworkable in practice. These public policy concerns weigh strongly against an insurable interest standard that hinges on the insured's unilateral intent in procuring the policy and against finding exceptions to New York's incontestability principles.

In enacting Section 3205(b), New York's legislature has provided a standard for evaluating insurable interest that is clear, easy to apply, and protective of both

consumer rights and investor rights. An insured has the freedom to procure a policy for the benefit of anyone he or she wishes and transfer that policy to anyone he or she wishes, so long as the insured is of legal age and has participated voluntarily, free of duress or coercion. In contrast, a third party cannot procure a policy unless it is payable to a person with an insurable interest in the insured. These contrasting provisions are specified in two separate sections of the statute and do not overlap. Specifically, Section 3205(b)(1) of the New York Insurance Law, which applies when an insured takes out a policy on his or her own life, provides:

> Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of *any* person, firm, association or corporation. *Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effectuated.* (emphasis added).

Section 3205(b)(2), which applies only when a third party procures an insurance policy on the life of an insured, provides:

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

The legislature has quite clearly provided that New York's insurable interest law can only be violated when someone other than the insured procures the policy, and that an insured is entitled to procure a policy for any reason – not just to

benefit those with an insurable interest – and to do with the policy as he or she sees fit. As this Court has previously explained, when an insured procures a policy, "the wagering aspect is overridden by the recognized utility of the contract as an investment to benefit others." *New England Mut. Life Ins. Co. v. Caruso,* 73 N.Y.2d 74, 80 (1989). Thus, this Court need only apply the plain language of New York's insurable interest statute to answer the certified question "no." Longstanding rules of statutory construction, clear legislative history and sound public policy all weigh in favor of the Court finding that Section 3205(b) does not prohibit an insured from buying a policy and immediately[2] transferring it to a person without an insurable interest in the insured's life, regardless of the insured's intent in buying the policy.

In their briefs, the Insurers also expand the certified question, and seek to have the Court find an exception to New York's incontestability statute for life insurance policies (Section 3203(a)(3)) which would permit insurers to challenge life insurance policies on insurable interest grounds after the statutorily mandated two-year contestability period has expired. For many of the same policy reasons

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[2] As discussed below, as part of the new "Life Settlement Act," effective as of May 2010, the legislature has now provided a two year waiting period, with some exceptions, before policies can be sold into the secondary market. *See* Section 7813(j)(1) of the Insurance Law. ILMA supported the adoption of this provision as a reasonable restriction on insured's property rights. This new provision, however, does not apply retroactively, and, significantly, does not purport to regulate the insured's intent in procuring the policy or provide that a policy violates insurable interest standards based on the insured's intent or how quickly the policy is transferred.

applicable to the certified question, New York law should not be changed to provide such an exception.

The proper interpretation of New York's incontestability statute is absolutely clear on this issue, as this Court has definitively ruled that insurable interest challenges can *not* be made after the contestability period, first, over a century ago in *Wright v. Mut. Benefit Life Ass'n*, 118 N.Y. 237, 241 (1890), a case involving allegations of fraud and a scheme to procure a wagering contract, and again in 1989 in *New England Mut. Life Ins. Co. v. Caruso,* 73 N.Y.2d at 80, a case involving allegations of lack of insurable interest and the suspicious death of the insured. Fully cognizant of these rulings, the legislature has chosen not to amend either New York's incontestability statute or insurable interest statute to allow insurable interest challenges to be made after the contestability period, including when it passed legislation concerning stranger originated life insurance ("STOLI") – the very concern the Insurers argue justifies an exception to New York's well-settled incontestability law – as part of this year's Life Settlement Act.

New York's clear and longstanding law that a life insurance policy cannot be challenged on insurable interest grounds by an insurer after two years is supported by sound public policy. The rule provides a bright-line standard that provides certainty to all participants in New York insurance transactions and participants in life settlement transactions. Consumer protection and economic

development require predictable rules of commerce and standards that are consistent and objective. That is precisely what New York's incontestability statute and the effect given to it by *Caruso* provide. The rule enhances the rights of insureds and policy owners and protects their property interests, and supports a robust secondary market that benefits consumers and investors alike.

INTERESTS OF AMICUS CURIAE

ILMA is a trade association formed in 2007 that is comprised of a number of the world's leading institutional investors in life settlements, formed to encourage the prudent and competitive development of this marketplace. ILMA members seek to expand consumer choice in one of their most important assets – their life insurance.

ILMA is a leader in establishing best practices and in raising awareness about the growing and vital industry of life settlements.[3] As part of its efforts, ILMA works regularly with legislators and regulators to help design appropriate and consumer-oriented regulation of the life settlement industry, including working with the New York legislature to pass the Life Settlement Act which became effective in May 2010. Such efforts are of vital importance to ILMA because it believes strongly in regulation that provides clarity and certainty in the market.

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[3] A copy of ILMA's guiding principles is included as Exhibit 2 to the Affirmation of John E. Failla.

A decision interpreting New York's insurable interest law could impact the validity of policies in which ILMA members have an interest and will impact the future of the life settlement market in New York, in which ILMA members participate. ILMA has an interest in the regulation of the life settlement market in New York, and in protecting the rights of both investors and New York policy owners, as its primary mission is to encourage a robust, consumer-oriented life settlement market.

Because of ILMA's substantial participation in the life settlement industry, and active involvement in the legislative and regulatory process, ILMA believes it is in a position to identify law, legislative history, policy and arguments that might otherwise escape the Court's attention.

BACKGROUND

To provide helpful context, ILMA provides background regarding the secondary market for life insurance and New York's insurable interest law that it believes will be useful to the Court.

I. The Life Settlement Market

The secondary market for life insurance or "the life settlement market" is a multi-billion dollar industry. Estimates of the total face value of policies sold by their owners to investors ("settled") in 2008 range from $9 billion to $12 billion. (Failla Aff. Ex. 1: GAO Report at Introduction, "What GAO Found. ")

Although the life settlement market has only recently developed in its present form, the concept of selling a life insurance policy to a third party is not new. The right to sell a policy has been recognized by judicial decisions for over a century. (Failla Aff. Ex. 1: GAO Report, at Letter, 1.) The modern secondary market developed as a response to the imbalance of power between insurers and policy owners. Historically, a policy owner who no longer wished to continue paying premiums on a policy had few options because life insurance carriers "wielded monopsony power" over the repurchase of their own policies. Neil A. Doherty & Hal J. Singer, *The Benefits of a Secondary Market For Life Insurance Policies*; *Real Property, Probate and Trust Journal*, 38 Real Prop. Prob. & Tr. J. 449, 450 (Fall 2003) ("Doherty and Singer"). The secondary market corrects this imbalance of power by providing buyers for unwanted policies as an alternative to compete with insurers and thus provide policy owners with a fair market value for their unwanted policies. (Failla Aff. Ex. 1: GAO Report, at Appendix I, Briefing to Congressional Staff, 17.)

Policy owners choose to sell their policies into the secondary market for a number of reasons, such as: (1) premiums becoming unaffordable; (2) changes in estate planning needs; (3) need for liquidity for medical bills or other needs; (4) desire to use funds for other investments; and (5) the original beneficiary being deceased or no longer in need of protection. *See, e.g.,* Doherty and Singer, at 453.

Investors, in turn, often choose life settlements to diversify their portfolios because they view life settlement returns as not being correlated with returns on equities and other traditional investments. (Failla Aff. Ex. 1: GAO Report, at Appendix I, Briefing to Congressional Staff, 38.)

The development of the secondary market has been of great benefit to consumers as policy owners receive significantly more money from a life settlement than they would receive from insurers for the surrender value of the policy. Indeed, the recent GAO Report reflects that policy owners received more than eight times the cash surrender value of the policies they settled in 2009, and an even larger factor from 2006 to 2008. (Failla Aff. Ex. 1: GAO Report, at Appendix III, page 112.)

As the secondary market has expanded, most states have begun regulating the market, thus recognizing its legitimacy and viability, passing licensing requirements, standards for practice, and other regulations on the market and its participants. As of February 2010, 38 states had insurance laws specifically regulating life settlements. (Failla Aff. Ex. 1: GAO Report at Introduction, "What GAO Found. ") New York has recently begun regulating the life settlement market, passing the Life Settlement Act, Article 78 of the Insurance Law, effective as of May 2010.

II. Evolution of New York's Insurable Interest Statute

A. Common Law Recognition Of Insured's Property Rights

Prior to the enactment of New York's insurable interest statute, this Court recognized several basic principles that have survived in today's statute. First, an insured is entitled to procure a policy and designate whomever he or she wishes as beneficiary, such that the question of insurable interest only arises when someone other then the insured buys the policy. *Olmsted v. Keyes*, 85 N.Y. 593, 600 (1881) ("It is abundantly settled in this State, that one who takes an insurance upon his own life may make the policy payable to any person whom he may name in the policy, and that such person need have no interest in the life insured"); *St. John v. Am. Mut. Life Ins. Co.*, 13 N.Y. 31, 39 (1855) ("It is only when one person insures the life of another that the question of interest in the life can arise.").

Second, an insured is entitled to treat a policy like any other property and has the freedom to transfer, sell or assign it. *Olmsted v. Keyes*, 85 N.Y. at 600 (insured may "deal with a valid life policy as he could with any other chose in action, selling it, assigning it, disposing of it, and bequeathing it by will, and it has been well said that if he could not do this life policies would be deprived of a large share of their utility and value."); *St. John v. Am. Mut. Life Ins. Co.*, 13 N.Y. at 39 ("[W]ithout the right to assign, insurances on lives lose half their usefulness.").

Third, an insurer cannot challenge a policy on insurable interest grounds

after the two-year contestability period provided in the policy expires. *Wright v. Mut. Benefit Life Ass'n*, 118 N.Y. 237, 241 (1890).

Finally, although these early cases observed that insurable interest laws might be violated if a third party used the insured as a cover for procuring a "wager policy," they made clear that a subsequent purchaser of a policy, who did not participate in its procurement, was entitled to enforce the policy against the insurer. *St. John v. Am. Mut. Life Ins. Co.*, 13 N.Y. at 39 ("The whole proof shows that [the insured] effected the insurance upon his own life; it was not done by the [ultimate buyer]; he had no agency in procuring the policies to be issued."); *Olmsted v. Keyes*, 85 N.Y. at 598 ("the policy will continue valid in the hands of the assignee, although he has no interest whatever in the life insured.").

These early New York cases are consistent with the general common law, which recognized an insured's right to obtain a policy on his or her own life and freely assign that property. *See Grigsby v. Russell*, 222 U.S. 149, 156 (1911) ("[L]ife insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property.... To deny the right to sell except to persons having [an insurable interest] is to diminish

appreciably the value of the contract in the owner's hands.")[4]

In *Grigsby*, the Supreme Court upheld an assignment of a policy to a person lacking an insurable interest, but suggested that there might be concerns if "a person having an interest lends himself to one without any, as a cloak to what is, *in its inception*, a wager" but not "where an honest contract is sold in good faith." *Id.* (emphasis added). In other words, it found that insurable interest concerns arise if a third party is the one who, in fact, procures the policy *initially* and as a wager, but do not arise when the insured procures the policy.

B. 1892 Statute

New York's insurance statutes initially prohibited the issuance of life insurance "except upon the application of the person insured" absent very limited exceptions, such as a wife taking out a policy on her husband. 1892 N.Y. Laws, ch. 690, § 55 (1892).

C. 1939 Re-Codification Of The Insurance Law

In 1939, when the insurance law was re-codified, New York's legislature provided, as § 146(1) of Article 7 of the New York Insurance Law, that:

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[4] *See also Lyman v. Jacobsen*, 128 Or. 567, 580 (1929) (policy owner "ha[s] the same right to dispose of [a life policy] as he would … a horse, or an automobile, or any other personal property."); *Rahders, Merritt & Hagler v. People's Bank of Minneapolis*, 113 Minn. 496, 499 (1911) ("the insured ought to be permitted to realize at any time on the value of his policy; … it is a species of property, and the value of life insurance as an asset would unnecessarily be lost, if not made assignable as other choses in action.").

> Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association or corporation, *but* no person shall procure or cause to be procured, directly or by assignment or otherwise any contract of insurance upon the person of another unless the benefits under such contract are payable to the person insured or his personal representative, or to a person having, at the time such contract is made, an insurable interest in the person insured.

1939 N.Y. Laws, ch. 882, art. 7, § 146 (1939) (emphasis added).

This statute made clear that two entirely different standards apply depending on who procures the life insurance policy. If the insured procures the policy, anyone can be designated as the policy's beneficiary. Only if someone other than the insured procures the policy must the policy beneficiary, at least initially, be someone with an insurable interest in the insured. The statute also defined "insurable interest" for the first time (*i.e.*, who could be the beneficiary of a policy procured by someone other than the insured), including a broader category of persons than previously permitted to procure policies, and thus broadening the concept of insurable interest, rather than restricting it.

Significantly, despite references in the common law to policies taken out in "good faith,"[5] the legislature adopted a statute that does not purport to restrict the insured's right to transfer a policy he or she procures, nor to prohibit the insured from procuring a policy with the intent to transfer it. Rather, confirming that the

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[5] *See Steinback v. Diepenbrock*, 158 N.Y. 24, 30-31 (1899); *Olmsted v. Keyes*, 85 N.Y. at 600.

"good faith" concern referred to at common law only concerned situations in which a third party in fact procures the policy in the first instance, the statute drew a sharp, plain distinction between situations in which an insured procures a policy and situations in which a third party procures the policy.

The legislature also specifically rejected an attempt to modify the insurance law so as to allow insurers to raise insurable interest challenges after the expiration of the contestability period. *See New England Mut. Life Ins. Co. v. Caruso,* 73 N.Y.2d at 80, citing N.Y. Legislature Joint Comm. for Recodification of Ins. Law – meeting Nov. 16, 1938, at 405-406.

D. <u>1984 Re-Codification Of The Insurance Law</u>

The 1984 re-codification of the Insurance Law divided into two subsections the provisions that "[a]ny person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association or corporation" and "[n]o person shall procure or cause to be procured, directly or by assignment or otherwise any contract of insurance upon the person of another unless the benefits under such contract are payable to the person insured or his personal representative, or to a person having, at the time such contract is made, an insurable interest in the person insured" in sub-sections (§ 3205(b)(1) and (b)(2)). 1984 N.Y. Laws, ch. 367, § 1. This separation further

emphasized the separate standard and review required depending on whether the insured or someone other than the insured procured the policy.

E. 1991 Amendment To Section 3205(b)

In 1991, after the IRS raised a question as to whether New York's statute is violated if an insured procures a policy with the intent of immediately assigning it to someone who lacks an insurable interest (in that case, a charity), the legislature amended the statute to make clear that an insured can procure a policy with the intent to transfer it to a party lacking an insurable interest, by adding the phrase "[N]othing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effectuated" to § 3205(b)(1). Failla Aff. Ex. 3: 1991 Bill Jacket, L. 1991, ch. 334. The bill was intended to "clarify that person who procures insurance upon his own self may immediately assign it to another." Failla Aff. Ex. 3: 1991 Bill Jacket at A8586. A letter from New York Assemblyman Howard L. Lasher further explained that "This bill amends section 3205(b)(1) of the Insurance law to make it clear that an individual who procures life insurance on his or her own behalf may immediately assign the policy to a third party." Failla Aff. Ex. 3: 1991 Bill Jacket at July 9, 1991 letter from Howard L. Lasher ("Lasher letter"). Despite the impetus for the change being a question regarding a transfer to a charity, the amendment did not limit the provision allowing immediate transfer to instances involving charities. Rather, the statute confirmed and clarified the

longstanding New York principle that an insured may obtain a policy on his or her own life and transfer it immediately to anyone.

F. The Life Settlement Act

In 2009, the legislature passed the "Life Settlement Act," a comprehensive law effective May of 2010 governing participants in the life settlement industry. New Section 7813(j)(1) establishes a two-year waiting period, subject to certain exceptions, before a newly issued policy may be sold into the secondary market. The legislature did not, however, amend Section 3205(b) in any way, thus leaving intact the statute's explicit language that nothing in the insurable interest statute prohibits an immediate transfer of a policy procured by the insured. In other words, even though, going forward, there are now restrictions on how soon a policy can be sold, those regulations are separate from New York's insurable interest requirements, which, when an insured procures a policy, are met automatically.

Consistent with Section 3205(b)(2), Section 7815 prohibits "stranger-originated life insurance" transactions, defined as "any act, practice or arrangement, at or prior to policy issuance, to initiate or facilitate the issuance of a policy for the intended benefit of a person who, at the time of policy origination, has no insurable interest in the life of the insured under the laws of this state." Consistent with § 3205(b)(1), however, this new provision does not purport to

regulate the insured's intent in procuring a policy. To the contrary, the definition of "stranger-originated life insurance" adopted by the legislature notably, and purposefully, differed from the model legislation of the National Conference of Insurance Legislators ("NCOIL") in that the New York legislation deleted from the NCOIL definition a "plan" to initiate a policy for the benefit of someone lacking an insurable interest. The term "plan" in the NCOIL definition could be construed as prohibiting the purchase of a policy with the plan or intent to sell it to someone without an insurable interest. New York's definition only includes an "act, practice or arrangement." Compare N.Y. Ins. Law § 7815 with Failla Aff. Ex. 4: NCOIL Life Settlements Model Act at page 8. The deletion of the term "plan" reflects a clear legislative view – found elsewhere in the Insurance Law – that the subjective intent or unilateral plan of the insured in obtaining a policy on his or her life to transfer or sell it is legally irrelevant.

ILMA supported both the two-year waiting period and the prohibition against stranger originated life insurance.

ARGUMENT

I. The Certified Question Should Be Answered "No"

A. 3205(B) Expressly Permits An Insured To Procure A Policy On His Or Her Own Life With The Intent Of Transferring It To Someone Lacking An Insurable Interest

The plain language of New York's insurable interest statute allows an insured to procure a policy with the intent to transfer it – as the certified question

asks. Indeed, the unambiguous language of the statute was amended to address the very question that has been certified and expressly *permits* an insured to procure a policy with the intention of transferring it.

Section 3205(b)(1) explicitly provides: "Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of *any* person, firm, association or corporation. Nothing herein shall be deemed to prohibit the *immediate transfer or assignment* of a contract so procured or effectuated." (emphasis added). By expressly providing that an insured may make an "immediate" transfer of a policy (as opposed to using a phrase such as "later transfer" or "future transfer"), the legislature has made clear that an insured is permitted to procure a policy with the intent to transfer it. Indeed, an "immediate" transfer of a policy necessarily entails that the insured intended to transfer the policy at the time he or she procured it.

The only requirements imposed by § 3205(b)(1) are that the insured (i) be "of lawful age" and (ii) procuring or effecting the policy "on his own initiative" (*i.e.*, not subject to fraud, duress or undue coercion). Accordingly, courts have found an insured's procurement of a policy and designation of a beneficiary effective so long as the insured procured the policy without being subject to fraud, duress or undue coercion. *See, e.g., Corder v. Prudential Ins. Co.*, 42 Misc. 2d 423, 424 (N.Y. Sup. Ct. 1964) (finding no evidence of fraud by beneficiary on the

insured and holding that "[w]here the deceased effects the insurance upon her own life, it is well-established law that she can designate any beneficiary she desires"); *Gibson v. Travelers Ins. Co.*, 183 Misc. 678, 680 (N.Y. Sup. Ct. 1944) (finding that beneficiary was entitled to proceeds because there was "no charge of fraud or undue influence" and "[i]t was the deceased who effected the insurance upon his own life"); *In re Estate of Stein*, 174 Misc. 465, 468-69 (N.Y. Sup. Ct. 1940) (upholding will and change in life insurance beneficiary because insured acted "[o]n his own initiative" with no "coercion, duress or domination" present). In other words, for an insured to procure a valid and enforceable contract of insurance upon his or her own life under § 3205(b)(1), the ordinary rules for an effective contract (*i.e.*, lawful age, competency, no duress) must be met, but no further conditions or restrictions are imposed. It is only when someone other than the insured procures the policy that Section 3205 imposes any additional requirement.

Taking the statute's language out of context, the Insurers both ask the Court to construe the phrase "on his own initiative," as not intended to protect insureds who did not competently name beneficiaries because of duress, fraud or undue coercion, but instead to sharply curtail insured's rights. According to the Insurers, this language means that an insured cannot procure a policy and name someone without an insurable interest as beneficiary, or transfer a policy he or she has procured, unless he or she decided to procure the policy without any

encouragement, influence or involvement of any other person.[6] If the Insurers' interpretation were correct, an insured could permissibly procure a policy for the purpose of selling it if the insured came up with the idea on his or her own, but would be violating New York's insurable interest statute if someone else first suggested the idea. The legislature could not have intended such a bizarre distinction.

The Insurers' interpretation of "on his own initiative" to mean without being influenced, rather than simply not under duress or coercion, is also at odds with the practical reality of the business of life insurance, in which someone other than the insured – usually an agent or broker of the insurance company, such as Mr. Lockwood – is virtually *always* involved in convincing the insured to buy a policy (thus, the old adage in the life insurance industry that "life insurance is sold, not bought").[7] The statute cannot reasonably be read in a manner in which an

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[6] The Insurers' argument that "on his own initiative" must mean something more than "consent," because § 3205(c) already requires the insured's consent (*see, e.g.,* Phoenix Brief at 23), is a strawman. Section 3205(1) *does* require more than that the insured consent to the policy's purchase; it requires that the insured procure or effect the policy. Section 3205(c), on the other hand, provides that no life insurance contract shall be made unless the insured "*applies for or consents* in writing to the making of the contract." (Emphasis added.) Thus, even when someone other than the insured procures or effects the policy, and § 3205(b)(2) therefore applies, it is still necessary that the insured consent to the transaction. However, when the insured does not merely consent to a policy's purchase, but rather procures or effects the policy, § 3205(b)(1) applies, and the insured has the right to name any beneficiary and to do with the policy as the insured wishes.

[7] *See, e.g.*, Failla Aff. Ex. 7: article from Forbes.com: "In the U.S. life insurance is sold, not bought. That is, a salesperson almost always initiates the transaction."

insured must have procured the policy without any suggestion or involvement by others in order to enjoy the broad rights provided to insureds under 3205(b)(1). Instead, when read in context, the phrase "on his own initiative" is properly understood as *protecting* the insured, not restricting the insured's rights as the Insurers contend.

Finding that § 3205(b) prohibits an insured from procuring a policy with the intent of transferring it would be contrary to the explicit language of the statute, which imposes no restrictions on an insured's rights to procure a policy for any reason, and specifically instructs that § 3205(b) should *not* be read as prohibiting an immediate transfer of a policy procured or effected by the insured, as answering the certified question "yes" would do. The Court should apply the statute's plain language. *Crucible Materials Corp. v. N.Y. Power Auth.*, 13 N.Y.3d 223, 229 (2009) ("The starting point is always to look to the language itself and where the language of a statute is clear and unambiguous, courts must give effect to its plain meaning"); *Washington Post Co. v. N.Y. Ins. Dep't*, 61 N.Y.2d 557, 565 (1984); *In re Accounting of Chem. Bank & Trust Co.*, 277 N.Y. 252, 259 (1938).

1. Legislative History Supports The Statute's Unambiguous Language

The legislative history of § 3205(b) confirms the plain meaning of the Section's "immediate transfer" language, and also makes clear that the statute has

never been intended to infringe upon the insured's property rights with respect to a policy on his or her own life.

New York's Insurance Law initially required that the insured must be the person applying for the policy, except for very limited exceptions such as a wife applying for insurance on her husband. 1892 N.Y. Laws, ch. 690, § 55 (1892). Even then, however, the Insurance Law included no restrictions on the insured's rights to procure a policy for any reason and to do with it as the insured wished. *Id.* Then, when the precursor to § 3205(b) was enacted in 1939, the statute, as it does today, allowed insureds to "procure or effect" policies on their own lives (if anything, an even broader standard than requiring them to apply for policies) with no restrictions, and permitted others to procure directly policies on the lives of insureds so long as such policies are payable to a person having an insurable interest in the insured. 1939 N.Y. Laws, ch. 882, art. 7, § 146 (1939).

However, when enacted in 1939, and re-codified in 1984, New York's insurable interest statute did not yet include the language "[n]othing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effected." Rather, this language was later added to address the very question that has been certified, and answer it "no."

In a 1991 Opinion Letter, the IRS had questioned whether a transaction would comply with New York's insurable interest statute if an insured had

procured a policy with the intent to immediately assign it to a charity, given that charities (at that time) did not have an insurable interest in insureds. Failla Aff. Ex. 3: 1991 Bill Jacket, at Lasher letter. In other words, the IRS raised the same question that is before this Court now: namely, if an insured procures a policy with the intent to transfer it to a party lacking an insurable interest, has Section 3205(b) been violated? The legislature responded by amending the statute, with retroactive effect, to make clear that the answer was "no." *Id.*[8]

B. Because 3205(B) Does Not Prohibit An Insured From Procuring A Policy With An Intent To Transfer It, The Court Should Not Read Such A Restriction Into The Statute

Even if New York's insurable interest statute did not expressly authorize the procurement of a policy by an insured for the purpose of transferring it, there is no reasonable way of reading the statute as *prohibiting* such act. Section 3205(b)(1) does not purport to place any limitation on the insured's rights, and, as discussed above, in fact provides that an insured can immediately transfer a policy without violating the statute. Section 3205(b)(2), on its face, only pertains to actions of persons other than the insured, and also does not purport to restrict the insured's rights in any way or subject the validity of a policy to the insured's intentions in

[8] The only state court decision to interpret § 3205(b)(1) since its amendment applied the literal language of the statute. *Hota v. Camaj*, 299 A.D.2d 453 (2d Dep't 2002) ("[I]nsurance Law §3205(b)(1) permits any person of lawful age who has procured a contract of insurance upon his or her own life to immediately transfer or assign the contract, and does not require the assignee to have an insurable interest.").

procuring it. Thus, in order to answer the certified question "yes," the Court would have to read into the statute an implied prohibition against insureds procuring policies with the intent to transfer them. Doing so would violate rules of statutory construction, render other explicit provisions of the statute meaningless, and would damage well-established property rights of insureds and inject uncertainty into the life settlement market, to the detriment of both responsible investors and insureds.

1. Reading An Implied Prohibition Into The Statute Eviscerates Explicit Provisions Of The Statute, And Is Contrary To Rules Of Statutory Construction

The District Courts in this case and in *Angel*[9] did not perform any analysis of whether, and how, the implied provision they read into the statute could be reconciled with the statute as a whole. Put simply, it cannot be. In order to read into the statute a prohibition against insureds procuring polices with the intent to sell them, or a requirement that insureds procure policies without an intent to sell them, other explicit provisions of the statute are rendered meaningless or absurd.

First, such an implied prohibition would render meaningless the provision that § 3205(b) should not be read as prohibiting an immediate transfer. If § 3205(b)(1) were rewritten to include a prohibition against insureds procuring policies with the intent to transfer them, it would read:

> "Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any

[9] *Life Prod. Clearing LLC v. Angel*, 530 F. Supp. 2d 646 (S.D.N.Y. 2008).

> person, firm, association or corporation. Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effected *unless the insured procured the policy for the purpose of transferring it*."

or

> "Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association or corporation *unless the insured procures the policy with the intent of transferring it*. Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effected."

To write such a provision into the statute renders the statute nonsensical. If the certified question is answered "yes," and an insured cannot procure a policy with the intent to transfer it, then § 3205(b) *would be* prohibiting an insured from immediately transferring a policy, which is exactly what the statute explicitly says *it does not do*. Avoiding such "a patently absurd result" is a fundamental rule of statutory construction. *See, e.g., Med. Soc'y of N.Y. v. State Dep't of Health,* 83 N.Y.2d 447, 451-52 (1994) (citing McKinney's Cons. Laws of N.Y., Book 1, Statutes, § 141).

Second, in order to answer the certified question "yes," the statute's explicit provision that an insured can procure or effect a policy and designate "any" person as beneficiary of the policy would also be rendered meaningless. Section 3205(b)(1) provides that, when an insured procures a policy, he or she can designate anyone as beneficiary. It is only when someone other than the insured

procures the policy, and § 3205(b)(2) is therefore implicated, that the beneficiary of the policy need have an insurable interest. Contrary to this clear statutory language, a "yes" answer to the certified question purports to require that an insured initially have intended the policy he or she procured to have benefited someone with an insurable interest in the insured in order to be able to later transfer it, despite the fact that an insured is *not* required under § 3205(b)(1) to have designated a beneficiary with an insurable interest in the first place, but is rather explicitly permitted to designate *anyone* as the beneficiary.

It is, thus, readily apparent that in order to answer the certified question in the affirmative, the Court must rewrite, rather than interpret, New York's insurable interest statute. It should not do so. *Chem. Specialties Mfrs. Ass'n v. Jorling,* 85 N.Y.2d 382, 394 (1995) ("a court cannot amend a statute by inserting words that are not there, nor will a court read into a statute a provision which the Legislature did not see fit to enact") (citing McKinney's Cons. Laws of N.Y., Book 1, Statutes, § 363, at 525).

The importance of enforcing these rules of construction, and applying the statute as written, is particularly clear in this instance. A person should be able to tell from reading a statute whether or not his or her conduct violates the statute. *Pringle v. Wolfe*, 88 N.Y.2d 426, 435 (1996) (statute must contain "a reasonable degree of certainty so that individuals of ordinary intelligence are not forced to

guess at the meaning of statutory terms") (citing *Foss v. City of Rochester*, 65 N.Y.2d 247, 253 (1985)). Here, there is no way from reading § 3205(b) that Mr. Kramer, or any other insured, would have known that he was not permitted to procure a policy with the intent to transfer it. To the contrary, based on the language permitting immediate transfer, an insured would have believed the opposite (*i.e.*, that it is permissible to procure policies with the intent of immediately transferring them). Nor would responsible investors, such as ILMA members, know that the policies they purchase from insureds on the secondary market would be vulnerable to challenge based on the insured's intent at the time the insured procured the policy, when the investor had no involvement in the procurement of the policy. Applying statutes as they are written provides clarity and certainty to those functioning in the markets the statutes govern; reading implied restrictions and prohibitions into statutes only leads to confusion and uncertainty.

It would be particularly inappropriate for the Court to rewrite the statute here because the legislature recently spent extensive time considering issues related to life settlements, passing the comprehensive Life Settlement Act (Article 78 of the Insurance Law), which now, going forward, includes a two-year waiting period before policies can be sold, with some exceptions, but did not amend Section 3205(b) to provide that the validity of a policy is dependent upon the insured's

intentions in procuring it, or include such a provision in the Life Settlement Act. *See Pajak v. Pajak*, 56 N.Y.2d 394, 397 (1982) ("It is a fundamental canon of statutory construction that courts 'do not sit in review of the discretion of the Legislature or determine the expediency, wisdom, or propriety of its actions on matters within its powers'") (citing McKinney's Cons. Laws of N.Y., Book 1, Statutes, § 73).

2. Reading An Implied Prohibition Into The Statute Is Contrary To Public Policy

The Court should be particularly hesitant to find an implied prohibition against insureds procuring policies with the intent to transfer them (or any retrospective or unexpressed subjective intent requirement), because creating such an implied prohibition would significantly impair property rights and infuse uncertainty into the life settlement market.

Like all markets, the life settlement market depends on clarity and certainty in order to function efficiently. Subjecting life settlements to challenge based on the insured's intentions in initially procuring the policy would create an unclear standard and preclude investors from having certainty regarding their assets. Indeed, such a subjective intent requirement would allow virtually unlimited challenges to these transactions based on uncertain circumstantial evidence of an insured's uncommunicated intent. This runs contrary to New York's strong public policy of providing certainty to financial transactions. *Banque Worms v.*

BankAmerica Int'l, 77 N.Y.2d 362, 372-73 (1991) (public policy favors "protection and encouragement of trade and commerce by guarding the security and certainty of business transactions"); *Estate of Thompson v. Wade*, 69 N.Y.2d 570, 574 (1987) (public policy favors certainty regarding property rights). This would also unfairly and unnecessarily punish responsible investors. Even if an investor plays no role in the procurement of the policies it later purchases (a standard ILMA members abide by), it would be subject to the risk of insurable interest challenges based on the insured's intent, not the investor's own actions. Requiring investors to determine an insured's intent in procuring the policy would be impractical, especially for an investor who is acquiring a policy previously sold in a life settlement transaction that is now trading in the tertiary market.[10] As this Court explained in *Banque Worms*, the "concern for finality in business transactions has long been a significant policy consideration in this State" and the Court should not apply rules that "disorganize all business operations and entail an amount of risk and uncertainty which no enterprise could bear." 77 N.Y.2d at 372, citing *Hatch v. Fourth Nat'l Bank*, 147 N.Y. 184, 192 (1895).

A standard based on the insured's "intent" would also be unfair to investors because, consistent with this case, insurers typically raise insurable interest

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[10] In some instances, investors don't even know the identity of the insured as the policy is serviced by a licensed life settlement provider on behalf of investors in order to protect the insured's privacy.

challenges only at the time a claim is made (*i.e.*, after the insured is dead), which would force the investor to defend the insured's intent without the best evidence of the insured's intent – the testimony of the insured. Such a standard would suffer from significant "hindsight bias," as insurers would argue that the fact that the policy was sold is evidence that the insured intended to sell it from the outset – a claim that would be difficult to rebut without the insured's testimony. Additionally, such a standard would present significant problems to courts in attempting to apply it and would potentially lead to absurd results. For instance, when an insured initially intends to sell a policy but ultimately decides to keep it, the insurer could still challenge the policy based on the insured's intent in procuring the policy even though no sale ever took place. Similarly, if an insured intends to eventually sell a policy but to keep it for some period of time, or buys the policy with the thought of potentially selling it, determining the insured's "intent" would be difficult if not impossible. For these reasons, an "intent" standard is fundamentally unworkable in practice.[11]

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[11] Although ILMA believes that the certified question can and should be answered in the negative based on the unambiguous language of § 3205(b), it is noteworthy that courts throughout the country have, based on these same public policy concerns, rejected arguments that an insured's procurement of a policy with the intent to sell it violated those states' insurable interest laws. Instead, these courts have found that the applicable state's insurable interest laws are only violated when someone *other than the insured* is the person who effectively purchased the policy in the first instance (*i.e.*, they have recognized the same distinction that is drawn by § 3205(b)(1) and (b)(2)). *See First Penn-Pacific Life Ins. Co. v. Evans*, 313 Fed. Appx. 633, 636 n.3 (4th Cir. 2009) (finding that the insured's intent to transfer did not violate insurable interest law and noting "the majority of courts that have directly considered the issue under various state

Reading an implied prohibition into § 3205(b) against procuring policies with the intent to transfer them would also harm insureds – the very people insurable interest laws are designed to protect. As this Court recognized well over a century ago, "without the right to assign, insurances on lives lose half their usefulness." *St. John v. Am. Mut. Life Ins. Co.*, 13 N.Y. at 39. *See also Grigsby v. Russell*, 222 U.S. 149, 156 (1911) ("To deny the right to sell except to persons having [an insurable interest] is to diminish appreciably the value of the contract in the owner's hands."). Consistent with this longstanding recognition of an insured's property rights in a policy he or she procures, New York's insurable interest statute has never purported to restrict insureds' rights to procure policies for any reason and to do with the policies as they wish. In creating such an implied prohibition, the Court would be turning a statute that has always unequivocally recognized the rights of insureds, while only regulating conduct of those *other than insured*, into a

laws have similarly concluded that intent to transfer a policy does not alone destroy an insurable interest"); *Sun Life Assurance Co. v. Berck*, 2010 WL 2607247, at *6 (D. Del. June 29, 2010); *Lincoln Nat'l Life Ins. Co. v. Gordon R.A. Fishman Irrevocable Life Trust*, 638 F. Supp. 2d 1170, 1178-79 (C.D. Cal. 2009); *Sun Life Assurance Co. v. Paulson*, 2008 WL 451054, at *2 (D. Minn. Feb. 15, 2008). In rejecting arguments that policies violate insurable interest laws, and can therefore be rescinded, solely based on the insureds' intentions in procuring the policies, these courts have rejected a subjective approach to insurable interest determinations that would create uncertainty in favor of an objective standard that can be clearly understood by all market participants and more easily applied by courts. As the Fourth Circuit aptly summarized in *Evans*, "[e]valuating insurable interest on the basis of the subjective intent of the insured at the time the policy issues, as [the insurer] would have us do, would be unworkable and would inject uncertainty into the secondary market for life insurance." 313 Fed. Appx. At 636. This Court, likewise, has refused to adopt interpretations of statutes that are unworkable in practice, *see People v. Nicholas*, 97 N.Y.2d 24, 29 (2001), and should do the same here.

statute that prohibits conduct by the very people insurable interest laws purportedly protect. Consumer protection, property rights, and contract rights all weigh against any such implied prohibition.

The implied prohibition would not only limit the rights of insureds who wish to procure policies with the hope of selling them in the secondary market, but would harm *all* insureds by severely limiting their options after they purchase a policy. If a policy could be rescinded based on an insured's intent to sell the policy, insurable interest challenges would significantly increase. This state of affairs would decrease the demand for, and value of, policies on the secondary market, as investors would have to take into account the increased risk of legal challenges in determining whether to purchase, and how much to pay for, policies. Ultimately, insureds who need to sell their policies for liquidity, to pay medical bills, or for any other number of important reasons, are the ones who would suffer the most, as they would have fewer options for selling policies and would receive less value for their policies.

This is of course what insurers want – a return to the days in which they had monopsony power over the policies they sold. Insurers are the only ones who could benefit from a standard under which policies can be challenged based on the subjective intent of the insured, as they can be expected to use the uncertainty of

such a standard to more freely deny claims and challenge policies. Countenancing such opportunistic behavior is plainly bad public policy.

Because insurable interest laws are not created to protect insurers, an insurable interest standard that benefits only them should be viewed with great skepticism to say the least. If an insurer believes that an insured's "intent" is relevant or does not wish to sell policies to insureds who intend to sell them, the insurer is free to include questions on its application regarding the insured's plans for the policy and, if the insurer discovers evidence that the insured lied, it can then seek to rescind the policy on that basis during the contestability period. But New York's insurable interest statute should not be judicially rewritten to impose a subjective standard that makes it easier for insurers to deny claims after having happily accepted premiums until the insured's death.

II. New York's Well-Settled Contestability Rule Should Not Be Modified

ILMA strongly opposes the Insurers' efforts to create an exception to New York's longstanding rule that insurers cannot challenge the validity of a life insurance policy after the statutorily mandated two-year contestability period. While ILMA is not certain whether the contestability issue will be considered by the Court at this time, ILMA understands that the Insurers have raised this issue. ILMA has a strong interest in preserving the clarity and certainty that New York's incontestability rules provide for insureds and investors in the life settlement

market. ILMA does not believe that there is any reason to overturn New York's settled law on this issue.

This Court has already definitively ruled that New York law does not permit an insurer to challenge a life insurance policy for lack of insurable interest after the contestability period. This rule provides certainty to those participating in the New York insurance market, and the life settlement market, and reflects a careful balancing of policy interests that protects consumers and provides needed stability to the market. If a change to New York's well-settled incontestability rule were warranted, as the Insurers argue, New York's legislature would have made such a change. It has not done so.

A. **This Court Has Already, Correctly, Held That New York's Incontestability Statute Prohibits Insurers from Challenging Life Insurance Policies Based on Insurable Interest after the Contestability Period**

New York's Insurance Law requires all life insurance policies to provide "that the policy shall be incontestable after being in force during the life of the insured for a period of two years from its date of issue...." N.Y. Ins. Law § 3203(a)(3). It does not provide an exception for challenges based on insurable interest or for fraud. Notably, in contrast to § 3203(a)(3), the Insurance Law does allow insurers to reserve the right to contest accident and health insurance policies

after two years based on fraud. N.Y. Ins. Law § 3216(d)(1)(b).[12] If the legislature had wished to similarly provide an exception to New York's incontestability statute for life insurance policies, it plainly knew how to do so. It did not.

The Insurers' argument that the Court should ignore this plain statutory language and nevertheless find an exception for insurable interest challenges is not new ground for this Court. In 1890, this Court found that fraud and insurable interest challenges cannot be made after the expiration of a life insurance policy's contestability period. *Wright v. Mut. Benefit Life Ass'n*, 118 N.Y. 237, 238-39 (1890). That has consistently been the law in New York for over a century.

Then, in 1989, this Court specifically held that Section 3203(a)(3) does not permit insurers to challenge insurable interest after the contestability period. *New England Mut. Life Ins. Co. v. Caruso,* 73 N.Y.2d 74, 78 (1989). As the Court found in *Caruso*, it is clear that New York's legislature did *not* intend to allow insurable interest challenges after the contestability period because:

(1) The legislature specifically discussed whether to change the rule from *Wright*, but determined not to do so and purposefully chose language intended to maintain the holding from *Wright*. *Caruso,* 73 N.Y.2d at 80.

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[12] In *New England Mutual Life Ins. Co. v. Doe*, 93 N.Y.2d 122 (1999), this Court noted that under § 3216(d)(1)(b), a disability insurer could have permissibly provided an exception to its incontestability clause for fraud, but chose not to do so, and thus could not rescind based on fraud after the contestability period. *Id.* at 131. Life insurers, however, are not permitted, under § 3203(a)(3), to reserve the right to contest policies after two years based on fraud because the statute, § 3203(a), has no such exception.

(2) The legislature did not make life insurance policies void for lack of insurable interest, as it did with respect to property policies. *Id.*

(3) The legislature provided a remedy to the insured's estate for insurable interest violations, thus recognizing that insurers might have to pay out proceeds despite statutory violations. *Id.* ("Manifestly the relief granted by the provision contemplates that such policies, although improper, may be issued and enforced.").

The Court in *Caruso* also weighed the policy concerns behind the insurable interest statute and the policy concerns behind the incontestability statute and properly determined that public policy did not warrant an exception to the incontestability statute for insurable interest challenges. Specifically, it found that the policy underlying the insurable interest requirement – prevention of gambling and of compromising public safety "by furnishing a temptation to bring about" the insured event – must be balanced against the parties' justified expectations, the forfeiture resulting from denial of enforcement and the public interest. *Caruso*, 73 N.Y.2d at 81. The Court correctly found that failing to enforce the incontestability statute would provide an "unnecessary advantage" to the insurer by "enabling it to avoid a claim it previously accepted" and that the policy behind the insurable interest rule is best implemented by a rule "which encourages the insurer to investigate the insurable interest of its policyholders promptly within the two-year period." *Id.* at 83.

B. Public Policy Does Not Justify Creating an Exception to the Incontestability Rule for Insurable Interest Challenges

1. The Legislature Has Chosen Not To Provide An Exception To The Incontestability Statute For Insurable Interest Challenges or "STOLI"

In asking the Court to find an exception to the incontestability statute for insurable interest challenges based on "public policy," the Insurers are seeking to have the Court substitute its judgment for that of the legislature. It has been the law in New York for over a century that insurable interest challenges cannot be brought by insurers after the contestability period, and the legislature has not chosen to change that rule. "The construction of a statute accepted for over a century without serious challenge should not be changed by the court without compelling reason." *In re Accounting of Chem. Bank & Trust Co.*, 277 N.Y. 252, 265-66 (1938); *see also Klostermann v. Cuomo*, 61 N.Y.2d 525, 535 (1984) ("The paramount concern is that the judiciary not undertake tasks that the other branches are better suited to perform").

The Insurers argue at length that *Caruso* would have been decided differently if this Court had been considering a "STOLI" case because, the Insurers argue, *Caruso* did not "involve a scheme to defraud an insurer" (*see, e.g.,* Lincoln Brief at 24) and this Court did not anticipate the possibility of such schemes (an odd claim given the Insurers' acknowledgement that "wagering policies" have been around for over a century). In making this argument, the Insurers entirely

ignore the fact that this Court rejected an insurer's attempt to challenge a life insurance policy based on a scheme to avoid insurable interest laws and defraud the insurer *over a century ago*, in *Wright*, a decision adopted by the legislature and followed in *Caruso*.

In *Wright*, the insurer sought to deny a claim based upon allegations that the insured and policy beneficiary defrauded the insurer by falsely representing the insured's health and based on the claim that the beneficiary "had no insurable interest in the life of the insured, in short, that *it was a speculative and fraudulent scheme, devised and practiced by [the beneficiary] to secure an advantage to himself upon the life of [the insured]* which must soon terminate from the diseases he was then afflicted with." *Wright v. Mut. Benefit Life Ass'n*, 118 N.Y. at 241, emphasis added. This Court rejected the insurers' claim, as being barred by the policy's incontestability clause, and rejected the very argument the Insurers make here. As the Court explained, "[the incontestability clause] is not a stipulation absolute to waive all defenses and to condone fraud. On the contrary, it recognizes fraud and all other defenses, but it provides ample time and opportunity within which they may be, but beyond which they may not be, established." *Id.* at 187.

Moreover, the Insurers' characterization of *Caruso* as having involved less significant public policy concerns than at issue here is simply incorrect. If anything, the facts of *Caruso* presented more serious public policy concerns than

raised by the Insurers in this case. In *Caruso*, the defendant had taken out a $1,000,000 policy on a proposed business partner prior to committing assets as security for a loan. *New England Mut. Life Ins. Co. v. Caruso*, 135 A.D.2d 129, 130 (4th Dep't 1988), *aff'd*, 73 N.Y.2d 74 (1989). No loan was ever obtained, and the insured's body "was found in his car, at the bottom of the Barge Canal in Pittsford." *Id.* Despite these facts raising a question as to whether foul play was involved in the insured's death, this Court found that public policy did not justify finding an exception to New York's incontestability statute because such public policy concerns could be, and had been, dealt with by the legislature in other ways. *Caruso*, 73 N.Y.2d at 81. If the potential *for insureds being murdered* to obtain death benefits does not justify a public policy exception to New York's incontestability statute, clearly the Insurers' purported concerns regarding STOLI (motivated plainly by maintaining their profits) do not warrant such an exception.

Unfortunately, fraud is not a recent invention, nor are wagering policies. If New York's legislature thought that either or both justified a change to New York's law on incontestability, it would have provided so. Instead, it has time and again chosen not to. As this Court noted in *Caruso*, New York's legislature considered, and rejected, in 1939, a provision that would allow policies to be challenged on insurable interest grounds after the contestability period, thus preserving the rule from *Wright*. *Caruso*, 73 N.Y.2d at 79-80. More than 20 years

have passed since this Court's *Caruso* decision, and the legislature has not amended either the insurable interest statute or incontestability statute to allow insurable interest challenges after the contestability period.

Significantly, when New York's legislature, this past year, passed legislation regarding "STOLI" (the very subject the Insurers argue necessitates an exception to the incontestability statute), it again chose *not* to amend or otherwise provide an exception to the incontestability statute. This was not an oversight. Rather, hearings in front of the Insurance Department, which informed the legislature's determination, make clear that it was understood to be the law that insurable interest challenges could not be made after the contestability period. (Failla Aff. Ex. 5: *Life Settlement Public Hearings before N.Y. Ins. Dep't* (Nov. 13, 2008)). If the legislature thought that "STOLI" concerns warranted overruling *Wright* and *Caruso* and amending the incontestability statute, it would have done so. It did not, and the Court should not substitute its judgment for that of the legislature.

2. Public Policy Supports New York's Long-standing Rule

The rule that insurable interest challenges cannot be brought by insurers after the contestability period provides a bright line, objective standard for all parties. It is easy for market participants to understand and easy for courts to apply. The rule that policies cannot be challenged after the contestability period also encourages insurers to act promptly to investigate and contest policies,

whereas they would otherwise have a perverse incentive to wait to see whether a policy would be profitable (*i.e.*, how long the insured lived) before challenging it.

The Insurers' argument that New York's incontestability rule encourages fraud and that, unless insurers are able to challenge policies after the contestability period, there will be no deterrent against "STOLI," ignores numerous other deterrents against "STOLI," in addition to the cause of action provided to the insured's estate provided by § 3205(b)(4) and discussed in *Caruso*. Indeed, as Lincoln's brief discusses (at 9-11), "STOLI" producers have been the subject of criminal investigations, SEC enforcement actions, and regulatory proceedings. Moreover, New York has recently provided additional safeguards against "STOLI" in the Life Settlement Act, with ILMA's support, while notably *not* providing for an exception to the contestability period based on "STOLI." The contestability period therefore does not, as the Insurers argue, provide a "loophole" for those who violate New York's insurable interest laws, as such individuals are still subject to suits by the insured's estate for any proceeds received in violation of the insurable interest statute, regulatory actions by the Insurance Department, and even criminal proceedings.

Despite the Insurers' claims that they cannot reasonably identify STOLI policies prior to the contestability period (which begs the question as to how they will identify them after the contestability period if given the opportunity),

insurance companies, including both Lincoln and Phoenix, have regularly announced, since 2007, in calls with investors that they have developed procedures to detect STOLI policies.[13] *See* Failla Aff. Ex. 6: "Could Insurers Already Have the Solution to Stoli?" For instance, John Hancock announced on February 13, 2007 that "We greatly strengthened our measures to eliminate the IOLI cases coming through that we all want to prevent from being issued." MetLife announced on February 14, 2007 that thanks to the steps it and its competitors had taken "we can actually see a time possibly a year from now when there is no more IOLI business." *Id.* Phoenix stated on February 27, 2007 that "In an effort to screen out IOLI sales, the company stopped accepting premiums on a non-recourse basis in February 2006, and has taken proactive steps to improve its surveillance/detection capabilities and its product designs." *Id.* Similarly, Lincoln stated on August 1, 2007 that "I think our success [in avoiding STOLI] is a combination of factors – great products, great distribution, and great underwriting." *Id.*

Insurers admit that they have the resources to avoid taking STOLI business

[13] For instance, one well known technique for determining STOLI is requiring insureds to provide proof that each of the premium payments is being made by the insured (or in the case of a trust owned policy, that the trust is being funded by the insured). Insurers can also investigate policies by speaking to the insured and/or insured's family members who are listed as beneficiaries on the policy or insurance trust prior to the expiration of the contestability period to determine if the policies or interests therein were transferred.

(if they want to). Finding an exception to the incontestability rule for STOLI is not only unnecessary but would reward insurers who fail to act diligently in ensuring they issue policies to those with an insurable interest, and in fact would provide an incentive to insurers to disregard questions regarding insurable interest until after claims are presented and they determine whether a policy has turned out to be profitable. This is particularly problematic given the fact that, as is the case here with Mr. Lockwood, insurers often point to their own duly appointed agents as having been responsible for alleged STOLI business. Insurers should be encouraged to monitor and control the activities of their sales force, not to turn a blind eye to their agents' activities until and unless a policy turns out to be unprofitable.

Indeed, commentators have noted that it is not in the insurers' interest to conduct such investigations in cases where they are allowed to challenge a policy after the contestability period. They refer to this as the "Insurable Interest Two Step." "First, sell your customer an insurance contract with as much willful indifference to insurable interest requirements as doctrinal ambiguity will allow. Second, if the insured event comes to pass, claim that the contract had no insurable interest after all and escape obligation for payment." Jacob Loslin, *Insurance Law's Hapless Busybody: A Case Against The Insurable Interest Requirement*, 117

Yale L.J. 474, (Dec. 2007). New York's contestability law prevents insurers from playing the "insurable interest two step."

New York's legislature has balanced the public policy concerns raised by the Insurers against the public policy behind New York's incontestability statute and determined that the concerns raised by the Insurers do not justify an exception to the incontestability statute, but can be better dealt with in other ways, such as providing a cause of action to the insured's estate for insurable interest violations and now passing regulations regarding "STOLI."

There is no need for the Court to create an exception to New York's incontestability statute to deal with public policy concerns the legislature has already addressed in other fashions and has decided do not warrant an exception to the statute.

CONCLUSION

For the reasons stated herein, *amicus curiae* The Institutional Life Markets Association respectfully request that the Court answer the certified question "no."

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Respectfully submitted,

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