STOLI – What you don't know may cost you

Introduction

Stranger-originated life insurance, "STOLI," has probably been the single most frustrating, discussed, debated, and litigated topic in the life insurance industry for the past decade. The problem began in the early to mid-2000s. Unaware that they were being deceived by sophisticated schemes, many life insurers began experiencing sales increases in large universal life policies. What those insurers did not know, however, was that many of these policies were STOLI and had been originated from scratch by hedge funds and other sophisticated investors who created these policies for their own gain. More to the point, many of these policies were not meant for any actual insurance purpose—such as financial protection for the insureds' loved ones—but instead were pure wagers by these disinterested investors who lacked any legitimate insurable interests in the insureds and who were looking to turn a profit when the insureds eventually passed—and the sooner, from the standpoint of return on investment, the better.

In conjunction with the global financial crisis in 2008, the true nature of some of these STOLI policies started to become clear. As access to credit dried up, many of the investors ran out of money to pay ongoing premiums, and as a result, many of their schemes collapsed. This led to multiple Securities and Exchange Commission investigations and bankruptcies, and also to various lawsuits between and among investors, capital providers, promoters, brokers, and even insureds. It was by way of these proceedings that many in the insurance industry started to realize what had occurred.

Not surprisingly, the life insurers' initial exuberance over increased sales turned to disdain as the fraudulent schemes behind these policies started to come into focus. Litigation by many of the insurers then ensued, and those insurers were generally quite successful.

Indeed, the litigation success was no accident. Under the vast majority of states' laws, policies procured as wagers are in violation of insurable interest rules and/or public policies against gambling, and are therefore void *ab initio.* It is also a majority rule that wagering policies are void from inception, and all of their provisions, including the two-year contestability clauses, are of no effect. Thus, challenges to wagering policies may usually be raised at any time, including after the insureds have passed and death claims are submitted. Moreover, in most states where this majority rule is applied, the courts are also required to scrutinize the circumstances under which the investors procured the policies, and courts cannot permit the mere form of the underlying transactions to convert wagering policies into legitimate insurance.

Courts interpreting the laws in a few states, however, have either denied challenges beyond a policy's two-year contestability provision or held that simple technical compliance with anti-wagering and insurable interest laws was sufficient to validate a policy. In other words, in these states, courts have sometimes determined that, under the laws that existed at the time the policy under consideration was procured, only mere technical compliance with the law was required and courts will not look beneath the veneer of the underlying transaction and consider what actually transpired. Nevertheless, in an attempt to prevent such STOLI transactions in the future, the legislatures in a number of these states have enacted statutes that expressly define and outlaw STOLI and make clear that human life wagers are void.

A few years ago, following the general success in the litigation and the enactment of these relatively new statutes, the insurance industry largely took the view that the STOLI problem was over, and most insurers stopped litigating. And who could blame them? After much distraction, disruption, and expense, the worst of the STOLI policies appeared to have been invalidated, and the investor community was quiet and did not seem to be generating many, or even any, new STOLI policies.

However, as explained in this article, the final chapter on this topic has not yet been written. Indeed, in many ways, the modern-day STOLI problem is only now starting to have a true impact and is far from over. *This is because there likely are still thousands of hidden STOLI policies on the books of many insurers, and those policies are only now starting to mature. Most importantly, while some are of the view that there is no way to combat claims on such policies, recent litigation developments suggest that, once scrutinized in a court of law, many of these policies will be declared void—meaning no death benefits will be owed.*

To fully understand the nature of STOLI for readers who have not been involved in these issues, the authors are providing background on the development and major events of the STOLI market. Readers already steeped in STOLI knowledge may choose to read ahead.

What is STOLI?

As its name implies, STOLI is a scheme whereby strangers to the insured — those without any true insurable interest — originate a policy for their own financial gain. Simply put, these schemes are wagers on human life and, unfortunately, have been in existence in some form or fashion since the advent of life insurance in England in the sixteenth century.[1]

This human life wagering problem began when strangers started taking out policies on individuals who they knew to be in poor or "predictable" health. Lacking any of today's access to medical records, insurers were induced into issuing contracts by applicants who often had better information on the insureds' situations than the insurers. When the inevitable happened sooner than the insurers had expected, they were left to foot the bill. To remedy this situation, the British Parliament passed the Life Insurance Act of 1774, which, in essence, made it illegal to own a policy on a person with whom there was not an insurable interest. This protected the insurers from unwarranted claims, the public from higher premiums to account for those claims, and the insureds from the most obvious.

These concepts eventually made their way to the United States, where life insurance as a wagering device was also made illegal. In the first of two seminal cases on the issue, the United States Supreme Court ruled in *Warnock v. Davis* that a life insurance policy lacking insurable interest "is a mere wager" and, "therefore, independently of any statute on the subject, condemned, as being against public policy."[2] The *Warnock* Court also held that, even if a policy had a proper insurable interest at its inception, the subsequent "assignment of [that] policy to a party not having an insurable interest is as objectionable as the taking out of a policy in his name." Under *Warnock,* therefore, an insurable interest had to exist throughout the life of the policy.

Thirty years later, the United States Supreme Court again opined on the topic in *Grigsby v. Russell*.[3] There, the insured, John C. Burchard, had obtained a policy on his own life and personally paid the first two premiums. Mr. Burchard fell ill and could not make the third premium payment, at which point he sold the policy to Dr. Grigsby who then made the remaining premium payments until Mr. Burchard's death. At issue in the case was whether some portion of the policy's death benefit was payable to the administrators of Mr. Burchard's estate, or whether Dr. Grigsby, as an assignee of the policy who admittedly lacked insurable interest in Mr. Burchard, was entitled to the proceeds.

Recognizing that a valid life insurance policy is the property of the policy owner with the potential to be sold for value, the *Grigsby* Court struck a careful balance. On the one hand, the Court memorialized the rule that "[a] contract of insurance upon a life in which the insured has no interest is a pure wager" and one cannot avoid this rule by taking out a policy for the purpose of having a stranger "pay the premiums and receive the greater part of the benefit." As the Court recognized, "cases in which a person having an interest lends himself to one without any as a cloak to what is in its inception a wager have no similarity to those where an honest contract is sold in good faith."[4] On the other hand, having found that Mr. Burchard himself not only procured the policy, but paid the first two premiums and only later chose to assign the policy to Dr. Grigsby, the Court held that the assignment was enforceable and did not render the contract a wager.[5] Under *Grigsby*, an insurable interest need only exist at the inception of a policy. If that requirement is met in good faith, and the transaction is not a "cloak to what is in its inception a wager," then the initial valid owner of the policy may transfer it to a subsequent owner without insurable interest.

As will be shown below, the modern-day STOLI market has distorted the rule in *Grigsby* through transactions that are dressed-up to look valid, but that were intended from the start to result in policies that would be owned by stranger investors with no insurable interest in the insureds. In short, the clearly valid transaction between Mr. Burchard and Dr. Grigsby, effected only after Mr. Burchard had personally obtained a policy on his own life for legitimate reasons, bears no resemblance to today's STOLI transactions, no matter what spin the STOLI promoters apply.

The typical modern-day STOLI scheme: A bet on when the insured will die

In the early to mid 2000s, the modern STOLI market emerged and saw sophisticated investors creating unneeded life insurance policies to be used as speculative investment vehicles. Because these policies were placed on insureds who did not need or want coverage and were strangers to the investors, the moniker "stranger-originated life insurance," or "STOLI," first appeared. In many ways, the basic idea behind these STOLI schemes was the same as with schemes first outlawed in England hundreds of years ago—gamblers were hoping to profit on the death of a human with whom they had no relationship.

But with the advent of modern medicine, access to medical records, and comprehensive medical underwriting practices being employed by life insurers, today's STOLI investors faced a new challenge. They could not realistically place policies (at least in any significant number to make their schemes worthwhile) on the lives of sickly insureds who would pass away quickly. Indeed, even if they identified an insured whose health was questionable, the insurers would either decline coverage or rate the insured in such a manner that the premium was too expensive. Moreover, investors understood that, if an insured passed within two years of policy issuance, the insurers were more likely to conduct a policy claim review to look for medical misrepresentations or omissions that would be actionable irrespective of insurable interest issues.

Understanding this, modern-day STOLI investors put a new twist on human life wagering. Rather than looking for insureds who would die quickly, these investors sought out insureds in reasonably good health who would not only medically qualify for coverage, but who would likely outlive a policy's two-year contestability provision and obtain a health rating that made the amount of premium palatable. Thus, rather than wagering that the insured would die quickly, these investors wagered on *when* the insureds would die, and structured their bets to capitalize on this event.

Specifically, these investors were looking for relatively healthy senior citizens (usually over age 70) on whose lives they could obtain large face amount policies, usually over $2 million and often in the range of $5 million to $10 million. The initial challenge for STOLI investors was finding enough seniors who met this profile. For obvious reasons, the investors could not overly publicize what they were doing, so they solved the problem a different way. The investors, often acting through intermediaries, sought out insurance brokers in key geographic areas throughout the country who were willing to serve as large-scale STOLI policy originators.

Operating through these brokers, STOLI investors would convince seniors to allow policies to be procured on their lives by marketing their programs as risk-free to the insureds, meaning that the insureds would incur no costs and the STOLI promoters would pay the policy premiums. Often, the STOLI promoters would also entice seniors by paying them compensation up front (in the form of cash, expensive automobiles, or lavish vacations) or by promising the possibility of future compensation.

Once they convinced a senior to allow a policy to be procured on their life, and often before any application for coverage was submitted to an insurer, the STOLI promoters would seek to determine whether a bet on any particular senior was worthwhile. To make this determination, the STOLI promoters would typically obtain a medical release, gather the insured's medical records, and hand those records over to various companies who touted themselves as "life expectancy" providers. These companies would conduct their own medical underwriting and ultimately issue what they called a "life expectancy report," which would indicate their prognostication as to the insured's anticipated life span. Armed with this information, the STOLI investors would then decide the potential value of wagering on *when* a particular insured was likely to pass, and decide how best to structure their transaction to maximize their financial gain.

While there are many twists on this basic scheme, all modern-day STOLI transactions share one thing in common: investors create and fund policies that have no true insurance purpose and are instead speculative investments on the lives of senior citizens who do not want or need the coverage. These schemes not only violate basic anti-wagering and insurable interest concepts—and directly contravene certain states' constitutions—but as explained below, are fraught with fraud committed upon the insurers.

The typical modern-day STOLI scheme: A transaction fraught with fraud

The level of fraud associated with many typical modern-day STOLI programs is astonishing. Motivated by the prospect of significant commission payments on high face amount policies, brokers went to great lengths to get the job done. Given the size of these policies, brokers were aware that they not only needed to find insureds who were healthy enough to pass medical underwriting, but also they needed to provide the insurers with a financial justification for the coverage.

Not surprisingly, and as revealed in many of the STOLI cases recently litigated, brokers would often materially misrepresent the insured's financial status, obtain falsely inflated financial disclosures from non-existent financial advisors and accountants, and otherwise lead the insurers into believing that these policies were needed for valid purposes, such as estate planning. And, of course, the insurers were led to believe that these policies were actually being paid for by the insureds and that the owners and beneficiaries had a true insurable interest.

The undisclosed reality was something else entirely. In many STOLI cases, the insureds were of only modest means, in terms of both income and net worth. Indeed, these were often seniors on fixed incomes living on the edge of financial stability—folks who would never need or want a multi-million dollar life insurance policy.

And regardless of whether the insureds had sufficient income and net worth to justify a policy, it was nearly always the case that the insureds themselves paid nothing towards the policies.

Although the applications would rarely identify a source of premium payments other than the insureds themselves or their trusts, much of the premium was paid through what is now known as non-recourse premium financing ("NRPF"). In a typical NRPF transaction, the investor "loans" the amount needed for the initial premiums, but the loan is not genuine and there is little or no expectation that the loan will ever be repaid. Instead, the "lender" can simply acquire the collateral (i.e., the policy) as repayment – with zero financial exposure or liability for the "borrower" (i.e., the insured or a trust in his or her name).[6] When these NRPF programs were discovered by insurers, most refused to approve applications with such arrangements, which of course led to more fraudulent representations concerning the method of payment for the policies.

But just as the insurers were being misled, so, in many cases, were the insureds. Indeed, litigation has revealed that while many insureds had been made aware that single policies were being procured on their lives, the brokers and funders would often obtain multiple policies on each of the insureds' lives, often from different insurers. And despite up-front promises of possible later large cash payouts to insureds, such promises appear to have rarely come to fruition.

Compounding this, applications for life insurance policies were often submitted to multiple insurers simultaneously without disclosing all or any other pending applications. To avoid having the applications detected through such programs as the Medical Information Bureau (MIB), "trial" applications were often used until the insurer agreed to accept the coverage. In cases where an insurer was told, or became aware of, applications with other insurers, applicants would falsely claim that they were simply shopping for the best coverage, and that only one policy would be selected from the insurers who made offers.

As noted above, the application amounts were generally in increments of $1 million to $5 million although higher amounts were often seen and $10 million policies were not uncommon. In fact, it was not unusual to see total lines of coverage purchased on insureds in the $10 to $50 million range. Extreme cases saw coverage on individual lives accumulate to be over $100 million.

To mask the parties to the transaction, the applicants would often create trusts that were to be the owners and beneficiaries of the coverage. This, in itself, was often a sham since it concealed not only the ultimate intended parties, but it also gave a false appearance of legitimacy to the applications and the false appearance of a legitimate insurable interest.

Regulatory response

At the prompting of various industry groups, the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL) created two similar, but separate, model acts in or about 2007 for states to consider. Both organizations recognized the negative impact STOLI transactions could have on the industry and the public. Both acts, although with different triggers, proposed limitations on the sale of life insurance policies on the secondary market. To date, 32 states have adopted some STOLI-related legislation—with most states adopting legislation closely tracking either the NAIC or NCOIL model acts. Although the acts use different terminology for secondary market transactions—referring to them as "viatical settlements" under the NAIC act, and as "life settlements" under the NCOIL act—both acts:

- Define a "settlement contract."
- Prohibit fraudulent viatical/life settlement practices.[7]
- Require certain disclosures to, and consents by, policy sellers.
- Allow policy sellers to rescind viatical/life settlements within a certain period of time after contract execution—within 15 days under the NCOIL act, and within 60 days under the NAIC act.
- Require the disclosure of viatical/life settlements to insurers—within 20 days of contract execution.
- Require insurers to promptly process verification of coverage requests by viatical/life settlement providers and brokers.[8]

- Require insurers to promptly respond to requests for changes in ownership and beneficiaries.[9]
- Require viatical/life settlement providers to be licensed.
- Require viatical/life settlement providers to establish and implement anti-fraud plans.
- Mandate fraud reporting to the Department of Insurance by viatical/life settlement providers.

Experience under these model acts reveals that they each have strengths and weaknesses. For example, a strength of the NAIC act is that it provides, subject to certain exceptions, for a five-year moratorium on a viatical settlement—a significant deterrence to STOLI investors. A weakness of the NAIC act is that it does not define what constitutes STOLI and does not expressly prohibit STOLI. On the other hand, a strength of the NCOIL act is that it does, unlike the NAIC act, contain a robust definition of STOLI and expressly prohibits it.[10] A weakness of the NCOLI act is that it only provides, subject to certain exceptions, for a two-year moratorium on a life settlement. This two-year moratorium is unlikely to provide any significant deterrence to STOLI investors since they often refrain, anyway, from transferring policies, or beneficial interests in policies, until after the two-year contestability period has expired—when they believe (albeit, incorrectly in the vast majority of states) that they are then immune to insurer challenges to the validity of STOLI policies.

Early case law

Litigation of various types arose out of the STOLI market, and this litigation expanded when the financial crisis arrived in 2008. One common type of case was brought by individual and hedge fund-type investors who were complaining about their returns in connection with deals they struck to participate in the STOLI market. Other investors who were involved in policy originations were also suing their business partners and vice-versa—each claiming that the other obtained more money in the various deals than that to which they were entitled. At the same time, federal and state agencies and prosecutors were investigating the STOLI market and commencing proceedings. Even the insureds and the families of the insureds were involved, often as plaintiffs suing investors, and claiming that those investors had cheated them or simply had no right to create or collect upon policies. In addition to all of this, the life expectancies of the insureds in many of these policies had been badly underestimated by the STOLI market. This meant that many of the insureds were living longer than the market expected, which of course was bad news for a market that was already in crisis.

Interestingly, on numerous occasions, transcripts, policy lists, and other discoverable information from these litigation cases were made public, and some insurers were thereby provided with evidence that certain of their policies were potentially STOLI. In response, a number of these insurers conducted litigation or negotiations to invalidate the involved policies, or at least the ones that, with the evidence from the other cases, might be proven to be STOLI. Generally speaking, the insurers did well in this litigation. Indeed, during the time period from 2009 to 2012, huge numbers of policies were invalidated and new pro-insurer STOLI decisions seemed to be issued by courts all across the country almost every week.

In the first few years of this STOLI litigation, much of the parties' focus was on whether the policy transactions in question were void because they violated the governing states' insurable interest laws, and within this context, courts were struggling to develop standards to apply to these cases. For example, in one of the earliest STOLI decisions, *Life Product Clearing LLC v. Angel,* 2008 U.S. Dist. LEXIS 4233 (U.S.D.C S.D. of NY 2008), the federal district court defined STOLI relatively broadly, setting a relatively low bar, explaining that insurable interest rules were violated any time the insured was intending for the as-yet-to-be-issued policy to be assigned in the secondary market. This came to be referred to as the "intent" standard. A significantly higher standard was set by the district court in *Sun Life Assurance Company of Canada v. Paulson,* 2008 WL 451054 (D. Minn. 2008), where the court explained that the focus in these cases is not solely on the insured's intent but more so on whether there is "mutual intent" by an insured and a third party and whether there is evidence of a "preconceived agreement" prior to policy issuance between those parties to avoid a prohibition on wagering. This came to be known as the "agreement" standard. A mid-level standard can be found in *First Penn–Pacific Life Insurance Co. v. Evans,* 2007 WL 1810707 (D. Md. June 2007). In *First Penn–Pacific,* the district court explained that more than mere intention on the part of the insured is necessary, but that a policy could be invalidated as long as there was also evidence that some third party participated in some way in effectuating the issuance of a policy that was intended for trade on the secondary market. This standard came to be known as the "third-party participation" standard.

Over time, litigants and courts have refined their arguments and positions, and the focus has turned away from the intent, agreement, and third-party participation standards, and instead towards an analysis that focuses on state constitutional and statutory prohibitions on wagering.

No doubt the best example of this is *PHL Variable Insurance Co. v. Price Dawe 2006 Ins. Trust,* 28 A.3d 1059 (Del. 2011). In *Price Dawe,* the Delaware Supreme Court clearly and unequivocally outlawed STOLI under Delaware law – only here, the focus was not on the language of the insurable interest statute but instead on the language of the Delaware Constitution. According to the Delaware Supreme Court in *Price Dawe,* the Delaware Constitution prohibits wagering; STOLI policies are wagers on a human life; and thus, such policies are void and can be challenged at any time and no matter what the circumstances.[11]

The *Price Dawe* decision was (and as explained below is) very bad news for the STOLI market. The Delaware Supreme Court was clear—STOLI policies are void *ab initio,* and a "court may never enforce agreements void ab initio, no matter what the intentions of the parties." Moreover, as explained below, there are huge blocks of policies that are governed by Delaware law and the *Price Dawe* decision.

Of course, the insurers did not win all of the STOLI cases. Indeed, after a federal district court certified a STOLI question to the New York Court of Appeals in *Kramer v. Phoenix Life Insurance Company,* 914 N.Y.S.2d 709 (2010), the court explained that, under New York law (as it existed then – because it has since been revised by statute), a person may procure an insurance policy on his or her own life and immediately transfer it to someone without an insurable interest, even where the policy was obtained precisely for this purpose. More recently, the Florida Supreme Court, focusing almost exclusively on the language of the Florida insurable interest statue, issued a decision articulating that in Florida, the form of a STOLI transaction matters more than the substance. *See Wells Fargo Bank, N.A. v. Pruco Life Insurance Co.,* 200 S3d 1202 (FL 2016) *("Brasner"). See also Hartford Life & Annuity Ins. Co. v. Doris Barnes Family 2008 Irrevocable Trust,* No. CV-10-7560, 2012 WL 688817, PSG (DTBx) (C.D. Cal.), *aff'd.,* 2014 WL 107790 (9th Cir. Jan. 9, 2014).[12]

Significantly, however, and as explained below, relatively few STOLI policies are governed by Florida or New York law (even if the insureds lived there). This is because, in the early STOLI days, the STOLI promoters were seeking to avoid the application of the laws of these states and were instead aiming at states like Delaware (which of course turned out to be bad for them due to *Price Dawe*).

The summary is this: although there are a minority of courts and jurisdictions that take a narrow view of STOLI and tend to validate transactions that feign technical compliance with the existing insurable interest laws, the vast majority of courts and jurisdictions go in the other direction and outlaw STOLI; finding such policies to be void either because they violate the language and/or intent of state insurable interest laws, or because they violate state constitutional prohibitions on wagering, or because they violate state anti-wagering statutes. Moreover, the vast majority of states permit STOLI challenges at any time, usually based on the rationale that, if the STOLI allegations are proven true, the policies are void, and as a result, the contestable clauses are ineffective to breathe life into a void policy. The cases described below make this clear.

Current landscape - there are a lot of STOLI policies

As noted above, over the course of the past few years, the insurance industry has become less focused on the STOLI market—which is somewhat logical because the STOLI market does not appear to be generating new policies and because many insurers have been of the view that the worst of the STOLI policies have already been invalidated—leading many in the insurance industry to believe that STOLI is over.

However, STOLI is not over. Indeed, the recently litigated cases have made a few things very clear. First, the originators of these STOLI policies, especially the large scale programs, originated *a lot* of policies.

The Coventry program may be the best example. Starting in 2001, Coventry entered into a series of contracts with AIG and various banks (most notably Wells Fargo and US Bank) whereby Coventry (using brokers like those described above) would originate life insurance policies for sale on the secondary market. These were essentially requirements contacts—meaning that subject to exceptions (which rarely applied) Coventry had to sell to AIG all of the policies that Coventry originated, and AIG, again subject to exceptions (which rarely applied) had to buy all such policies.

A lot is known about the Coventry and AIG relationship because these parties were in litigation with one another, and much of the discovery in that case was placed on the public record. And we know this much without question: By way of this program, Coventry generated, and AIG bought, approximately 7,000 polices with an aggregate face amount of approximately $20 billion.

There are other large-scale programs as well. GIII is a great example. GIII was involved in the *Price Dawe* case, and has been involved in a large number of litigated cases, many of which are governed by Delaware law. Almost all of these cases involve significant fraud, and although statistics on the size of the GIII program have been difficult to uncover, the sheer number of litigated GIII cases suggests that this is another very large block.

In addition to these, there is an entire spectrum of smaller STOLI players, some of whom generated just a few policies and some of whom generated hundreds of policies.

Based on the foregoing, we know for sure that there are still thousands of potentially suspect policies on the books of insurers, which translates into billions of dollars of insurance.

Further, as explained further below, many of these policies are governed by the laws of states like Delaware that take a harsh view of STOLI.

And here is the kicker. As already noted, the life expectancies of many of these insureds were initially understated. But no one lives forever. So what we are seeing now is that a large number of the elderly insureds who were the subject of these transactions are starting to die.

Current case law – many of these STOLI policies are invalid

This is the final and perhaps most important point—over the course of the past 24 months or so, when presented with death claim challenges, *courts have been concluding on a relatively consistent basis that many of these policies are void and that the death claim proceeds are not owed to the investors.*

One example of this is *Sun Life Assurance Co. of Canada v. U.S. Bank Nat'l Assn,* No. 14-cv-62610-BLOOM/VALLE, 2016 WL 161598 (S.D. Fla. Jan. 14, 2016) *("Malkin").* In *Malkin,* the insurer challenged a $5 million death claim involving a Florida insured and a policy procured as part of the Coventry program described above. After uncovering massive fraud (that related not just to the policy in question but to hundreds of other policies from various insurers), the court properly held that Delaware law (meaning the *Price Dawe* case described above) should apply, and as a result, the court found the policy to be void as an illegal wager and granted summary judgment—finding that trial was not needed and the insurer was to pay nothing on the $5 million death claim. Early in the opinion, the district court explained that not only was this policy part of the Coventry block, but that there were thousands more of these. This decision was then affirmed in June 2017 by the 11th Circuit, which found the district court's decision to be "thorough and well reasoned." *See Sun Life Assur. Co. v. U.S. Bank Nat'l Ass'n*, 693 Fed. Appx. 838 (11th Cir. June 12, 2017) (affirmed on all issues except prejudgment interest).

A second example comes from a nearly identical case, *U.S. Bank Nat'l Assn v. Sun Life Assurance Co. of Canada,* No. 14-cv-4703-SJF/ARL, 2016 WL 8116141 (E.D.N.Y. Aug. 30, 2016), *report and recommendation adopted,* No. 14-cv-4703-SJF/ARL, 2017 WL 347449 (E.D.N.Y. Jan. 24, 2017) *("Van de Wetering").* There, the insurer secured a similar summary judgment victory in connection with a $10 million policy. This was another policy from the Coventry block, and although this time the insured was from New York (normally a bad STOLI state for insurers), the court again correctly applied Delaware law (and again the *Price Dawe* decision), found that a trial was not necessary, and declared that the policy was a void wager. Thus, the insurer owed nothing on the $10 million death claim. This case was settled while on appeal to the 2nd Circuit.

Significantly, the application of Delaware law in these Coventry cases was no coincidence. To the contrary, the evidence suggests that there was a conscious effort by certain originators to procure policies created under Delaware law. Presumably, the logic was that Delaware law would be favorable to investors on STOLI issues just like it is favorable to investors on many other corporate issues. But this theory turned out to be very wrong in 2011 when the Delaware Supreme Court issued the *Price Dawe* decision. This strategy could have profound effects if indeed, as it appears, the Coventry block of policies is governed (like *Malkin* and *Van de Wetering*) by Delaware law.[13]

And making matters even worse for the STOLI community, the recent wave of insurance industry victories is not limited to policies governed by Delaware law. This is because other courts are adopting the reasoning from *Malkin* and *Van de Wetering* and are applying it in cases that are governed by the law of other states. For example, in *Sun Life Assurance Co. of Canada v. Wells Fargo Bank, N.A.,* No. 14-cv-5789-PGS/LHG, 2016 WL 5746352 (D.N.J. Sept. 30, 2016) *("Bergman"),* New Jersey law was applied. The undisputed facts showed that a $5 million policy on the life of a New York resident was originated and paid for by stranger-investors. Based on these facts, and after the insured's adult grandson (who was also the original trustee of the policy owner) invoked his Fifth Amendment rights and fled his deposition, claiming "I'm not going to jail for nobody," the insurer obtained yet another summary judgment STOLI victory.

Most recently, a court applying Tennessee law came to the same conclusion in *Sun Life Assurance Co. of Canada v. Conestoga Tr. Serves., LLC,* No. 3:14-cv-00539, 2017 WL 2982990 (E.D. Tenn. July 12, 2017) *("Collins").* Finding that Tennessee, like many states, has common law cases that outlawed human life wagers over a century ago, the court in *Collins* concluded that the undisputed facts demonstrated that this policy was created and financed by investors, that the $2 million policy was invalid, and that no death claim proceeds were owed. This decision was affirmed by the Sixth Circuit in April 2018.

Of course, not all of the cases are STOLI and not all are winners. It is important to study and investigate case facts before making a policy challenge. STOLI is hidden. Sometimes there are policies that are STOLI for certain but it is simply not possible to prove it, even in jurisdictions with favorable laws. Other times, there may be issues about which state's laws will govern and whether that state's law is clear. This means that the individuals working on these cases must be careful to pick the right cases to challenge.

In short, the secondary market would like the insurance industry to think that STOLI is over and that certain decisions like *Brasner* (which is limited to Florida) and *Margolin* (which is limited to Wisconsin) are significant. But the much more accurate read is that these are outlier cases and that the large blocks like Coventry and GIII are governed by the laws of states like Delaware that will compel rulings that void the policies. Thus, there is only one logical conclusion: a new wave of STOLI litigation is only now just beginning to develop; the majority of jurisdictions (including most significantly Delaware) remain favorable to insurers; and challenges to death claims on select STOLI policies are succeeding and likely will continue to succeed.

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Endnotes

[1] *See, generally PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Tr.,* 28 A.3d 1059, 1069 (Del. 2011) (discussing the historical use of life insurance policies to wager on the lives of strangers, including through so-called "dead pools").

[2] *Warnock v. Davis,* 104 U.S. 775, 779, (1881).

[3] *Grigsby v. Russell,* 222 U.S. 149, 154 (1911).

[4] *Id.* at 156.

[5] *Id.* at 155 ("Obviously it is a very different thing from granting such a general license, to allow the holder of a valid insurance upon his own life to transfer it to one whom he, the party most concerned, is not afraid to trust.")

[6] NRPF lenders had no insurable interest in the continued life of the insureds. In fact, the parties paying the premiums had no interest in the well-being of the insureds other than having the insureds pass away earlier rather than later. The longer the insureds lived, the longer the investors had to pay the premiums on the policies.

[7] Both acts define "fraudulent" practices to include, among other things, (i) presenting or preparing "false material information, or concealing material information" relating to insurance applications, underwriting, claims, premium payments, changes in ownership and beneficiaries, and policy reinstatements and conversions. The NAIC act further prohibits "[e]mploying any plan, financial structure, device, scheme, or artifice to defraud relating to" viaticated policies." And the NCOIL act further prohibits, "[i]n the "solicitation, application or issuance of a life insurance policy, employing any device or artifice in violation of state insurable interest laws."

[8] Under both acts, the VOC must be provided by the insurer within 30 days of a request on a Department of Insurance approved form and "the insurer must indicate whether, based on the medical evidence and documents provided, the insurer intends to pursue an investigation at this time regarding the validity of the insurance contract."

[9] The NAIC act requires insurers to respond, within 30 days, to requests for changes in ownership and beneficiaries—by either processing the change or "specifying the reasons why the requested change cannot be processed." The NCOIL act provides that "[t]he insurer shall not unreasonably delay effecting change of ownership or beneficiary."

[10] The NCOLI act defines "STOLI" as: "A practice or plan to initiate a life insurance policy for the benefit of a third party investor who, at the time of policy origination, has no insurable interest in the insured. STOLI practices include but are not limited to cases in which life insurance is purchased with resources or guarantees from or through a person, or entity, who, at the time of policy inception, could not lawfully initiate the policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy and/or the policy benefits to a third party. Trusts that are created to give the appearance of insurable interest, and are used to initiate policies for investors, violate insurable interest laws and the prohibition against wagering on life."

[11] In determining whether a policy is an illegal human life wager, the *Price Dawe* court focused on who really procured the policy, and more specifically, on who really paid for the policy. If that entity lacked an insurable interest, the policy was a void *ab initio* wager.

[12] Similarly, the Seventh Circuit validated an alleged STOLI policy in *Sun Life Assurance Co. of Canada v. U.S. Bank, N.A.,* 839 F.3d 654 (7th Cir. 2016) *("Margolin"); See also Sun Life Assurance Company of Canada v. Wilmington Trust,* Case No. 2:15-cv-00758 (D. Utah Mar. 13, 2017). However, that case has extremely narrow application because it was based a unique provision of Wisconsin law that expressly stated that insurers could not refuse payment on the basis of a lack of insurable interest. The only other state with a provision potentially like this is Utah, and there are very few STOLI policies governed by Wisconsin or Utah law.

[13] Many of the GIII policies are likely also governed by Delaware law. In fact, the policies in *Price Dawe* were GIII policies.