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The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody and Linas Sudzius. *WRNewswire* #15.03.11 was written by *Steve Leimberg*, co-author with Howard Zaritsky of Tax Planning With Life Insurance, Publisher of Leimberg Information Services, Inc. (LISI) and CEO of Leimberg & LeClair, Inc.

TOPIC: STOLI ON THE ROCKS? (AGAIN)

CITATION: *Pruco Life Insurance Company v. Wells Fargo*, D.C. Docket No. 9: 10-cv-80804-JIC; No. 13-12135; *Pruco Life Insurance Company v. U.S. Bank, N.A.*, No 13-15859; No. 13-12135 (Ct. App. 11th Cir., Feb. 25, 2015); Florida Statutes Sections 627.404 and 627.455.

SUMMARY: This combined case is a Certification to the Supreme Court of Florida (essentially a request for guidance from the highest court in the state because of a conflict in lower courts). These consolidated appeals request a determination of the validity of two individuals' stranger-originated life insurance (STOLI) policies that the issuing insurer sought to have invalidated years after the incontestable period expired. The insurer cited a Florida statute that requires a person who procures life insurance to have an insurable interest in the life of the insured at the inception of the policy. The insurer contended that there was no such interest when these policies were issued and that alone entitles it to have the policies declared void from the start.

This contention is undermined by another Florida statute requiring all insurance policies to include a clause providing that a policy is incontestable after it has been in force for two years. The public policy behind the incontestable clause is threefold: (1) To force insurers to timely investigate suspicious circumstances, (2) to protect policyholders, and (3) to prevent insurers from receiving a windfall years down the road. The policies at issue contained such a clause, and the insurer clearly failed to contest the policies within that two-year window.

So the question certified to the Florida Supreme Court is, "Which statute controls?" Does Florida's public policy interest in prohibiting the issuance of insurance policies purchased by a speculator with no insurable interest trump the state's interest in requiring insurance companies to identify and take timely action on a policy that lacks insurable interest? Florida law does not definitively answer these questions and federal district courts have disagreed when asked to interpret these laws.

If the answer to this question is that the Florida statute requiring an insurable interest in the insured trumps the statute requiring an insurer to challenge a policy's validity within two years of issuance, a second question arises with respect to policies such as the one discussed below. That question is whether the insurable interest statute is violated when the individual who procures the insurance has *technically* met the required insurable interest at the time of issuance, but nonetheless procured the policy in bad faith?

RELEVANCE: The issues before the court neatly frame two central issues in many STOLI cases:

1. Was there ever a contract subject to the incontestable clause if there never was insurable interest?

2. Even if the technical requirements for insurable interest were met, are state insurable interest statutes complied with when the policy was procured in bad faith?

Regardless of whether or not STOLI-like schemes rise up again as they have so many times in the past, the resolution of these issues—particularly that of the importance of good faith in the application for life insurance—will have great importance and lasting significance to life underwriters, insurers, and insureds.

FACTS: The consolidated appeals request indicates that the two cases before the Florida Supreme Court involve three STOLI policies and provides the information below about the facts and legal issues involved.

Wells Fargo, N.A., the present owner of a STOLI policy on the life of Arlene Berger, appealed a district court's final judgment, entered in favor of Pruco Life Insurance Company, invalidating this policy on the grounds the policy was void from inception. The second appeal was by Pruco. There, a different district court dismissed its claim seeking the invalidation of two STOLI policies issued on the life of Rosalind Guild on grounds that it was not void from inception.

The Berger Policy: Arlene and Richard Berger attended numerous financial planning seminars during 2005 and 2006 where they were told they could obtain free life insurance. The Bergers talked with insurance agent Stephen Brasner, who arranged for them to participate in his STOLI scheme by obtaining (1) financing for the payment of premiums from a third-party lender and (2) a fraudulent financial report listing Arlene Berger's net worth as $15.9 million and her annual income as $245,000. Brasner then applied to Pruco for a $10 million insurance policy on the life of Arlene Berger, naming her husband Richard as beneficiary. Pruco issued the policy on April 27, 2006.

Brasner subsequently established an irrevocable trust to hold the Berger policy. The trust named Wilmington Trust Company as trustee and Richard Berger as co-trustee and beneficial owner.

Despite their signed authorizations, according to the Bergers, they:

- neither needed nor wanted life insurance,
- did not intend to pay any of the premiums,
- never had any intention of controlling or keeping any insurance and
- only accepted the policy because it was free.

At some point, ownership of the Berger policy was transferred to the trust. For their participation in this transaction, Brasner paid the Bergers nearly $173,000. Then, in September of 2008, Arlene Berger instructed Wilmington Trust to relinquish all her interests and rights under the policy to the third-party lender in satisfaction of the financing agreement. The policy was ultimately sold to a client of Wells Fargo.

On July 9, 2010, about four years after it had issued the Berger policy, Pruco filed suit against Wells Fargo. It asserted the policy was void *ab initio* for lack of an insurable interest. The district court granted summary judgment to Pruco on its claim. The court held there was no valid insurable interest in the life of the insured by the party procuring the insurance, a violation of Florida's requirement of such an interest at the time an insurance policy is issued. Since this meant the policy was void *ab initio* (i.e. there never was a contract), the court reasoned the incontestability provision did not bar Pruco's claim, asserted more than two years after issuance of the policy.

The Guild Policy: In September of 2005, broker Gary Richardson persuaded octogenarian Rosalind Guild to participate in a $10 million STOLI scheme. He offered her free life insurance and monetary compensation. Richardson established an irrevocable trust to hold the Guild policies. Richardson then submitted two life insurance applications to Pruco, each seeking a $5 million policy and listing Guild's daughter as primary beneficiary and the trust as contingent beneficiary.

Guild never thought her daughter would receive the proceeds. She always knew that any beneficial interest would eventually be sold to an investor with no insurable interest in her life. In support of the applications, Richardson submitted a fraudulent financial statement portraying Guild's net worth as $19.2 million and annual income as $345,000. Pruco issued the Guild policies on October 21, 2005. A third party paid over $2 million in premiums over the course of the next few years. Then, on February 13, 2008, Pruco received a request to change the ownership and beneficiary of the policies from the Guild Trust to securities intermediary, U.S. Bank, N.A., in connection with the sale of the beneficial interest in the policies to an investor. Pruco made the requested change.

On December 17, 2012, approximately seven years after it had issued the Guild policies and almost five years after it had approved the change in beneficiary and ownership to U.S. Bank, Pruco filed suit against U.S. Bank asserting that the policies were void *ab initio* because they lacked insurable interest at inception. U.S. Bank filed a motion to dismiss Pruco's complaint.

Analyzing the interplay between the two Florida statutes differently than did the district court in the Berger case, the district court in Guild found that, because Pruco had not

raised the issue within the two-year time limit provision to contest the policy, it barred Pruco's claim.

Pruco argued that the Berger and Guild life insurance policies should be declared void because the purchasers of these policies lacked an insurable interest in the persons insured. Florida's insurable interest statute (Section 627.404) bars the purchase of a life insurance policy on another individual unless the benefits of the insurance contract are payable to the insured individual, his or her personal representative, or a person having an insurable interest in the insured individual. Insurable interest is defined to include "the life, body, and health of another person to whom the individual is closely related by blood or by law and in whom the individual has a substantial interest engendered by love and affection." Because the purchasers of the policies here did not have an insurable interest, as defined by statute, Pruco insisted the policies must be invalidated.

Wells Fargo and U.S. Bank, the present owners of the Berger and Guild policies responded that, even if Pruco was correct as to the lack of an insurable interest, Pruco waited too long to make that argument and therefore its requests to invalidate the policies should be denied. They relied on Florida's incontestability statute (Section 627.455) that states that every insurance contract shall provide that the policy shall be incontestable after it has been in force during the lifetime of the insured for a period of two years from its date of issue (i.e. they argued that contests are barred by what is in essence a statute of limitations that applies regardless of the basis of *any* challenge to the validity of the policy). Here, Pruco did not challenge the Berger and Guild policies until years after the two-year contestability period had expired. Wells Fargo and U.S. Bank argued that delay forecloses Pruco's efforts to undo these insurance contracts, on which it had been readily accepting large premium payments without complaint for several years.

The question becomes: "Which of the above two statutes controls these disputes?"

If the Florida Supreme Court determines that Pruco's challenge to the validity of the Berger and Guild policies is barred by the incontestability clause, things will end there. However, if the Florida Supreme Court decides that, regardless of Pruco's failure to contest the policies within two years of their issuance, it may still seek to invalidate those policies as being non-compliant with insurable interest requirements, the technical compliance issue must be addressed. Under Florida law, a third party can procure an insurance policy on the life of another if benefits under that policy are payable either to the named insured, his or her personal representative, or a person who, at the time the insurance contract is made, has an insurable interest in the insured individual. Further, an insurable interest is not required to exist after the inception date of coverage. Although the Berger policy was eventually assigned to Wells Fargo, Arlene Berger was listed as the owner and Mr. Berger was named as the beneficiary at its inception. Clearly, both of those individuals had an insurable interest in Mrs. Berger's life. Thus, Wells Fargo argued that the insurance contract complied with the Florida law requirement that there be an insurable interest at the inception of the policy.

By contrast, the *Berger* court, in rejecting that argument, held that such assignments must be made in good faith, and not as sham assignments seeking to circumvent Florida's law prohibiting a wagering contract on the life of another. If the insurance

policy were procured with the intent of making such sham assignments, the policy would be deemed to be obtained in bad faith.

According to the *Berger* court, bad faith is established if the policy was obtained with the intent that it would later be assigned to an entity or person with no insurable interest in the life of the insured. Intent to transfer could be proven by evidence of: (1) a preexisting agreement or understanding that the policy would be assigned to one without an insurable interest; (2) the payment of premiums by someone *other* than the insured (particularly by the assignee); and (3) the lack of a risk of actual future loss.

In concluding that the Berger policy was not obtained in good faith, the court noted the Bergers:

- never intended to keep the policy,
- always knew a speculator third party would receive the benefits,
- never paid, nor intended to pay, any premium for the policy, and
- knew and participated in an "elaborate scheme" to make it look as if Mrs. Berger was paying the premiums.

Wells Fargo argues that there is no good faith requirement in the Florida insurable interest law. It notes that Florida law requires an insurable interest only at the moment of the policy's inception and state assignability statute generally permits the assignment of an insurance policy to a third party with no insurable interest. It further argues that had Mrs. Berger died within that initial two-year period, her husband, the beneficiary of the policy, would have received the $10 million—which, it argues, undermines the claim that an insurable interest was lacking at the inception of the policy.

THE BOTTOM LINES: Absent controlling precedent from the Supreme Court of Florida, the Supreme Court was asked for guidance on the following questions for a determination of state law:

1. Can a party challenge an insurance policy as being void ab initio for lack of the insurable interest required by Fla. Stat. Section 627.404 if that challenge is made after expiration of the two-year contestability period mandated by Fla. Stat. Section 627.455?

2. Assuming that a party can do so, does Fla. Stat. Section 627.404 require that an individual with the required insurable interest also procure the insurance policy in good faith?

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