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After Supreme Court Ruling, Lawyers Should Examine Life Policies Benefiting Clients

"Strangers" with no relationship to the insured should not be permitted to benefit by investment or wager on the life expectancy of another individual whether or not someone with an insured interest obtains a benefit by initially becoming the the named beneficiary of the policy.

By **Law Journal Editorial Board** | June 09, 2019

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Pursuant to Rule 2:12A, the New Jersey Supreme Court may accept for decision cases involving unanswered questions of state law certified to it for consideration by the Third Circuit. One such case is *Sun Life Assurance Company of Canada v Wells Fargo Bank, NA*, decided by our Supreme Court on June 4, 2019. By their very nature, questions of law are certified because of a lack of controlling state precedent, and therefore the court's rationale in certified cases make particularly interesting reading.

In the *Sun Life* case, the court considered the novel issue of whether "the swift transfer of control over a life insurance policy and its benefit, from a named beneficiary who had an insurable interest to investors who did not, satisfies New Jersey's insurable interest requirement." Stated differently, may a person or group of persons with no insurable interest, as defined by statute in NJSA 17B:24-1, be permitted to fund the purchase of a life insurance policy through a person or entity with an "insurable interest," such as a family member, and take transfer of the beneficial interest by payment, or otherwise, of that interest. Put bluntly: can a stranger invest in the life of someone for purposes of making a profit through life insurance proceeds—usually with the hope or expectation of a short "turn around" on the investment?

In this case, the insured's grandson, who had an insurable interest in his grandmother's life, was the purchaser of a life insurance policy through a trust of which he was a trustee. The premiums were paid by the other trustees who were "strangers" in the sense they did not have an "insurable interest" which by law could be protected through life insurance proceeds. Under the arrangement, the grandson's interest in the trust was eliminated about five weeks after the policy issued, and when the carrier declined to pay death benefits upon the grandmother's death, after the two year period of incontestability, the Court was asked to consider the legality of a "stranger-originated life insurance" ("STOLI") policy, purchased by or for the benefit of beneficiaries with no statutory insurable interest. Speaking through Chief Justice Rabner, the court concluded that such policies were void ab initio because they violate the public policy embodied in title 17B "and would effectively allow strangers to wager on human lives." Hence, as such policies are void from the outset the period of incontestability is never triggered and the "strangers" cannot collect on the policy.

On the other hand, the court made clear that validly issued life insurance policies can be sold by those with insurable interests who purchased them, at least two years after they are issued, and they can be sold to investors who otherwise lack an insurable interest. The court pointed to various reasons that justify such transfers or sales, often to raise cash for the benefit of the insured or needs of the beneficiary. The essential difference is that the policy is not initially purchased with investor funds in order to obtain a policy with a high face value for the investor, or otherwise purchased for the financial benefit of someone with no insurable interest. Moreover, even when the contract was issued illegally, the purchaser or transferee may have the right to the refund of premiums if a record is developed to support such relief upon balancing of the various equitable factors, including the purchaser's "level of culpability," any knowledge and participation he or she had in "the illicit scheme," and "failure to notice red flags."

We agree with the policy embodied in the *Sun Life* opinion and believe that the "strangers" with no relationship to the insured should not be permitted to benefit by investment or wager on the life expectancy of another individual whether or not someone with an insured interest obtains a benefit by initially becoming the the named beneficiary of the policy. In any event, we believe that practitioners in the area of estate planning should add to their checklist, for consideration with clients, the question of how they may have acquired a beneficial interest or became beneficiary of life insurance on the life of someone who is not a member of the family, business associate or person with an insurable interest pursuant to statute.
