ABSTRACT. Life insurance settlements, or life settlements, are life insurance policies owned by investor-beneficiaries on the lives of unrelated individuals. With life settlements, investors make substantial payments to the insured individuals upon purchasing such policies, pay any remaining premiums, and collect the death benefits upon the demise of the insured individuals. Transactions involving life settlements seem poised to become a major source of profits for investment banks, comparable in dollar amount to subprime mortgages. With life settlements, the insured individuals suffer no immediate harm, and the sale of a policy an individual owns is permissible under current law. Nevertheless, moral questions can be posed about the social values expressed by these practices, the effect of these practices on the virtue of charity, and the overall loss of social utility that will result from life settlements. We consider life settlements from utilitarian and libertarian perspectives, and then consider the effects of life settlements on social values and on individual character. On balance, we favor legislative changes in insurance and tax laws to discourage life settlements, and argue that certain forms of life settlements should be banned outright.

KEY WORDS: insurance ethics, investor-initiated life insurance (IILI), investor-owned life insurance (IOLI), life insurance settlements, life settlements, speculator-initiated life insurance (SOLI), spin-life insurance, stranger-originated life insurance (STOLI), value of life

Introduction

There are various forms of life insurance, some more problematic than others. Nurnberg and Lackey (2008) explored the ethics of Company-Owned-Life-Insurance, (COLI), sometimes referred to as “janitor insurance.” In this article, we consider the ethics of life insurance settlements (henceforth, life settlements). Formerly known as viaticals, life settlements are insurance policies that are owned by investor-beneficiaries on the lives of otherwise unrelated individuals in whom the investors have no insurable interest. One subset of life settlements are Investor-Owned Life Insurance (IOLI), which involve the purchase by investors of existing policies that were initially taken out to compensate the original beneficiaries for some perceived loss due to the death of the insured and that might otherwise be cashed in or allowed to lapse. Investor-Initiated Life Insurance (IILI) or spin-life insurance is another subset of life settlements; they involve new policies that were initially taken out with the financial encouragement of and loans provided by investors, with the intention of being purchased by these investors in satisfaction of the loans at the end of the contestability period, usually 2 years. For all life settlements, the investors pay any remaining premiums, and collect the death benefits upon the demise of the insured individuals.

A front page article in The New York Times dated 6 September 2009 reports that the purchase and securitization of life settlements is the new frontier in investment banking, a prospective source of profits to investment banks equal in magnitude to subprime mortgages. If Wall Street is turning in this direction, then it is imperative that the ethical dimensions of life settlements be considered with care.

Our thesis is that IOLI should be discouraged by changes in insurance and tax laws because of its many morally and socially undesirable features, but that certain positive aspects argue against banning IOLI outright. We argue, however, that IILI involves gambling on lives and free riding on the insurance market, and should be banned. Our
ethical analysis of life settlements isolates two basic factors, the right of freedom of contract, and the changes in social welfare brought on by massive purchases of life settlements. Unfortunately, the results of the rights analysis and the welfare analysis point in opposite policy directions. We introduce two additional factors to break the impasse: the factor of *symbolic utility*, the values a society expresses through its social policies, and the effect of life settlements on virtues and character. Our view is that large scale purchases of life settlements express an attitude toward the value of life that is not found in the ordinary sale of life insurance. This expression will have the effect of trivializing our sense of the value of life, and transforming lives and deaths into business commodities. Though individual insureds may desire for themselves the cash that life settlements provide, the same individuals may prefer not to live in a society in which lives are viewed in this way.

**How life settlements differ from ordinary life insurance**

*Conventional individually owned life insurance*

Typically, the insured is the policyholder, and his/her spouse, dependents, relatives, friends, or business associates are the beneficiaries of an individually owned life insurance policy; death benefits are designed to compensate beneficiaries for the loss of the insured’s economic support, love, guidance, friendship, business skills, and/or capital. Such insurance makes the beneficiaries “whole” upon the death of the insured; they do not profit from his/her death. The insureds share the risks among themselves that some will live to a full term and some will not. As such, most view conventional individually owned life insurance as both proper and prudent personal financial planning involving few ethical issues, and not some version of gambling, wagering, or speculation. A life settlement is a life insurance policy in which the beneficiary is an investor who is unrelated to the insured by family, friendship, or business connections. When the insured dies, the result is a bonanza for the investor-beneficiary, who suffers no economic or emotional loss but reaps a large gain from the death of the insured. The earlier the death, the earlier the gain for the investor-beneficiary. This is opposite of conventional life insurance, where the earlier the death, the greater the sense of loss to the beneficiary.

Initially, most life settlements involved existing life insurance policies being sold by desperately ill persons, usually AIDS victims, who had no other financial means to support themselves during the last few months of their lives. The seller or transferor or the insured was the *viaticatee*; the buyer or transferee or investor was the *viaticator,* and the transfer was a *viatication.* Owing to the desperation of the viaticates, viatication was rife with exploitation and viatics came into disrepute. In addition, many insurance companies responded by providing terminally ill persons with the option of obtaining a substantial fraction of the death benefit a few months before death occurs.

Presently, more and more *IOLI* policies involve healthier insureds, usually over age 65 or 70, in relatively good but declining health given their age, and with a life expectancy of more than 2 years. “Life settlement” emerged as a more innocuous term to describe the process of transferring ownership of existing life insurance policies to unrelated investors.

**How life settlements function as investments**

*Forms of life settlements*

*IOLI*

In *IOLI,* the insured sells his/her existing life insurance policy to a third-party investor for more than its cash surrender value (CSV) but less than its face value. (The typical sale is done for 10–25% of face value.) The investor pays any remaining premiums and receives the death benefit proceeds upon