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TOPIC: Policy Purchased by Insured's Son Held Void for Lack of Insurable Interest

CITATION: *Lincolnway Community Bank v. Allianz Life Insurance Company of North America*, 2015 WL 7251931; No. 11 C 5907 (U.S.D.C. ND Ill. 11/17/2015).

SUMMARY: LincolnWay Community Bank requested a ruling that a life insurance contract it owned on Raymond Veselik was valid, or, if the policy was ruled invalid, that the court restore the premiums it paid. But the court held that the undisputed facts proved the policy unlawful because it was a STOLI policy.

RELEVANCE: This is yet another insurance law case where, similar to the pattern in tax law cases, a court has looked beyond the mere *form* of the transaction in question and considered the *substance*. Technical compliance with the letter of insurable interest law by itself is not dispositive. Courts will look behind the smoke and mirrors in arriving at decisions. Arrangements made solely to create the illusion of an insurable interest – where insureds are "puppets" and the policies are bets by strangers on the insureds' longevity – are illegal.

This case is a great reminder of key insurable interest principles of law that apply in most states, which are listed below:

(1) To purchase a policy on another person's life, there must be a close relationship of love and affection, through blood or law, or through a reasonable expectation of pecuniary advantage through the insured's continued life or demonstrable loss at the insured's death;

(2) A person has – absent fraud or deception – unlimited insurable interest in his own life;

(3) Insurable interest is generally necessary only at inception of a policy;

(4) The insurable-interest requirement does not prohibit the legitimate, post-procurement transfer of a policy to someone without insurable interest;

(5) No proof of insurable interest is necessary at the insured's death;

(6) A policy issued without insurable interest is – from inception – null and void, and typically an insurer has no liability though most repay premiums;

(7) After a policy is issued (assuming no fraud or deception), it may be assigned even to a party with no insurable interest.

FACTS: Scott Veselik was an independent agent who sold life insurance for a number of insurers. William Passero was a real estate developer and Scott Veselik's neighbor, officemate, and social acquaintance. In the mid-2000s, Veselik and Passero went into business as premium financiers. In 2006, they met with George Alexenko, the Chief Credit Officer and Executive Vice President of LincolnWay Community Bank, to provide an overview on premium financing and the secondary market. Passero proposed using LincolnWay-funded loans to pay premiums on policies for a 26-month period (a period designed to slightly exceed the length of a policy's contestability period).

After the 26-month financing period, there were three "exit options" for the financier: (1) the insured could buy the policy back from the financier by repaying the loan; (2) the financier could sell the policy on the secondary market to recoup the premiums paid; or (3) the financier becomes the owner of the policy and either lets it lapse or continues paying the premiums.

Veselik and Passero told Alexenko that they planned to "fill out applications for potential insureds at companies that didn't try to weed out policies that would ultimately be sold."

After Alexenko approved the plan, Veselik and Passero coordinated the financing for at least eleven policies, including a policy on Raymond Veselik, Scott's father, using loans from LincolnWay. The three men discussed the specific loan to fund Raymond Veselik's policy. But Passero, who was not related to Raymond and had no lender-creditor or other business relationship with him, had no insurable interest in Raymond's life.

In January 2008, Scott Veselick applied for a policy on his father's life through Allianz and named his mother as the beneficiary. On March 14, 2008, LincolnWay sent a letter to Passero with loan documents and a check for $210,900 to fund the premium. Shortly afterward, Scott wrote a personal check to Allianz for $210,900, knowing the money from Passero and LincolnWay would be available before his check to Allianz cleared.

Nine months after the policy's issuance, Scott filed a request with Allianz to transfer the policy to Passero, a change that Allianz confirmed on the following day. Passero transferred the policy to LincolnWay on August 31, 2010.

On August 25th, 2011, LincolnWay sued seeking a declaratory judgment that the Veselik policy was valid, or, if the policy was held not valid, then restitution of the premiums paid to Allianz. Allianz requested partial summary judgment on LincolnWay's validity claim, arguing that the undisputed facts showed that the policy was really procured by Passero, who had no insurable interest in Raymond Veselik's life, and was thus invalid under Illinois common law.

Illinois requires "the procurer of a policy on the life of another must have an insurable interest in the other's life." Insurable interest is defined as "an interest in having the life of the insured continue," rather than an interest in the insured's early death. Insurance purchased by an individual with no insurable interest is an unlawful wager on the insured's life and is illegal and void from inception (and now also statutorily prohibited by Illinois'2009 Viatical Settlements Act).

The insurable interest requirement does not prohibit the legitimate, *post*-procurement transfer of a policy to someone without an interest in the continued life of the insured, "such as when an insured sells a policy on the open market as a means of liquefying the asset." Once sold, the policy belongs to an investor who collects the payouts when the insured dies.

The key to legality is that the policyholder must have an insurable interest in the insured's life at the *inception* of the policy. Note, however, that an arrangement "solely to create the illusion of an insurable interest … to procure the policy for investors" is impermissible. A policy is a STOLI and void if someone other than the "insured[s] owned and controlled the policy before attempting to sell it," meaning the "insureds were the defendants' puppets and the policies were bets by strangers on the insureds' longevity."

Here, the relevant question is: "who was, in reality, the party who procured the policy on Raymond Veselik's life? Was it his son, Scott, or was Passero buying the policy as an investment vehicle and using Raymond Veselik as a straw man? To make this determination, courts "should look beyond the mere form of the transactions in question and consider their substance." Technical compliance with the insurable interest requirement is not dispositive.

Here, the court decided that it was not enough by itself that Scott, who had an interest in the life of his father, signed the policy application. In the eyes of this court, Passero used Scott, someone with an insurable interest, "to disguise the true owner of the policy." However, the mere fact that Passero funded the policy's premiums through LincolnWay was not enough, by itself, to decide the case. Premium financing is legal and an insured's ability to procure a policy is not limited to paying the premiums with his own funds; borrowing money with an obligation to repay also qualifies as an insured procuring a policy.

The court here looked past the form and considered the nature of the understanding between Passero and Scott at the policy's inception. Specifically, it looked at: (1) who had control over the Policy; (2) whether there was a pre-existing agreement to transfer the Policy to Passero; and (3) whether Scott intended to repay the premiums. The court concluded the insureds were the defendants' puppets and the policies were bets by strangers on the insureds' longevity.

Passero had control over the policy and expected the policy to be transferred to him after its issuance. Passero and Scott had worked together to identify and finance policies for various acquaintances and family members, including Passero's mother, Scott's father, and Scott's father-in-law. They knew that in the secondary life insurance market, "the older the insured the better." On the front end, the insureds agreed to this plan because they got two years of free insurance. Although some tried to buy the policies back by repaying the loan after the 26-month period, all parties ultimately transferred their policies to Passero.

Put another way, in substance—looking past the form—Passero was wagering that Raymond Veselik would live for 26 months, and then Passero would own the policy. The reason Passero was not listed as the owner in the first place was because the application had to meet technical insurable interest requirements: he and Scott had explained to Alexenko that "when the insurance policy is originally obtained, it needs to be obtained by the insured, a beneficiary and an owner who had the appropriate relationship to the insured." And Scott never had the intention of repaying Passero—when asked what assurances Passero had of recouping the money, Scott responded: "Passero was hoping I couldn't pay him back and he could sell it for more."
