

# Life Insurance Policies Were STOLI and Void Ab Initio

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Applying Illinois Law, Seventh Circuit Affirms District Court's Ruling

*Ohio National Life Assurance Corp. v. Davis*, 803 F.3d 904 (7th Cir. 2015) **Case at a Glance** Ohio

National Life Assurance Corp. ("Ohio National") sued a number of individuals alleging that they were participants or investors in a plan which resulted in the issuance of \$2.8 million of life insurance which it contended was STOLI, which is illegal and void under Illinois law. The district court granted Ohio National summary judgment holding that the policies were Stranger Originated Life Insurance ("STOLI"), void *ab initio*, that Ohio National could retain the premium paid for the voided policies with one exception, and that Ohio National was entitled to recover \$726,000 in damages. The United States Court of Appeals for the Seventh Circuit affirmed. **Summary of Decision** *The STOLI scheme* A lawyer and an insurance agent put together a plan to solicit elderly individuals to become the nominal buyers (and the insureds) of life insurance policies issued by Ohio National. The lawyer and agent had no insurable interest in the lives of those they solicited to participate in this plan. The policies at issue in this case, which had an aggregate face amount of \$2.8 million, were placed in irrevocable trusts created by the lawyer and insurance agent, of which the lawyer was the sole trustee. The applicants for the policies were paid a small amount of money to lend their names to this plan. The initial premiums for the policies were paid by the trust. The applicants/ nominal owners did not pay any amount for any purpose. Rather than using the life insurance trusts as a legitimate tax planning vehicle, the trusts were used "to hoodwink Ohio National." The lawyer and agent contended that they did not know that STOLI policies were illegal. The court of Appeal termed such a position "hard to believe" but found that ignorance of the fact that STOLI is illegal would not be an excuse. The trusts were used to conceal from Ohio National the fact that the policies were controlled by the lawyer and agent rather than by the applicants, and that the intention from the beginning was to procure policies for sale in the investment market. The applications were manipulated to make the insureds appear more attractive to Ohio National from an underwriting standpoint, i.e., more prosperous, healthier and likelier to live a longer time than was "realistic to expect." To facilitate the scheme the initial beneficiaries of the trusts typically were members of the applicant's family or other trusts controlled by the applicants. Within several months of the issuance of the policies the applicants/nominal owners would assign the beneficial interest in the trusts (and therefore the policies) to a corporation owned by the insurance agent's husband, who funded the payment of the

initial premium for the policies and then resold the beneficial interest in the trusts to investors. The investors paid subsequent premiums and waited for the insureds to pass away so that they could collect the benefits of the policies. The scheme targeted elderly persons or others with an anticipated short life expectancy to be the applicants for the insurance, since such persons were likely to pass away and trigger the payment of policy benefits for the investors sooner. Ohio National moved for summary judgment, seeking an adjudication that the policies were STOLI and that it did not have to return the premium it had been paid for the policies. The district court granted Ohio National's motion, applying Illinois law and holding that:

- The life insurance policies at issue were STOLI and void *ab initio*;
- Ohio National could retain the premium paid for the void policies, even if the defendants did not appreciate the illegality of the STOLI scheme, with the exception of \$91,000 in premium paid by an investor who purchased an interest in a trust, who the court found to be innocent of wrongdoing; and
- Ohio National was entitled to \$726,000 in damages from the complicit parties. The damages included the commissions that Ohio National had paid to the agent and Ohio National's attorneys' fees and costs incurred in proving that the policies were STOLI and void.

*Seventh Circuit's Decision* The United States Court of Appeals for the Seventh Circuit affirmed. The appellate opinion addresses three issues: (1) whether the insurance policies were STOLI; (2) what to do about the premiums that had been paid for the policies; and (3) Ohio National's request for damages. The court found that the life insurance policies were STOLI and void *ab initio* under the circumstances presented, and that this scenario violated Illinois' prohibition of gambling on the life of another person. Although family members of the insureds were the initial beneficiaries of the trusts, the court found it to be persuasive that third parties controlled the process and initiated, paid for and controlled the policies from the outset. The agent's participation in this scheme also violated the agent's contractual duties to Ohio National, which included an "absolute prohibition against participation in any type of premium financing scheme involving an unrelated third party," which the Seventh Circuit found to be "an exact description" of the STOLI scheme. The court held that while policies which were procured in good faith could be assigned at a later date to third parties which did not have an insurable interest in the life of the insureds, the policies at issue here did not fall into that category because they were procured initially by someone who did not have an insurable interest in the life of the insureds. Although the insureds' family members retained beneficial interests in the policies for a short time, they never controlled the trusts, and the court described the insureds as "the defendants' puppets and the policies were bets by strangers on the insureds' longevity." With respect to the premiums, the court held that when an illegal contract is voided, the parties to the contract normally will be left where they had placed themselves with no recovery of the money paid for the illegal services. The court therefore affirmed the district court's ruling that Ohio National did not have to pay to the participants in the STOLI scheme the funds paid as premiums for the voided policies. However, the court found that one of the defendants, an investor in one of the trusts, was

not to blame for the illegality and had no knowledge of the wrongful STOLI scheme. Therefore, it affirmed the district court's ruling that Ohio National return to him the \$91,000 he had paid for premium for one of the voided policies. Finally, the court affirmed an award of damages to Ohio National in the amount of the commissions it paid to the complicit agent and its attorneys' fees and expenses paid in contesting the policies. **Comment** This is likely to be an important opinion in this area. It may be the only appellate opinion to date which addresses the issue of the fate of premium paid for STOLI, and the allowance of damages to the insurer which included its attorneys' fees may change the financial calculus of these actions. *Reprinted with permission of Thomson Reuters, Inc. All rights reserved.*

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