STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

George E. Pataki
Governor

Howard Mills
Superintendent

The Office of General Counsel issued the following opinion on December 19, 2005 representing the position of the New York State Insurance Department.

Re: Life Insurance Transactions

Questions

1. Does a valid "insurable interest" exist in the described transactions under the New York Insurance Law?

2. Would the below-described transactions (and, in particular, the put provision assignment) be permissible under the New York Insurance Law, especially N.Y. Ins. Law § 3205(b)(1)?

Conclusions

1. No, a valid "insurable interest" does not exist in the transactions described.

2. No, the below-described transactions are not permissible under the New York Insurance Law.

Facts

The inquirer’s inquiry seeks the Department’s views regarding certain transactions involving life insurance policies. The transactions in question are essentially structured as follows.

Third party banks ("Loan Providers") propose to loan money to high net worth individuals ("Clients") to purchase insurance policies ("Policies") from life insurance companies and pay premiums due under an option agreement ("Put Option") to sell such Policy to a third party on a predetermined date ("Exercise Date"), which will be at least two years from the date of the loan. The full recourse loans ("Loans") provided to the Clients by the Loan Providers would mature on a date on or after the Exercise Date and be secured by the Policies and by the rights of the Clients under the Put Option. In the event that the Client dies before the maturity (or repayment, as described below) of the Loan, the Loan would be repaid out of the Policy's death benefit, with the remainder paid to the beneficiary of the Policy or the Client's estate.

Under the Put Option, the put provider, a hedge fund ("Put Option Provider"), would commit to purchase the Policy from the Client (if the Client so requests) on the Exercise Date. The exercise price of the Put Option would be equal to a pre-determined formula, the sum of which would cover the repayment of the Loan by the Client, as well as Loan interest. However, if the Client elects not to exercise the Put Option, he or she would be fully liable for repayment of the Loan (and interest thereon) and would continue to be the owner of the Policy (and responsible for future premiums under the Policy). In such a case, the Put Option would lapse unexercised and the Put Option Provider's rights would terminate. The Policy would be assigned to the Put Option Provider (at the earliest two years from contracting) only if the Client exercises the Put Option.

In summary, should the Put Option expire unexercised, the Client would be responsible for annual interest payments on the Loan following the Exercise Date. Should the Put Option be exercised, the Client would be responsible to repay the Loan amount plus interest on or about the Exercise Date (upon receiving the exercise price of the Put Option). No payments under the Loan would be due prior to the Exercise Date.

In addition to the above, a licensed bank ("Guarantee Provider") would, for a fee paid by the Put Option Provider, provide to the Client a guarantee ("Guarantee"), whereby it would guarantee the obligations of the Put Option Provider towards the Client under the Put Option. Thus, should the Put Option Provider not be able to meet its obligations under the Put Option, the Guarantee Provider would assume all obligations and benefits of the Put Option Provider under the Put Option (if exercised by the Client). The Guarantee Provider and the Put Option

Provider would regulate their internal relations under a separate agreement.

Analysis

The provision of the New York Insurance Law governing the issue raised herein is N.Y. Ins. Law § 3205(b), which provides, in pertinent part, as follows:

> (b) (1) Any person of lawful age may on his own initiative procure or effect a contract of insurance upon his own person for the benefit of any person, firm, association or corporation. Nothing herein shall be deemed to prohibit the immediate transfer or assignment of a contract so procured or effectuated.
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> (2) No person shall procure or cause to be procured, directly or by assignment or otherwise any contract of insurance upon the person of another unless the benefits under such contract are payable to the person insured or his personal representatives, or to a person having, at the time when such contract is made, an insurable interest in the person insured.

N.Y. Ins. Law § 3205(b) (McKinney Supp. 2005).

The term "insurable interest" is in turn defined under the New York Insurance Law as follows:

> (1) The term, "insurable interest" means:
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> (A) in the case of persons closely related by blood or by law, a substantial interest engendered by love and affection;
>
> (B) in the case of other persons, a lawful and substantial economic interest in the continued life, health or bodily safety of the person insured, as distinguished from an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the insured.

N.Y. Ins. Law § 3205(a)(1) (McKinney Supp. 2005).

The Department has been presented in the past with proposals similar to the one herein. Although it is not expressly stated in the inquirer’s description, based on our review of the transaction it appears that the arrangement is intended to facilitate the procurement of policies solely for resale. It is our view that a plan of this nature does not conform to the requirements of the New York Insurance Law. First, the policies obtained by the Clients herein are arguably not obtained "on [their] own initiative" as required by N.Y. Ins. Law § 3205(b)(1). Secondly, the potential transferees do not appear to have a legitimate "insurable interest" in the lives of the Clients.

While it is true that N.Y. Ins. Law § 3205(b)(1) expressly allows an individual to procure and immediately transfer or assign to another a policy on his own life, irrespective of the existence of an insurable interest in the assignee [a position upheld by Hota v. Camaj, 750 N.Y.S. 2d 119 (2nd Dept 2002), which the inquirer cites in the inquirer's letter] it is the Department's view that the transaction presented involves the procurement of insurance solely as a speculative investment for the ultimate benefit of a disinterested third party. Such activity is readily distinguishable from the facts underlying Hota[1] , and is contrary to the long established public policy against "gaming" through life insurance purchases.

In addition, there may exist other potential problems, such as rebating violations, with the proposed transaction. Although not set forth in the inquirer's letter, it is foreseeable that some entity will be responsible for coordinating the plan and perhaps matching the Loan Providers, Put Providers, and Clients. Upon the sale of the Policy by a Client (following the exercise of the Put Option) it is conceivable that the policy premiums would be effectively rebated since the Client may well recoup from the proceeds of the Policy sale the amounts it borrowed and paid as policy premiums. Such a Client would thus receive cost free coverage for the two-year incontestability period, arguably an inducement to enter into the transaction.

In light of the above, the Department does not view the transaction as permissible.

For further information one may contact Supervising Attorney Michael Campanelli at the New York City office.

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1 In Hota , the court noted that the assignee of the policy did in fact possess an insurable interest in the life of the decedent by virtue of the fact that the assignee therein was a creditor of the decedent. In the proposed transaction, the Loan Providers will be the creditors of the Clients, but the indebtedness exists only in connection with the purchase of the insurance. Thus, theirs is "... an interest which would arise only by, or would be enhanced in value by, the death, disablement or injury of the insured" under N.Y. Ins. Law § 3205 (a)(1)(B).