December 8, 2010

New York Court of Appeals Upholds STOLI Policies Under Pre-2009 New York Law

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In a 5-2 opinion in a closely watched case, the highest court in New York has found a stranger-owned life insurance ("STOLI") policy to be valid under the state's insurable interest law. *Kramer v. Phoenix Life Ins. Co.*, 2010 N.Y. Slip Op. 8376 (Nov. 17, 2010). The decision was based on a prior version of the insurable interest statute, which was amended in 2009.

Arthur Kramer, a prominent New York attorney, obtained several insurance policies on his own life. The policies collectively provided $56,200,000 in coverage. Through a series of complex transactions involving his adult children, family trusts, and third parties, the ownership and beneficial interests in the insurance policies were promptly transferred to third-party investors, who paid the premiums.

After Mr. Kramer died in January 2008, his widow filed an action in federal district court alleging that the assignments were void under the state's insurable interest statute, and that the policy benefits should be paid to her. New York's insurable interest statute provides that a party cannot purchase an insurance policy on someone else's life unless the beneficiary of the policy is either the insured or someone who, at the time the policy was issued, held an "insurable interest" in the insured's

life. N.Y. Insurance Law § 3205(b)(2). An insurable interest is defined as ". . . in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection," or, for others, a "lawful and substantial economic interest in the continued life, health or bodily safety of the insured." N.Y. Insurance Law § 3205(a)(1).

In *Kramer*, the district court certified the following question to the New York Court of Appeals: "Does New York Insurance Law §§ 3205(b)(1) and (2) prohibit an insured from procuring a policy on his own life and immediately transferring the policy to a person without an insurable interest in the insured's life, if the insured did not ever intend to provide insurance protection for a person with an insurable interest in the insured's life?"

The Court of Appeals answered that the transaction was not prohibited. It noted "the basic distinction between policies obtained on the life of another and those obtained on one's own life," which is codified in the New York Insurance Law. Section 3205(b)(2), quoted above, prohibits parties from taking out "wager policies" on someone else's life. The Court of Appeals found that this concern over wagering on someone else's life does not exist when the insured procures the policy on his own life. This is reflected in New York Insurance Law Section 3205(b)(1), which states that any person may purchase insurance on his own life to benefit anyone else, and that such an insurance policy may be immediately transferred or assigned.

The court rejected the argument that the insurable interest requirement in Section 3205(b)(2) should apply to someone who purchases insurance on his own life with the intention of immediately transferring it to a third party. Because the policies were purchased by Mr. Kramer on his own life, they were governed by Section 3205(b)(1),

which contains no insurable interest requirement. According to the court, it is irrelevant that Mr. Kramer apparently purchased the policies with the intention of immediately transferring them to third parties. The court observed that Section 3205(b)(1) allows for "immediate transfer or assignment," which "evidently anticipates that an insured might obtain a policy with the intent of assigning it, since one who 'immediately' assigns a policy likely intends to assign it at the time of procurement."

The court also rejected the argument—adopted in the dissenting opinion—that Section 3205(b)(1) is subject to a common-law exception that "an insured cannot obtain a life insurance policy with the intent of circumventing the insurable interest rule by immediately assigning it to a third party." The court clarified that, to the extent that there is any conflict between the common law and Section 3205(b)(1), "the common law has been modified by unambiguous statutory language."

Thus, the *Kramer* court found the STOLI policies to be valid. Yet *Kramer*'s effect in New York should be limited going forward. The state legislature revised the Insurance Law in 2009 to 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." This should also be the case in the 29 other states—including California—that have recently passed similar prohibitions. *See*, *e.g.*, Cal. Ins. Code § 10113.1(w).

Kramer may, however, serve as a wake-up call to those states that are contemplating STOLI legislation but have not yet acted. If *Kramer* is

any indication, courts may look to the legislatures to curb perceived STOLI abuses and to address any perceived ambiguities relating to insurable interest.