Nos. 11-55366, 11-55665

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

WELLS FARGO BANK, N.A., as trustee for the
BENJAMIN CABAL 2007 INSURANCE TRUST

Plaintiff-Counter Defendant-Appellee,

v.

AMERICAN NATIONAL INSURANCE COMPANY,
a Texas insurance company

Defendant-Counterclaimant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA
CIVIL CASE NO. 2:09-CV-01840-DDP (Honorable Dean D. Pregerson)

BRIEF OF AMICUS CURIAE INSTITUTIONAL LIFE MARKETS ASSOCIATION IN SUPPORT OF PLAINTIFF-COUNTER DEFENDANT-APPELLEE AND URGING AFFIRMANCE

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae Institutional Life Markets Association is not a publicly traded corporation. There are no parent corporations or other publicly held corporations that own 10% or more of amicus.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

STATE CASES

STATE STATUTES

OTHER AUTHORITIES

TABLE OF AUTHORITIES
(continued)

Page(s)

QUESTIONS PRESENTED

1. A husband purchased a life insurance policy through a trust. The husband designated his wife as the beneficiary of the trust, making her the ultimate beneficiary of the policy. Three months after the policy was issued, the wife sold her interest in the trust to a third party. The insurance company seeks a ruling that any policy is void from the start for lack of an insurable interest when the purchaser or beneficiary intended to re-sell the policy at the time of purchase. Was the district court correct in rejecting that argument, given that the husband, the wife, and the trust all had an insurable interest in the husband's life when the policy was issued?

2. Was the district court correct in holding that, when an insurance company renounces a contract and persuades a court to rescind it, the insurer cannot keep the premiums it collected under the contract?

INTERESTS OF AMICUS CURIAE

Institutional Life Markets Association ("ILMA") is a not-for-profit trade association focused on the secondary market for life insurance. ILMA members seek to educate consumers that their life insurance is a valuable asset, expand consumer choice in life insurance, and support the responsible growth and regulation of the life settlement industry.

No counsel for a party authored this brief in whole or in part. No person or entity, other than amicus curiae, its members, or its counsel, made any monetary contribution to the preparation or submission of this brief.

All parties have consented to the filing of this brief.

INTRODUCTION & SUMMARY OF ARGUMENT

American National Insurance Company ("ANICO") wants to have its cake and eat it … twice. ANICO already won the rescission it sought, but asks this Court to layer on another basis for rescission—one that would enhance its own bottom line but eviscerate a competitor that has brought an enormous measure of financial security to millions of Americans grappling with how best to structure billions of dollars worth of life insurance. Then, having canceled the contract to evade any obligation, ANICO asks this Court to let it pocket all the benefits it secured under the contract. This level of gluttony is not only a vice, but a violation of California law.

It is easy to miss from ANICO's brief, but as the district court correctly found, this is a straightforward case about an individual act of fraud in the purchase of a life insurance contract. As both sides agreed below, Mr. Cabal and his insurance agent lied about material facts—including his net worth, his ability to pay the premiums, and his desire to keep the policy—and ANICO would not have issued the policy but for the lies. The district court remedied this abuse by rescinding the policy for fraud, just as ANICO had requested. And no one is challenging that holding.

But ANICO wants more—much more. It wants this Court to add another basis for reaching the same exact result—rescission. It seeks a holding that could recast every consumer's decision to buy and then subsequently sell a life insurance policy as a sham purchase, thereby making every such policy voidable at the insurer's option for lack of an insurable interest.

The only way to reach that result is to redraft California's insurance statutes. California law allows consumers to sell their life insurance freely to any third party and specifically provides that a person's intent to exercise that right is irrelevant as to whether an insurable interest exists at the time the policy is issued. To accept ANICO's invitation to graft an intent requirement onto the insurable interest statute would upset the expectations of millions of consumers by depriving *all* individual policyholders—not just the rare swindler—of the ability to use their life insurance effectively as an investment asset that can be bought and sold.

What is devastating to the consumer would be a boon to insurance companies. Not too long ago, only the insurance company that issued a policy would purchase it back from the consumer. That gave the insurance company the absolute power to set the price. Insurers used that power to offer the consumer only a fraction of her policy's true value. Responding to consumer frustration with such a one-sided arrangement—and protected by laws, like California's, that enshrine the consumer's right to re-sell a policy—a vibrant secondary market in insurance policies developed. This market—the "life settlements market"—affords consumers vastly more, and more flexible, financial planning options than they had enjoyed when they were beholden to the insurance companies. As beneficial as it was to consumers, the life settlement market weakened the insurance industry's bottom line.

A seismic change in law like the one ANICO seeks here would enable insurance companies to achieve through the courts what they could not achieve in the marketplace or the legislatures: gutting the secondary market for life insurance by casting doubt on the validity of some $35 billion of policies that have been openly and honestly procured and sold. In the process, the shift would grant insurance companies the irresistible power to game the system, as they have already started doing, by collecting premiums for years on policies they believe to be of questionable validity and then contesting only those unprofitable policies that ripen into claims.

The gaming would only be exacerbated by ANICO's further argument that an insurer, unlike any other party that seeks rescission, should be allowed to cancel its obligations under its contract but retain the payments it collected.

In short, if ANICO gets its way, everyone loses except insurance companies—which win big. This Court should reject ANICO's over-reaching positions and affirm.

ARGUMENT

I. THE TRIAL COURT CORRECTLY REJECTED ANICO'S ATTEMPT TO REWRITE CALIFORNIA INSURABLE INTEREST LAW TO THE ADVANTAGE OF INSURERS AND AT THE EXPENSE OF CONSUMERS.

A. This Case Is Not About Insurable Interest.

The central gambit in ANICO's brief is like using a bazooka to kill a gnat that is already dead.

This case is not about "insurable interest." "Insurable interest" refers to the interest—personal or financial—that a person has in the life of the insured. As Wells Fargo explains, *see* Response Brief ("RB") at 46-50, two provisions of the California Insurance Code confirm with unmistakable clarity that the insurable interest rule does not bar a consumer from purchasing insurance with the intention of later selling it—and certainly does not authorize a court to psychoanalyze every consumer to discern whether he bought the insurance with the proper intention. One section provides that a person who takes out a policy on his own life has an "unlimited insurable interest in his or her own life." Cal. Ins. Code § 10110.1(b). And another provides that he also has the unlimited right to sell his life insurance policy "to any person, whether or not the transferee has an insurable interest." Cal. Ins. Code § 10130. For nearly a century, California courts have recognized that the latter provision was "designedly adopted to set at rest any question as to the assignability of a life insurance policy and also to affirm the right to make such assignment to a person having no insurable interest in the life of the insured." *Lewis v. Reed*, 48 Cal. App. 742, 746 (1920).

The district court was indisputably correct in finding that Mr. Cabal had an insurable interest in his own life when he applied for the policy and when it was issued. So did his wife, who was the original beneficiary of the Trust and ultimately the policy. Whether Mr. Cabal or his wife intended to sell the policy does not alter the result: Whether a person procures a policy intending to exercise his acknowledged right to sell it has absolutely no bearing on whether an insurable interest exists at the time the policy was issued. *See Lincoln Nat'l Life Ins. Co. v. Gordon R. A. Fishman Irrevocable Life Trust*, 638 F. Supp. 2d 1170, 1179 (C.D. Cal. 2009) (holding that the insurer "may not avoid its obligations under the Policies merely because [the insured] or the Trust … intended to exercise the right to sell or transfer them at some point in the future," because the insured's "intent, and the intent of the Trust to exercise its rights, standing alone, are legally irrelevant"); *Lincoln Life & Annuity Co. v. Berck*, 2011 WL1878855, *7 (Cal. Ct. App. May 17, 2011) ("Although the evidence shows the trust intended that [a third party] ultimately acquire the beneficial interest in [the] policies, that intent does not negate the fact that when the trust acquired the policies, they were supported by an insurable interest."), *review denied* Aug. 31, 2011.

The district court's task in this diversity action was to "approximate state law as closely as possible," *Ticknor v. Choice Hotels Int'l, Inc.*, 265 F.3d 931, 939 (9th Cir. 2001)—which is exactly what it did. "Where the state's highest court has not decided an issue, the task of the federal courts is to predict how the state high court would resolve it." *Id.* In making this prediction, federal courts should "look to existing state law without predicting potential changes in the law." *Id.* Here, the existing state law says nothing about a person's intent to sell a policy, and the California Court of Appeal has held such an intent is irrelevant—in an opinion the California Supreme Court declined to review. *See Berck*, 2011 WL1878855, *7. California law is clear that an insurable interest either exists or does not exist based upon the relationship of the insured to the person taking out the policy. In this case, under the plain language of Insurance Code section 10110.1(b), an insurable interest clearly did exist.

The fact that Mr. Cabal or his agent lied about his finances and his intention to sell the policy makes this a simple issue of fraud, not insurable interest. Had Mr. Cabal told the truth about his finances or his intention to sell the policy, he would obviously have had an insurable interest in his life. His relationship to the policy did not change just because he lied.

Based on its fraud claim, ANICO persuaded the district court to invalidate the Cabal policy—and rightly so. That would be enough for ANICO if it were only after that (very substantial) gnat. But ANICO is after a mammoth. What ANICO really wants is to overhaul the law to destroy every person's right to obtain and sell a policy—not just those who commit fraud. One can hardly blame ANICO for trying in light of the windfall it—and the entire insurance industry—stands to gain. Redefining insurable interest as a function of the purchaser's intent to keep a policy will cast a cloud on the validity of billions of dollars in life insurance policies that have been sold—or potentially would be sold—on the secondary market. At last count, there was approximately $35 billion in life insurance in force on that market. *See* Oliver Suess, *Death Derivatives Emerge from Pension Risks of Living Too Long*, www.bloomberg.com/news/2011-05-16/death-derivatives-emerge-from-pension-risks-of-living-too-long.html (last visited Jan. 3, 2012). The ruling ANICO seeks would allow it and other insurers to avoid their obligations under these policies while retaining millions of dollars in premiums they have collected. The district court wisely rejected ANICO's attempt to convert the insurable interest requirement into a windfall for insurance companies, and this Court should too.

B. The Court Should Apply The Insurable Interest Rules With An Understanding Of Life Insurance As It Exists Today.

We agree with ANICO that one cannot assess the consequences of its proposed insurable interest rule without some "historical perspective." Appellant's Opening Brief ("OB") at 15. But ANICO's terse telling of the history reads like an "historical perspective" on the Constitution that neglects to mention the Bill of Rights. ANICO omits the most important part of the story—the role that life insurance plays in the financial security of millions of Americans today. Life insurance today is more than just a way to protect against the risk of death; it is an investment that consumers use—with the insurance companies' enthusiastic complicity—for income protection, growth, and even immediate financial return. It is a valuable asset that in California and elsewhere individual consumers can freely buy, hold, or sell, as their personal and financial circumstances dictate.

Until recently, consumers who wanted to sell this asset were limited to one potential purchaser—the company that issued the policy. Just in the last decade, a robust secondary market erased that market defect by empowering consumers to snub the exclusive buyer who was low-balling them and capture the full value that the market placed on their policies. No "historical perspective" of the life settlement market is complete without an accounting of the benefits it has brought to consumers.

1. Modern life insurance is more than just a way to protect against the risk of death.

Over the last thirty years, insurance companies have transformed life insurance from a simple mechanism to protect against the risk of death into a valuable and infinitely malleable form of investment for consumers. That transformation took place when insurers introduced new forms of permanent life insurance. Traditional term life insurance would expire at the end of a particular term, which meant that a customer could pay premiums for, say, 20 years and never collect a so-called "death benefit." In contrast, permanent life insurance stays in force until the insured dies (assuming premium payments are current), thus guaranteeing the policyholder a return on the premiums she invests. Permanent life insurance also accumulates a cash value from premium payments, which grows tax-deferred. *See* KENNETH BLACK & HAROLD D. SKIPPER, LIFE INSURANCE 83-84 (12th ed. 1994); Charlene D. Luke, *Taxing Risk: An Approach to Variable Insurance Reform*, 55 BUFF. L. REV. 251, 258 (2007).

Today, the vast majority of people who own life insurance own permanent life insurance. *See* BLACK & SKIPPER, *supra*, at 83. While permanent life insurance comes in many different flavors, each of them has distinct investment characteristics. Universal life insurance, for example, gives policyholders flexibility to make premium payments into a savings account that accrues interest. *Id.* at 130-36. With variable life insurance, the cash value of the policy and the death benefit it pays vary directly with the performance of a separate investment account. *Id.* at 114. The policy "shift[s] all or part of the investment from the insurance company to the [policy's] owners," making it almost a "pure investment." Luke, *supra*, at 258, 261. For that reason, insurers that invest variable life insurance assets in securities are considered "investment companies" under federal law, and both they and their variable policies are subject to federal securities laws. BLACK & SKIPPER, *supra*, at 115.

The insurance companies that devised these products aggressively market them as investments, variously touting them as combining "insurance protection with investment opportunity," offering "a range of investment choices," http://www.axa-equitable.com/life-insurance/variable-universal-life-insurance.html (last visited Jan. 4, 2012), and marketing the "upside potential of variable investment options," https://www.lfg.com/LincolnPageServer?LFGPage=/lfg/lfgclient/fprod/life/index.html&LFGContentID=/lfg/llc/prd/all/aag/var (last visited Jan. 4, 2012). And the insurance industry's marketing campaign worked wonders. Millions of Americans now hold trillions of dollars of life insurance as part of their personal financial plans. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES, TABLE 1220, LIFE INSURANCE IN FORCE AND PURCHASES IN THE UNITED STATES—SUMMARY: 1990 TO 2009, 754-55 (2012).

2. A robust secondary market enables consumers to realize the full value of their life insurance investments.

As more consumers used life insurance as investments, more and more consumers sought to monetize their investment as their personal or financial circumstances changed.

In years past, when consumers wanted to cash out their investments, insurance companies offered them two options: Nothing, and next to nothing.

Option 1: They could let their policies lapse and forfeit all their premiums.

Option 2: They could surrender their policies for an often-nominal cash surrender value. The problem for consumers was that "life insurance policies were bound by a monopsony, in which there was only one buyer for the instrument. If a consumer wished to sell a life insurance policy, the only buyer was the company that originally sold it." Ron Panko, *A Matter of Trust: Financial Planning; Insurance Market*, A.M. BESTWIRE, Dec. 1, 2002, at 22. That meant that "the policyholder [could] not bargain effectively over the surrender value—there is no other potential buyer for the policy." Neil A. Doherty & Hal J. Singer, "The Benefits of a Secondary Market for Life Insurance," WHARTON FINANCIAL INSTITUTIONS CENTER, #02-41, at 18 (2002). The policyholder is "forced to either accept an amount that is substantially less than the true economic value or elect not to surrender the policy." *Id.* Insurers profited handsomely from their monopsony position because they would never have to pay the death benefits on lapsed or surrendered policies, even after raking in substantial premiums for them. *See* GEOFFREY CHAPLIN ET AL., LIFE SETTLEMENTS AND LONGEVITY STRUCTURES: PRICING AND RISK MANAGEMENT 13-14 (2009).

The life settlement market was a response, in part, to this glaring economic inefficiency: Individuals no longer needed or wanted to keep their policies, and investors "were willing to purchase [them] for substantially more than the prearranged termination terms offered by the insurance companies." Doherty & Singer, *supra*, at 3. This broke the insurance industry's chokehold on their customers. By giving customers another option for converting their insurance investment to cash, the secondary market enabled consumers to realize much more of the value of their policies, as much as ten times more. *See Recent Innovations in Securitization: Hearing Before the Subcomm. on Capital Mkts., Ins., & Gov't Sponsored Enter. of the H. Comm. on Fin. Serv.*, 111th Cong. 43, 68-69 (2009).

"Viatical settlements" of the 1980s, which were the precursors to modern-day life settlements, show how the secondary market promotes consumer choice. AIDS patients were unable to work but needed cash to cover their high medical expenses. *See* CHAPLIN ET AL., *supra*, at 13-14. They also could not afford to continue paying life insurance premiums. Yet, the insurance companies gave these individuals no out. The insurers would merely let the patient cash out his policy for a pittance, leaving the insured with nothing to show for years of premium payments—no money to cover his medical bills *and* no life insurance to leave loved ones. Into the breach entered viatical settlement companies with a solution that was as straightforward as it was welcome. The company would purchase a patient's policy for a lump sum and assume the obligation to pay the premiums. That meant the patient had a nest egg to cover expenses and was relieved of the burden to pay premiums. In return, the company received the rights and obligations under the policy. *Id.* ANICO can look down its nose at such arrangements, but it cannot deny that its customers were far better off with viatical settlements than with what ANICO was offering them.

Terminal illness, of course, is not the only reason to sell a life insurance policy. A husband who obtained a policy to protect his wife in the event of his early death might not want to keep the policy when he outlives her. A widow who bought life insurance when she was young may decide, in light of changed circumstances, that she is better off with an annuity that will pay her a fixed income for the remainder of her life. A person who has been laid off might simply decide he or she wants the cash. Like viatical settlements, life settlements enable consumers to realize the immediate value of their life insurance.

That is the "historical perspective" from which ANICO's proposed rule should be judged.

C. ANICO's Intent-Based Rule Would Destroy The Secondary Market For Life Insurance And Undermine Consumer Interests.

What has been good for consumers has not been good for insurance companies. Insurance companies now find themselves redeeming fewer policies for pennies on the dollar, and they now have to pay claims on policies that would have lapsed when the insurers were happily positioned as the only buyers in the market. That is why ANICO is not satisfied with a ruling that voids the Cabal policy on the basis of fraud alone. Far better for the bottom line is ANICO's wildly expansive rule that redefines "insurable interest" to potentially invalidate every insurance policy that might have been purchased with some intent to re-sell it. A rule like that would enable the insurance industry to regain the ground it lost with the emergence of the secondary market. It would also wreak havoc with life settlements in California—and negate the consumer benefits they have wrought.

1. ANICO's intent-based rule would disable the life settlement market with ambiguity.

If a trade group were commissioned to devise a legal rule that would sow maximum uncertainty into the life settlement market, wreak the greatest havoc on consumer choice, and bring the insurance industry the greatest profit, it would look a lot like ANICO's intent-based rule. The risk of paying for policies that insurers might later claim are void would deter investors from buying any more policies, which in turn would force consumers to keep policies they do not want or surrender them to the insurers for much less than their actual value. The upshot would be the evisceration of the secondary market.

The ambiguities in ANICO's proposed intent-based rule abound: For example, what kind of intent would negate insurable interest? If a consumer intends to sell a policy many years after it is purchased, is that enough? If so, how firm must that intent be: Must it be expressed as a firm commitment or will an unexpressed plan suffice? How about a clear intention to leave the option open? What if she purchases a policy with the intent to sell it, but changes her mind and never does? Does a court have to wait until the policy is sold to determine that it was always void? If so, what is the court to do with the rule that the existence of an insurable interest is determined at the time the policy takes effect? *See* Cal. Ins. Code §§ 286 ("[A]n interest in the life or health of a person insured must exist when the insurance takes effect, but need not exist thereafter or when the loss occurs."), 10110.1(d) ("An insurable interest shall be required to exist at the time the contract of life … insurance becomes effective, but need not exist at the time the loss occurs.").

These are not academic musings. They are real questions posed in real cases based on positions that insurance companies—not coincidentally, represented by the same counsel who represents ANICO in this appeal—have pressed against real consumers. Consider two examples:

Example 1: A father takes out a loan to pay the first two years of premiums on three life insurance policies. He forms a trust to hold the policies and designates his sons as the beneficiaries. The loan is non-recourse, secured only by the policies, and the interest rate is high. When the father procures the policies, he believes he will probably eventually sell them, but he procures them because he can finance the premiums, and if after two years, he does not want to keep the policies, he can try to sell them. But if he dies or becomes seriously ill during the two-year period of the loan, he (or his heirs) will keep the policies. Are these policies void? In *Fishman*, 638 F. Supp. 2d at 1179, the insurer argued yes, but the district court, applying California law, disagreed.

Example 2: A husband takes out a policy and designates his wife as the beneficiary. He also signs an agreement to allow a third party to broker the sale of his policy—if he ever decides to sell it—and assist him with obtaining premium financing. A few months after the policy is issued, he obtains a non-recourse premium finance loan, like the loan in Example 1. He never sells the policy. He dies shortly after the loan matures, and his wife is still the beneficiary. Is his policy void? In one real-life case, the insurance company banked all the premiums and waited until the widow sought payment of the death benefit to declare for the first time that this policy was always void for lack of insurable interest. *See Sciaretta v. Lincoln Nat'l Life Ins. Co.*, Case No. 9:11-cv-80427 (S.D. Fla. filed Apr. 21, 2011), Plaintiff's Motion for Summary Judgment, Docket Entry #61 (filed Dec. 8, 2011).

As these cases illustrate, the problem is that an insured's true intent is elusive and, regardless of what he knows to be his own intention, he (and any potential buyer) will never know up front what some jury will determine the truth to be. Worse yet, when the insurer decides not to contest the policy until the insured dies, it eliminates any risk of testimony from the most definitive authority on the insured's actual intent. That uncertainty is utterly incapacitating from the customer's (and any potential buyer's) perspective. Where the law should "protect[] the integrity of the life insurance transaction in terms of both preserving the contractual freedom of the parties and assuring the stability of the contractual commitment," ROBERT E. KEETON & ALAN J. WIDISS, INSURANCE LAW § 3.3(b)(1) (1988), ANICO's intent-based proposal would destabilize the contractual commitment.

2. ANICO's intent-based rule would incentivize insurance companies to take advantage of consumers.

In contrast to the consumer, ANICO and other insurers would thrive in the uncertainty ANICO's proposed rule would foster. Life insurance companies would have every economic incentive to issue policies of questionable validity and decide later, after collecting premiums for years, whether to contest a policy for lack of insurable interest. With that power would come enormous potential for abuse—a power certain insurers are already trying to exploit.

First, ambiguity shifts all of the cost of a potentially invalid policy to consumers, at no cost—and, indeed, a substantial benefit—to insurers. If a policyholder wants any chance to collect on a policy, the holder must continue to pay the premiums, hoping that the insurer will honor its obligation to pay the death benefit. Until the insurer pays the death benefit, the insurer is receiving all of the monetary benefits under the contract, and the policyholder is receiving none. Because an insurance company seeks to keep those benefits when it contests a policy, the policyholder bears all the risk that the insurer will seek to invalidate a policy for lack of insurable interest. This is no hypothetical risk. As is discussed below, in this very case, ANICO is attempting to keep the premiums it collected, including premiums it received *after agreeing* that the policy should be rescinded for material misrepresentations, on the theory that if the policy is void *for lack of insurable interest*, the Court should "leave the parties where they are found." OB 25.

Second, an insurer with any sense will cherry-pick profitable policies and contest only the ones it deems unprofitable. That is exactly what happened in the *Sciaretta* case discussed above, where the widow had to wait until her husband died to learn that the insurance company was reneging on the deal, while retaining the premiums. *See Sciaretta*, Case No. 9:11-cv-80427, Plaintiff's Motion for Summary Judgment, Docket Entry #61 (filed Dec. 8, 2011).

Third, the more ambiguous the insurable interest rule, the more discretion the insurer has to exercise its option to cancel a policy: "[U]ncertainty about the ultimate validity of an insurance policy with a questionable insurable interest permits insurers to issue policies that appear valid to policyholders, but that may nevertheless be deemed invalid by courts. The potential for invalidation decreases the value of the policy to the policyholder but increases the value to the insurer." Jacob Loshin, Note, *Insurance Law's Hapless Busybody: A Case Against the*

Insurable Interest Requirement, 117 YALE L. J. 474, 478 (2007). A clear, objective insurable interest standard protects the policyholder from this unseemly dance that one commentator has derided as the insurable interest "two-step." *Id.* at 495.

Fourth, insurers have every incentive to contest policies for lack of insurable interest—even when they will lose. Insurers benefit the most when a policy is deemed void for lack of insurable interest and they are allowed to keep the premiums. But their worst-case scenario is that the policy is upheld, in which case they will have to perform on the contract they were already paid to perform. Bringing a challenge is a no-risk proposition.

Indeed, the insurer wins even when it loses. With every challenge to the validity of a policy, the investors who purchased the policy on the secondary market are forced to incur substantial defense costs. Those costs increase the transaction costs of every life settlement, which in turn depresses the value of any policy being sold, and depresses demand for all policies.

Ambiguity is thus the insurance company's friend and the consumer's enemy.

3. ANICO's proposed rule would arbitrarily restrict the rights of consumers.

None of these consequences would be defensible even if they were based on a consistent principle. But, to make matters worse, ANICO's proposal distinguishes one consumer from another on grounds that are downright arbitrary.

It is undisputed that a person who already owns a policy can sell it for a variety of financial planning purposes if he forms the intent to sell after he has purchased it. The following examples illustrate how bizarre it is to deny the same benefits to similarly situated consumers who are simply planning in advance rather than waiting for circumstances to change:

Example 1-A: Wife purchases a life insurance policy on her life and designates Husband as the beneficiary. A few days after purchasing the policy, Husband is diagnosed with cancer. Wife decides she no longer wants to keep the policy. She sells the policy and uses the proceeds for Husband's medical care. The policy is clearly valid.

Example 1-B: Same exact scenario, but Husband was diagnosed with cancer before Wife purchased the policy. Wife is concerned that the medical expenses will deplete the family's savings. But she learns that she can obtain a life insurance policy and later sell it on the secondary market to help pay for the medical expenses should the need arise. Should this policy be considered void because she allowed this "wrong" intention to affect her decision when she bought the policy?

Example 2-A: Mother purchases a life insurance policy after the birth of her second child and designates both of her children as beneficiaries. Several years later, when the children are entering college, she decides that rather than continuing to pay the premiums, she will sell the policy to help pay for the children's college tuitions. Obviously valid.

Example 2-B: Same exact scenario, except Mother purchases the insurance policy when the children are already entering college. Shortly after purchasing the policy, she sells it and uses the proceeds to help pay for the children's tuition. Should this policy be void?

Example 3-A: Wife owns a life insurance policy, and Husband is the beneficiary. Wife is laid off from her job. The couple are unable to make their mortgage payments, and the lender threatens foreclosure. Wife sells her policy and uses the proceeds to make the next several mortgage payments. Clearly valid.

Example 3-B: Same scenario, but Wife is laid off before she purchases a policy. A financial advisor explains to the couple that they might be able to obtain a life insurance policy and sell it to a life settlement company if she does not get a job soon. Wife is able to procure a policy and sells it on the secondary market. Should this policy be void?

A rule that permits the individuals in the A examples, but not the B examples, to obtain life insurance simply prevents some people from realizing an important benefit of life insurance—the ability to obtain a cash settlement for it—based solely on the happenstance of whether they owned a policy at the time their need for a cash settlement arose. Such an arbitrary rule serves no purpose—except to enrich insurance companies.

D. Life Settlements Are Not Wagers.

ANICO wags a finger in protest asserting that the procurement of a policy with the intent to sell it is an "illicit … wager[] on human life"—akin to a barroom bet over when some seafaring sailor or Hollywood celebrity is going to die. OB 1-2, 15-16. As dramatic as it sounds, the argument is unhelpful, and in any event wrong.

The argument is unhelpful, because all sorts of financial transactions—including each of the A examples described above and most of the transactions ANICO engages in—can be recast in that same way. The legal question in each of those situations (and in this case) is not whether clever lawyers can recharacterize the transaction as a "wager[] on human life," OB 18—a term that ANICO does not even try to define beyond the vague statutory language prohibiting a "policy executed by way of gaming or wagering." Cal. Ins. Code § 252. The question is whether the transaction falls within the provisions of the Insurance Code that define with precision what sorts of transactions are permissible.

To see how unhelpful the term "wager" is, let us start with how ANICO makes its profit. ANICO sells life insurance. Life insurance is quite literally a gamble on how long a premium-paying policyholder will live; the insurance company profits if the insured lives longer and loses if the insured dies earlier. Anyone with the most rudimentary understanding of the insurance industry knows that underwriters set the premium for a particular consumer by looking up his life expectancy in a table and then asking such unseemly questions as: How much earlier will his smoking kill him? Or what are the chances that his skydiving hobby will result in a fatal accident?

ANICO also sells life annuities, which is just the same gamble in reverse. Under this arrangement, an insurer pays a person a fixed periodic income for the remainder of her life. The insurance company pays less, and profits more, if the customer dies young. In setting the terms, ANICO asks the same unsavory questions. Are these "wager[s] on human life"? Perhaps in the colloquial sense. But they are certainly not the sorts of wagers that are statutorily prohibited. A life settlement is not much different from a life annuity. The only difference is that a life settlement company—after reevaluating the insurer's underwriting judgments—pays the insured a lump sum up front, instead of paying a periodic income. If life settlements are "wagers," then life annuities and, indeed, life insurance itself is as well.

ANICO tries to distinguish life insurance from a life settlement on the ground that life insurance involves the allocation, as opposed to the creation, of risk. *See* OB 1-2. This distinction appears nowhere in the statute and ANICO invokes not a single case in support of it. That is because the distinction is hollow. The re-sale of a life insurance policy does not create risk any more than the original sale does. The re-sale transfers a policyholder's existing risk of continuing to pay premiums under the policy to the buyer and assigns the benefit to the buyer as well. In any event, the distinction proves too much: If the re-sale of an insurance policy were an improper wager, it would be an improper wager regardless of whether or not the insured contemplated re-sale when he purchased the policy. But even ANICO acknowledges that the re-sale of insurance is perfectly permissible—and presumably not a wager—when the re-sale is not intended at the moment of purchase.

In outlawing a "policy executed by way of gaming or wagering," the California Legislature was obviously not addressing the re-sale of insurance policies. It was addressing the "mischievous Kind of Gaming" that "disgusted … the English Parliament." OB 15 (citation omitted). It was distinguishing socially acceptable contracts—which are by their very nature almost always about "allocating risk"—from unsavory practices based upon "whether the practice underlying the transaction has antisocial effects." Roy Kreitner, *Speculations of Contract, or How Contract Law Stopped Worrying and Learned to Love Risk*, 100 COLUM. L. REV. 1096, 1096-97, 1121-22 (2000).

There is nothing unsavory or antisocial about selling a life insurance policy. It is an investment, and one that is especially attractive because it is insulated from the sometimes erratic financial markets. *See* Sam Rosenfeld, “Life Settlements: Signposts to a Principal Asset Class,” WHARTON FINANCIAL INSTITUTIONS CENTER, #09-20 (2009). It provides enormous benefits to consumers. Like insurers, investors in the life settlement market aim to acquire and bundle a large number of policies and spread the risk of those policies across many people. *See* CHAPLIN ET AL., *supra*, at 52 (“The objective in risk managing a life settlement portfolio is measurement and control of risks—similar to an insurance company ….”). Because of this risk-spreading, no one person or fund has a direct or substantial pecuniary interest in the death of any single insured. Instead, investors are provided with modest but fairly consistent returns as policies mature. Life settlements are simply the flip side of the life insurance coin. As if to prove the point, some of the most prominent life insurance companies play both sides of this coin. *See, e.g.*, Matthew Goldstein, *Even the Insurers Have Hopped on Board*, BUS. WEEK, July 30, 2007, at 50 (observing that AIG is “one of the biggest buyers of life settlements”).

To reject ANICO’s position does not in any way extinguish the insurable interest requirement; it merely limits it to its express terms and original purpose. An insurable interest is based on the relationship between the person who takes out a policy and the insured. And when the insured takes out a policy on his own life, there is no insurable interest issue; and there is no reason to prohibit him from later selling his policy "to one whom he, the party most concerned, is not afraid to trust." *Grigsby v. Russell*, 222 U.S. 149, 155 (1911). To do so would "diminish appreciably the value of the contract in [his] hands." *Id.* This is exactly what ANICO wants, because it is ANICO and other insurance companies that would capture this lost value.

II. THE TRIAL COURT RIGHTLY PREVENTED THE WINDFALL RESULT THAT ANICO SEEKS BY RULING THAT INSURERS MUST RETURN PREMIUMS WHEN THEY RESCIND A POLICY.

All of the mischief that ANICO's proposed insurable interest rule would foster would be multiplied many times over by its proposal to let insurance companies keep the premiums even while renouncing, and rescinding, a policy. Simply put, ANICO wants to keep the benefits of the contract it claims is illegal, but provide nothing in return.

As Wells Fargo accurately explains, the black-letter rule is that an insurance company cannot have its cake and eat it too. If the insurer wants to rescind its contract, it must return the premiums it collected under the contract. *See* OB 24-28. That is the law for any contract and it is the only rule that is fair. ANICO grossly distorts the statutory language in asserting that section 483 of the California Insurance Code codifies a "fraud exception." OB 25-30. That section governs the circumstances under which the *policyholder*—not the *insurer*—may terminate a policy and recover the premiums he paid. ANICO's reading turns section 483 on its head and contradicts a long line of cases holding that an insurer—like any other party to a contract—must return the premiums when it rescinds a policy. *See* RB 24-28.

ANICO's proposal to anoint insurers the rare exception to this fundamental rule aggravates all the policy concerns described above. The mere *possibility* that insurers could keep the premiums would compound their incentive to challenge valid policies. It would also discourage them from performing proper underwriting when they are supposed to: *before* they issue a policy.

Worse yet, it would affirmatively encourage insurers to issue policies even if they knew the application contained false information. They would just issue the policy, book the premiums, and rescind the policy later and keep the premiums. It would also incentivize insurers to continue collecting premiums on policies even after they have learned all the facts they need to rescind the policy—just as ANICO did in this case when it continued to collect nearly $400,000 in premiums even after the Cabal Trust dutifully alerted ANICO to the fraud. *See* RB 11. Even after filing a counterclaim seeking to rescind the policy, ANICO threatened to cancel it outright if the Trust did not continue to pay premiums that ANICO now seeks to keep. *Id.* at 39. These perverse incentives would further destabilize not just the life settlement market, but the entire life insurance market.

As to life settlements, purchasers of insurance policies on the secondary market buy policies in reliance on the assumption that the insurance companies have properly underwritten their policies and confirmed the accuracy of the information in policy applications. If the law allowed insurers to keep the premiums when they rescind a policy, life settlement companies would pay much less for a policy because they would risk losing all of their investment for a policy that the insurance company might rescind.

ANICO should be fully satisfied that the district court rescinded the Cabal policy for fraud. It should return the premiums it received, and then sue the wrongdoer for any damages it claims to have suffered. The Court, however, should not let ANICO and other insurers game the system by being able to pass all of the costs of a bad policy—which it, as the underwriter, had the responsibility to discover—onto those who are blameless.

CONCLUSION

This Court should affirm the judgment below in all respects.

Respectfully submitted,

Dated: January 10, 2012

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CERTIFICATE OF COMPLIANCE

I certify that pursuant to Fed. R. App. P. 29, Fed. R. App. P. 32(a)(7), and Circuit Rule 32-1, the foregoing brief is proportionally spaced, has a typeface of 14 points Times New Roman, and contains 6,993 words, excluding those sections identified in Fed. R. App. P. 32(a)(7)(B)(iii).

Dated: January 10, 2012

By: *<u>/s/ E. Joshua Rosenkranz</u>*
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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on January 10, 2012.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

By: *__/s/ David P. Fuad__*