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A legal update from Dechert LLP

Recent Developments in the Life Settlement Industry

The Delaware General Assembly is considering new legislation to address a contentious issue in the life settlement industry. A new law proposed in May 2012, Delaware Senate Bill No. 220 (the Senate Bill), would require a life insurance company that rescinds an insurance policy on the grounds that the policy holder lacked an insurable interest to refund the premiums that the insurer has collected from the owner of the rescinded life insurance policy.¹ If enacted, the Senate Bill would codify the Delaware common law with the stated goal of protecting investors in the secondary market for life insurance in Delaware.² This *DechertOnPoint* discusses the Senate Bill's content and intended effect.

The Senate Bill has its origins in an issue that, in the last decade, has faced the life settlement industry not only in Delaware, but in a number of U.S. jurisdictions. Courts across the United States have been confronted with a significant amount of litigation between life insurance companies and policy owners in which the point in dispute is whether an insurance policy should be deemed void on the grounds that the

insurance policy lacked an "insurable interest."³ Related to this question is whether, in the event the life insurance company obtains a favorable decision in the dispute over the insurable interest, the life insurance company should be permitted to keep the premiums paid by the policy owner. According to the sponsors of the Senate Bill, insurance companies continue to file pleadings in Delaware courts seeking to withhold the premiums paid by the policy owners, despite the "well-settled" common law rule that "an insurer must return the premiums it has collected on the policy."⁴

While the sponsors of the Senate Bill have cited a number of cases demonstrating that this controversy may be well-settled in Delaware,⁵ other states have reached the conclusion that

¹ See S.B. 220, 146th Gen. Assemb., Reg. Sess. (Del. 2012).

² See *id.*

³ See *Lincoln Nat'l Life Ins. Co. v. Joseph Schlanger 2006 Ins. Trust*, 28 A.3d 436 (Del Supr. 2011); *Kramer v. Phoenix Life Ins. Co.*, 940 N.E.2d 535 (N.Y. 2010); *Lopez v. Life Ins. Co. of America*, 406 So.2d 1155 (Fla. 4th DCA 1981); *Equitable Life Assur. Soc. of U.S. v. Johnson*, 127 P.2d 95 (Cal. App. 1942); *Holland v. Pyramid Life Ins. Co. of Little Rock*, 199 F.2d 926, 929 (5th Cir. 1952) (applying Texas law). For previous *DechertOnPoints* that have discussed insurable interest and the life settlement industry in general, see Oct. 2009 "[Life Settlement Securitizations Under Scrutiny](#)," Aug. 2010 "[Additional Governmental Oversight Recommended for Life Settlement Industry](#)," Feb. 2011 "[Recent Developments in the Life Settlement Industry](#)," Nov. 2011 "[Recent Developments in the Life Settlement Industry](#)."

⁴ S.B. 220.

⁵ See *id.*

the insurance companies may withhold premiums paid by policy owners who held insurance policies fundamentally flawed by the lack of an insurable interest. Florida and Arkansas appellate courts, for example, have reasoned that to compel insurance companies to refund premium payments after an adverse determination of insurable interest would not appropriately disincentivize what such courts view as “wagering contracts” on the life of an insured individual, which these courts consider void as against public policy.⁶ Thus, in Florida and Arkansas, insurance companies may retain premiums paid on policies that are later deemed to have been void on the grounds that such policies lacked an insurable interest.

However, contrary to the conclusions reached by the Florida and Arkansas courts, courts in other jurisdictions have reasoned that permitting insurance companies to retain premiums paid in cases where there was no insurable interest would provide an unfair windfall to life insurance companies. According to one federal appellate court in Texas, for example, it is “settled [Texas] law” that individuals “without insurable interests, who in good faith pay premiums, [are] entitled to a claim against the proceeds of the policy for their repayment.”⁷ Similarly, in California, policy owners are entitled by statute to a return of the premiums paid if the policy is determined to be “voidable on account of facts, of the existence of which the insured was ignorant without his fault,”⁸ a rule followed by the California courts adjudicating insurable interest disputes since as far back as the 1940s.⁹

Delaware courts have, for at least two decades, ruled consistently in accordance with the views of the Texas and California courts rather than with the views of the Florida and Arkansas courts. According to at least two Delaware federal cases, when an insurer rescinds an insurance policy, the insurer must return the premiums that it has collected on the policy.¹⁰ Notwithstanding this line of cases, the sponsors of the Senate Bill believe that insurers have continued to file lawsuits that seek to rescind the life

insurance policies they have issued in Delaware and allow the insurance companies to keep the premiums paid on those policies.¹¹ The Senate Bill is expressly designed to stem the flow of such litigation by “eliminat[ing] any possible uncertainty about the state of the law by adopting the common-law [sic] rule that an insurer cannot rescind a life insurance policy issued in [Delaware] unless it refunds the premiums to the owner of the policy.”¹² In order to accomplish this stated goal, the Senate Bill would amend Section 2704 of the Delaware insurance code by adding a new subsection (h), which would provide “that if a life insurance policy is rescinded, voided or otherwise terminated” because such insurance policy was procured by “a person not having an insurable interest,” the insurer shall pay to the owner of the policy (at the time the policy was rescinded), “an amount equal to the total premiums paid with interest at an interest rate no lower than that specified in the [insurance policy] for calculating the cash surrender value” of the policy at the time the policy was rescinded.¹³

According to the sponsors of the Senate Bill, in addition to eliminating uncertainty about the state of Delaware law, if enacted, the new law would advance three additional goals.¹⁴ First, the law would provide “certainty to investors who purchase life insurance policies in the secondary market” which would “benefit Delaware consumers — particularly senior citizens — by giving [the consumer] the chance to sell a life insurance policy that the consumer no longer want[s] or need[s] for a substantially higher price than the cash surrender value of the policy.”¹⁵ Second, the law would “eliminate the undesirable effect of incentivizing insurance companies to bring rescission suits as late as possible as they continue to collect premiums at no actual risk.”¹⁶ Third, the Senate Bill would “eliminate the risk of expensive and unnecessary litigation for owners of life insurance policies in Delaware by establishing a clear and unambiguous rule that is consistent with existing case law.”¹⁷

⁶ See *TTSI Irrevocable Trust v. ReliaStar Life Ins. Co.*, 60 So.3d 1148, 1150 (Fla.App. 5 Dist. 2011); *Security Mut. Life Ins. Co. v. Little*, 178 S.W. 418 (Ark. 1915).

⁷ *Holland*, 199 F.2d at 929.

⁸ Cal. Ins. Code § 483.

⁹ See *Equitable Life*, 127 P.2d at 108.

¹⁰ See, e.g., *Lincoln Nat’l Ins. Co. v. Snyder*, 722 F.Supp.2d 546, 565 (D.Del. 2010); *Oglesby v. Penn Mut. Life Ins. Co.*, 877 F.Supp. 872, 890 (D.Del. 1994).

¹¹ See S.B. 220.

¹² See *id.*

¹³ *Id.*

¹⁴ See *id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

On May 9, 2012, the Senate Bill was assigned to the Delaware Senate Judiciary Committee and is awaiting further action.¹⁸

¹⁸ See *Senate Bill #220*, DEL. GEN. ASSEMB., (May 9, 2012), <http://www.legis.delaware.gov/LIS/LIS146.nsf/vwLegislation/SB+220?Opendocument>.

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