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The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody and Linas Sudzius. The *WRNewswire* provides timely reports and commentary on tax and legal developments important to AALU members, clients and advisors, delivered to your inbox as they happen.

TOPIC: Insurer That Allowed Change of Beneficiary to Person with No Insurable Interest Is Sued for Negligence

CITES: *Barton v. Liberty National Life Insurance Company*, No. 2130443. (AL Ct. App. Dec. 12, 2014); *Life Insurance Co. v. Weldon*, 267 Ala. 171, 100 So.2d 696 (1957); Ala.Code 1975, § 27–14–3.

SUMMARY: This is a very unusual case and the court's conclusion here may not go far (but if it does, it will have profound implications for insurers and agents and brokers who must advise clients). It certainly contains many important reminders and lessons for life underwriters and insurers. Here, an Alabama State Appeals Court reinstated a negligence claim that was initially dismissed by a lower court. The claim was against an insurer, based on the assertion that the recipient of life insurance proceeds had no insurable interest in the life of the insured at either the time she named herself beneficiary of the policy or at the time of the insured's death, so that when the insurer allowed a change of beneficiary that would pay the proceeds to her, it unjustly enriched her to the detriment of the rightful beneficiary.

RELEVANCE: To my knowledge, this is the first time a court has ever declared a change of beneficiary void due to a lack of insurable interest. Whether it will be followed in other courts remains to be seen. Certainly, the decision in this case puts insurers and agents and brokers on the alert and warns them to take great care. As a practical matter, if this conclusion is followed by other courts, it will present many practical difficulties. For instance, during the underwriting process, the issue of insurable interest from both the insurer's viewpoint and state laws is examined by a trained and experienced underwriting staff. However, a change of beneficiary form is examined and the change itself is executed in an insurer's home office by a clerk who typically is merely recording the request and is ill equipped by training, experience, or by the information available to make insurable interest determinations.

As noted above, regardless of whether or not other courts follow this court's holding, this case contains important reminders and lessons about insurable interest, how it works, and its great importance.

First, this case highlights my theory that there are really two insurable interest tests that must be met with respect to life insurance: First, there is the insurable interest required by insurers to meet their financial, health, and moral underwriting standards and second, there is the insurable interest imposed and required under state law. They may be similar but might also differ significantly.

Second, assuming a lack of fraud or deception, a person has unlimited insurable interest in his own life.

Third, courts will not permit mere strangers to speculate upon the life of one whose continued existence would bring them no expectation of possible benefit or advantage.

Fourth, a policy owner typically will not have an insurable interest on a third party's life if there is no a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of the proposed insured and consequent loss by reason of his or her death or disability or the policy owner is not closely related by blood or by law.

Fifth, policy owners must have an insurable interest on the life of the insured at the time the life insurance contract becomes effective.

Sixth, despite the holding of this case, generally the beneficiary of life insurance need not have an insurable interest in the life of the insured at the date of the insured's death. As a practical matter, would any insurer be in a position to determine if the beneficiary had an insurable interest when a change of beneficiary form was submitted?

Seventh, if a life insurance contract is held to be void because of a lack of insurable interest, the insurer has no liability under the contract but in most cases will be required to repay all premium payments (typically without interest) to the party who paid the premiums.

FACTS: Benjamin Miller ("Senior") purchased a policy on the life of his son, Benjamin Jr. ("Junior"), in whom he presumably had an insurable interest under state law. At some point, Senior changed the beneficiary of the policy to himself. He died, and about six months later, his son, the insured died; at that point, Senior's estate owned the policy. Senior's widow, Leanne Miller, was named administratrix of his estate. As such, she had requested that Liberty National change the beneficiary and make her—personally—the recipient of the proceeds of the policy. Liberty National granted that request and paid the proceeds of the policy to Leanne personally when Junior died.

Misty Barton, as personal representative of the estate of Junior sued Liberty National and Leanne Miller, the policy beneficiary. The estate asserted that, because Leanne had no insurable interest in the continued life of Junior, her stepson, Leanne's naming herself as beneficiary of the policy was ineffective and void. The estate also asserted Liberty National had been negligent in failing to determine, at the time Leanne requested that she be named beneficiary, that Leanne had no insurable interest in the life of Junior; that, as a proximate consequence of the negligence and wrongful conduct of Liberty National, Junior's estate had been deprived of those benefits; and that Leanne's actions had resulted in her being unjustly enriched in an amount equal to the insurance proceeds that had been paid to her by Liberty National.

The trial court granted Liberty National's motion to dismiss.

However, the appeals court agreed to hear the following argument by the insured son's estate:

> Liberty National's allowance of Leanne's change to the beneficiary of the policy created a *wager policy*, which is void under Alabama law, thereby depriving Benjamin Jr.'s estate of the insurance proceeds to which it was entitled.

According to state (Alabama) insurable interest case law (obviously written before courts considered politically correct wording):

> There is no limit to the insurable interest which a man may have in his own life; but there are forcible reasons why a mere stranger should not be permitted to speculate upon the life of one whose continued existence would bring to him no expectation of possible benefit or advantage.... The reason of the law which vitiates wager policies, is the pecuniary interest which the holder has in procuring the death of the subject of insurance, thus opening a wide door by which a constant temptation is created to commit for profit the most atrocious of crimes.

Although insurable interest law varies from state to state, the general principles are mainly the same:

- An insurable interest is one based upon:
    - a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by reason of his or her death or disability or
    - a substantial interest engendered by love and affection in the case of individuals closely related by blood or by law.
- Most states provide that the policy owner must have an insurable interest in the life of the insured only at the time the contract of personal insurance becomes effective.
- Most states provide that the beneficiary of life insurance need not have an insurable interest in the life of the insured at the date of the insured's death.
- Most states also provide that life insurance procured, or caused to be procured, upon *another* individual is void *unless* the benefits under the contract are payable to the individual insured, or his or her personal representative, or to a person having, at the time when the contract was made, an insurable interest in the individual insured.
- Typically, when a life insurance contract is held to be void, the insurer is not liable on the contract but is required to repay to the person, or persons, who have paid the premiums, all premium payments without interest.

Here, the insurer, Liberty National, in its defense, argued that in enacting state law, the legislature (Alabama) "did not intend to require an insurable interest to exist beyond a life insurance policy's initial issuance" and that "[a] policy of life insurance, taken out by the insured himself or by a person having an insurable interest in the life of the insured, in good faith may, unless the policy provides otherwise, be assigned to anyone as any other chose in action without regard to whether the assignee has an insurable interest in the life insured or not."

However, this court held that there is a distinction between an assignment and a change of beneficiary.

> The matter of change of beneficiary and assignment of policies are two separate and distinct things. An assignment is the transfer by one of his right or interest in property to another. The power to change the beneficiary is the power to appoint.

Here, the court insisted that legislative intent is to be determined from a consideration of the *whole* act with reference to the subject matter to which it applies and the particular topic under which the language in question is found rather than from a particular part considered separately. Although the court could have interpreted legislative intent as meaning that the section of the state Insurance Code allows for a change of beneficiary, regardless of whether the proposed new beneficiary has had an insurable interest in the insured at any time, it chose not to. Instead, this court decided that:

> the statute merely allows a person who has taken out an insurance policy on the life of another while he or she had an insurable interest in the insured, to still receive benefits from that policy if, at the time the loss occurs, he or she no longer has an insurable interest in the insured. But this does not allow for the change of a beneficiary on the life-insurance policy of another when the proposed new beneficiary does not possess an insurable interest in the insured.

Since Leanne did not have an insurable interest in Junior either when the policy was issued or at any time thereafter, this court held that her change of beneficiary to herself was not effective.

Does state law impose a *duty* on an insurer to determine whether an insurable interest exists *after* a policy is issued? This court looked to prior decisions that held that an insurer in fact does have a legal duty to ascertain the existence of insurable interest. For instance, in one case the aunt-in-law of a young child purchased a policy on the child's life.

> The court in that case – in which this 2 ½ year old child was murdered by the aunt by marriage—held that the insurance companies who had issued the policies had a duty to use reasonable care not to issue a policy of life insurance in favor of a beneficiary who has no insurable interest in the life of the insured.

Why impose on the insurer a *continuing* duty of care?

> Where this court has found that such policies are unreasonably dangerous to the insured because of the risk of murder and for this reason has declared such policies void, it would be an anomaly to hold that insurance companies have no duty to use reasonable care not to create a situation which may prove to be a stimulus for murder.

Policies issued without insurable interest are void as against public policy because the injury or harm from the issuance of such policies is foreseeable, if not likely. The *Barton* appeals court cited a 1957 decision in *Life Insurance Co. v. Weldon*:

> Such policies, if valid, ... furnish strong temptations to the party interested to bring about, if possible, the event insured against.

Thus, this court held that it was foreseeable that the issuance of life insurance policies on the life of a person as to whom the beneficiary had no insurable interest was likely to provide a stimulus for murder, and, therefore, a company issuing a life insurance policy is held to owe a duty to use reasonable care to ascertain whether the intended *beneficiary* of the policy had an insurable interest in the life of the person to be insured.

> That's what this Alabama court concluded – even though the original policy owner, the insured's father, presumably possessed insurable interest at the time the policy was purchased!

RESULT: The appeals court reinstated the estate's negligence claim against the insurer and remanded it for further proceedings.

***WRNewswire* #14.12.29 was written by Steve Leimberg, Co-Author with Howard Zaritsky of Tax Planning with Life Insurance, Publisher of LISI (Leimberg Information Services, Inc.) and CEO of Leimberg and LeClair Inc. (NumberCruncher Software).**

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