

Robin & Peter on LIFE SETTLEMENTS



June 26, 2014

Life Settlements and Insurable Interest

Producers often approach us with concerns about the legality of life settlements. In particular, they wonder about the buyer's lack of insurable interest on the life of the insured. However, the legal basis for life settlements is firmly established, going back more than 100 years to a 1911 United States Supreme Court ruling in the case of *Grigsby v. Russell*. The decision, written by the legendary Justice Oliver Wendell Holmes, Jr., ruled that the sale of a life insurance policy, validly obtained by someone with insurable interest, could be legally sold to a third party without insurable interest.

The facts of the case were similar to many life settlement situations we see today. John C. Burchard, had acquired a life insurance policy on his own life. Sometime later he fell ill and into financial difficulty. As a result, he could no longer afford the premium and needed cash for medical expenses. Dr. Grigsby bought the policy from Mr. Burchard for \$100 and took over paying the premiums. When Mr. Burchard died, his heirs contested the validity of the sale of the policy, arguing that the purchaser lacked insurable interest and they, not Dr. Grigsby, should be entitled to the proceeds.

The court ruled in favor of Dr. Grigsby saying that insurable interest was required only at the inception of the policy. The requirement of insurable interest on inception exists so that unrelated third parties would not be able to speculate or wager on the lives of others, especially without their knowledge or acquiescence. However, the court reasoned that where a policy is validly issued to someone with insurable interest, the later sale of that policy does not carry with it the same dangers as a policy originated without insurable interest.

Furthermore, the court stated that "So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property." Ordinary property can be bought and sold and to deny policy owners similar rights would be to significantly diminish the value of their life insurance policy.

Today, more than 100 years later, 42 states have enacted legislation regulating life settlements by establishing standards of conduct and disclosure that protect insureds, policy owners and investors. Consistent with the ruling in the Grigsby case, insurable interest for life insurance is required only at the inception of the policy. In addition to the insurable interest requirement at inception, to prevent speculation in life insurance policies, these laws also forbid the sale of a policy within two years of origination (or more in some states) except under exceptional hardship provisions.

Today, like one hundred years ago, people continue to suffer financial setbacks and have policies they no longer want, need, or can afford. A life settlement offers policy owners the opportunity to maximize the value of their property, just as Justice Holmes envisioned. As you encounter clients who are about to lapse or surrender a policy, be sure to give us a call. Remember: It can't hurt to try - it can only hurt not to.

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