Alert

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COZEN O'CONNOR

New Jersey Assembly Overwhelmingly Approves Anti-STOLI Legislation

As many of you may know, Cozen O'Connor was victorious last year in obtaining a ruling by the New Jersey Supreme Court in *Sun Life Assurance Company v. Wells Fargo Bank, N.A.*, 238 N.J. 157 (2019) (*Bergman*) that stranger-originated life insurance (STOLI) is illegal and void in New Jersey.

In a bold and direct response to this decision, the New Jersey Assembly, in an overwhelming 78-0 vote last week, passed legislation prohibiting STOLI and effectively codifying the entirety of the *Bergman* decision. This legislation has been sent to the New Jersey Senate, which introduced the legislation, on February 25, as S.B. 1914.

The Assembly-approved bill, A.B. 1263, supplements New Jersey's Viatical Settlements Act, N.J.S.A. 17B-30B-1, *et seq.*, and prohibits STOLI that is broadly defined as "an act, practice, or arrangement to initiate or procure the issuance of a policy in this State for the benefit of a third-party investor who, at the time of policy inception has no insurable interest under the laws of the State in the life of the insured." STOLI practices are non-exclusively deemed to include "cases in which (a) a policy is purchased with resources or guarantees from or through a person or entity who, at the time of policy inception, could not lawfully initiate or procured the policy himself, herself, or itself; and (b) at the time of policy inception, there exists an arrangement or agreement, to transfer, directly or indirectly, the ownership of that policy or the policy benefits to a third party."

This legislation (i) prohibits any person from engaging in any "act, practice or arrangement that constitutes" STOLI; (ii) renders, as "void and unenforceable," any written or verbal "contract, agreement, arrangement, or transaction" — including a "financing agreement" — in "furtherance" or "aid" of STOLI; and (iii) provides that a "trust that is created to give the appearance of an insurable interest and that is used to initiate or procure policies for investors shall be in violation of the insurable interest laws of this State and the prohibition against wagering on life."

This legislation authorizes (i) civil actions by any "person damaged" by any such violation; and (ii) insurers to contest the validity of STOLI policies, with an express exemption from the two-year contestable statute, N.J.S.A. 17B:25-4. Moreover, the legislation imposes a civil penalty of up to $10,000 per violation.

The Commissioner of Banking and Insurance is also authorized to (i) seek an injunction to restrain any violation; (ii) issue cease and desist orders; and (iii) order restitution "to persons aggrieved by violations of this act."

In a statement accompanying the bill, the Assembly Financial Institutions and Insurance Committee recognized that "modern STOLI schemes have endeavored to hide the offensive ownership of the policy from insurers at inception" and "often include acts of fraud in the application for new insurance, such as the applicant misrepresenting their net worth or the amount of in force insurance they have." The committee stated that STOLI schemes are not only "harmful because they circumvent insurable interest laws," but "they can also limit an insured's ability to purchase life insurance later if he has used up his capacity for insurance on the STOLI arrangement."

The committee explained that this legislation was "intended to codify" the holding in the New Jersey Supreme Court's *Bergman* decision and to "provide appropriate penalties for violations arising from" STOLI. In *Bergman*, the court held that a life policy procured with the intent to benefit persons without an insurable interest violated New Jersey public policy and was void *ab initio*. The $5 million policy at issue in *Bergman* was part of a larger scheme in which a total of five policies (issued by multiple insurers) with a total face amount of $37 million were allegedly taken out by

Charles J. Vinicombe

Of Counsel

cvinicombe@cozen.com
Phone: (856) 910-5003
Fax: (856) 910-5075

Michael J. Miller

Chair, Life Insurance & Annuities
 Co-Chair, Software

mjmiller@cozen.com
Phone: (215) 665-4114
Fax: (215) 372-2347

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stranger investors on an elderly insured's life. The application for the policy failed to disclose the existence of these other policies and misrepresented that the insured was a wealthy woman with a need for insurance. The policy was initially owned by a trust created in the insured's name with her adult grandson as trustee, while stranger investors covertly funded the premiums. Within weeks of the policy being issued, the investors replaced the grandson as trustee and his beneficial interest in the trust was transferred to them. Upon expiration of the two-year contestable period, the policy was sold (as originally planned) on the secondary market, with the sales proceeds going to the investors.

The policyowner in *Bergman* argued that the policy was valid based upon technical compliance with the insurable interest statute because (the owner argued) an insurable interest only has to exist at the time that the policy is issued and the initial policyowner and beneficiary was a trust with the insured's grandson as beneficiary. The court rejected this form over substance argument, holding that, "[i]f a third party without an insurable interest procures or causes an insurance policy to be procured in a way that feigns compliance with the insurable interest requirement, the policy is a cover for a wager on the life of another and violates New Jersey's public policy."