SUTHERLAND

LEGAL ALERT

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New York's Highest Court Approves STOLI Policy Sales

The New York Court of Appeals held yesterday that "New York Law permits a person to procure an insurance policy on his or her own life and immediately transfer it to one without an insurable interest in that life, even where the policy was obtained for just such a purpose." That holding, which responded to a certified question from the U.S. Court of Appeals for the Second Circuit in *Kramer v. Phoenix Life Ins. Co.* (please click here for the certification order), appears to approve stranger-owned life insurance (STOLI) schemes in New York that predate recent anti-STOLI legislation, at least where such schemes were "free from nefarious influence or coercion." (Please click here for the opinion.)

According to the allegations of his widow Alice, Arthur Kramer, a prominent New York attorney, obtained various insurance policies on his own life, with the intent of immediately assigning the policies to investors. He did so, she alleged, after being approached by the principal of Lockwood Pension Services, Inc., about participating in a STOLI scheme. The policies, collectively providing some $56 million in coverage, were issued to two trusts established by Mr. Kramer, which named his children as beneficiaries. Shortly after the trusts were funded, the children assigned their beneficial interests to stranger investors. Following Mr. Kramer's death in January 2008, Alice refused to turn over copies of his death certificate to the investors, instead deciding to file suit, alleging that the policies acquired by her husband violated New York's insurable interest requirement and should be paid to her.

New York's insurable interest requirement is codified in Insurance Law § 3205(b). Section 3205(b)(1) addresses individuals obtaining life insurance on their own lives: "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." Section 3205(b)(2) addresses a person's ability to obtain insurance on the life of another: "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."

Pointing out that, at common law, the insurable interest requirement was adopted to prevent people from wagering on the lives of others, the New York Court of Appeals explained that, where an individual procures insurance on his own life, the wagering concern is overridden by the "social utility of the policy as an investment to benefit others." On that premise, the court refused to read a prohibition against intended assignments to non-interested parties into § 3205(b)(1), holding instead that, because the statute codified the common law rule that an insured has complete discretion in naming policy beneficiaries, it must also be read to allow for unfettered assignment by the insured, regardless of his or her intent at the time of procurement.

Further, the court narrowly construed § 3205(b)(1)'s mandate that a policy must be obtained on an insured's "own initiative," determining that under common usage, "one's own initiative" simply means "at one's own discretion: independent[] of outside influence or control." Accordingly, the court held that an insured acts under his or her own initiative for purposes of § 3205(b)(1) provided the insured's decision to procure insurance is "free from nefarious influence or coercion," regardless of whether or not the notion of obtaining insurance originated with the insured in the first place. Though dismissive of the dissenting

opinion that Mr. Kramer was merely a "cloak for a wager," the court acknowledged that "there is some tension between the law's distaste for wager policies and its sanctioning an insured's procurement of a policy on his or her own life for the purpose of selling it." The court concluded, however, that it is not the role of the judiciary "to engraft an intent or good faith requirement onto a statute that so manifestly permits an insured to immediately and freely assign such a policy."

The court noted that New York has enacted new insurance law provisions regulating permissible life settlement contracts and that such provisions prohibit "'stranger-originated life insurance,' 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' (Insurance Law § 7815). It also prohibits anyone from entering a valid life settlement contract for two years following issuance of a policy, with some exceptions (see Insurance Law § 7813 [j] [1])." Because these provisions did not go into effect until May 18, 2010, they did not govern *Kramer*.

The court declined to expand the scope of the certification from the Second Circuit to include the question of whether the insurers' claims to void the policies were properly dismissed by the district court on the grounds that the policies were issued two years earlier and were thus incontestable. Click here for Sutherland's Legal Alert on the recent decision in *Settlement Funding, LLC v. AXA Equitable Life Ins. Co.*, No. 09 CV 8685 (HB) (S.D.N.Y. Sept. 29, 2010), which held that, in egregious circumstances, a policy may be rescinded even though it is beyond the two-year contestability period.

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