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Ownership and Transfer of Interests in Life Insurance Policies

By Lewis D. Asper*

At the end of 1967, life insurance in force in the United States totaled $1079.8 billion.1 This figure, of course, represents the total, substantially unmatured obligation of insurance companies; but this obligation was backed by $177.4 billion of assets held by the companies.2 Life insurance is probably the single most important form of savings for many if not most citizens. The investment in life insurance, in common with most other forms of savings, is transferable. It can be withdrawn, hypothecated, sold or given away. While investment in life insurance continues to grow at an accelerated rate, the legal principles governing ownership and transfer of this enormous pool of assets remain uncertain, disorderly, even misleading. As the editors of a leading insurance casebook have pointed out, the methods of disposition of this singularly important form of wealth have developed without the benefit of a background of feudal land law and with little assistance from recording acts or other legislation addressed directly to questions of transfer.3 The system, such as it is, has evolved largely from a judicial interpretation of those terms inserted in policies by insurers for their own protection.4

Historical Foundation

Life insurance has been a significant economic fact in the United States only since the middle of the nineteenth century.5 From the beginning the state has recognized that it has an interest in private contracts which ensure that families of deceased breadwinners will not become public charges.

Exemption Statutes

As early as 1840, New York enacted its Verplanck Act6 authorizing

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* Professor of Law, University of Maryland.
1 INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 19 (1968).
2 Id. at 63.
4 Id.
6 N.Y. Laws 1840, ch. 80, at 59.

[1175]
any married woman to insure the life of her husband. The Act provided that if the wife survived her husband the money payable under such a contract was to be payable to her for her own use, free of the claims of her husband’s representatives or creditors. Massachusetts followed in 1844 with a statute providing that any policy procured for the benefit of a married woman by any person on any life was to be for her separate use and benefit, free of any claims of her husband, his representatives or his creditors. These statutes were widely copied and at present are found in the codes of all the states in the union. The present significance of such statutes lies in their exemption features. The early statutes were also designed to foreclose any questions about a wife’s insurable interest in her husband’s life and to remove for this special purpose the incapacity of a married woman to contract. Their influence on the development of insurance law principles extended beyond what early legislators anticipated.

To courts and legislatures of the middle nineteenth century the life insurance contract must have been something of a puzzle. Lawrence v. Fox was still several years away when the New York and Massachusetts statutes were enacted. As noted, the Massachusetts act was from the beginning directed to any policy procured by anyone for the benefit of a married woman, and the New York statute was amended in 1858 to “clarify” the intention that the stated exemptions were to apply even though the premiums were paid out of the husband’s assets. In effect, a class of third party beneficiaries (and donee beneficiaries at that) was created by statute some years before the courts had squarely faced the phenomenon of a contract promise for the benefit of a stranger.

Professor Vance was persuaded that the early statutes exercised an unusual influence on the development of insurance law. The early life insurance contract was a relatively simple document providing that, conditioned on payment of premiums, the insurer promised to pay a sum of money to a designated beneficiary upon the death of the insured. Absent anything else, there was no reason to believe

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7 Mass. Laws 1844, ch. 82, at 282.
9 Id. at 589.
11 20 N.Y. 268 (1859).
that the contracting parties, insurer and insured, were powerless to
rescind or modify the contract by mutual agreement at a later date.
However, after the 1840's, courts, called upon to decide what rights
accrued to a beneficiary under these contracts, looked to the exemp-
tion statutes and found in these enactments the creation of an “equity”
or “equitable right” in the beneficiary. 14 Within a remarkably short
time the “equity” blossomed into the “vested interest” of a donee
beneficiary of a life policy. 15 Under this judicially conceived form of
spontaneous combustion, the policy and its proceeds became the prop-
erty of the beneficiary from the moment it was issued. 16 There-
after no power remained in the person procuring the policy to transfer
any interest to another person or to appropriate any interest to him-
self. 17 Once articulated, this theory was grasped enthusiastically by
courts which apparently shared the concern of the early legislatures
for widows and children. 18 The “vested interest” of the beneficiary
of a life policy became the law of every state but one. 19

Nonforfeiture Statutes

Meanwhile other developments were taking account of the invest-
ment character of this method of saving by which, in the usual case, a
breadwinner creates a fund readily accessible to his dependents
when he dies (with the additional risk protection advantage of making
that fund available even if his death is premature). The most con-
venient and practical means of creating such a fund is through the
use of the “level premium,” 20 and the great majority of life policies
soon employed this premium payment form. 21 One effect of the level

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18 Professor Vance attributed extraordinary influence to one early text-
writer. The first edition of Bliss on Life Insurance published in 1872 stated
the “vested interest” theory as an established rule, even though there was
little, if any, support for it in the decisions. G. Bliss, The Law of Life Insur-
ance § 318 (1st ed. 1872). Within a few years it “soared from the pages
of his text book, cast off its quotation marks” and took its place in opinions
as a statement of a settled rule. Vance, The Beneficiary’s Interest In A Life
19 4 G. Couch, Cyclopaedia of Insurance Law § 27:56 (2d ed. R. Anderson 1960). Wisconsin is the exception. Clark v. Durand, 12 Wis. 223 (1860); see
Ellison v. Straw, 116 Wis. 207, 92 N.W. 1094 (1902).
20 This is the term used to describe the familiar arrangement under which
the premium remains the same from year to year.
1951) [hereinafter cited as Vance].
premium is that in the earlier years of the policy the annual premium payment exceeds the annual "cost" of covering the risk. Thus, if policy lapse is to mean simply termination of the obligation of the insurer, the companies in many instances will enjoy a substantial windfall. Indeed, in the early years of the industry when policies contained no provisions for surrender value, cash or otherwise, some companies were able to pay their entire operating expenses out of “profits” made from lapsed policies. To rectify this inequity, the state legislatures once more were called upon, and what are usually referred to as nonforfeiture acts were enacted. The early statutes were comparatively modest, requiring insurers, upon default in premium payment, to grant extended term insurance calculated on the basis of a specified percentage of the “net value” of the policy at time of lapse. The modern nonforfeiture statute, which commonly requires insurers to offer a choice of surrender options including a minimum cash value, was first introduced into the New York insurance law in 1906 and has been widely copied in other states.

Effect of the Early Statutes

These two classes of statutes, exemption and nonforfeiture, were among the earliest expressions of legislative concern with life insurance. Addressed directly to the interests of the parties to the con-

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22 This is not the place for detailed discussion of actuarial calculations that go into determining proper level premiums. Obviously, the premium paid in the earlier years of the life of an insured when the risk is smaller includes an amount in excess of the actual "cost" of covering the risk. The excess builds up a reserve needed for the later years when the level premium is less than the cost of covering the risk. The windfall to the insurer results when a lapse of the policy terminates the insurer's obligation to pay the policy value upon the death of the insured—and the windfall is equal to the amount of the reserve which has been accumulated by the insurer prior to termination. Relatively simple explanations are found in the textbooks. See, e.g., J. MacLean, Life Insurance 13-19 (9th ed. 1962); Vance, supra note 21, at 70-75.

23 J. MacLean, Life Insurance 173 (9th ed. 1962); Vance, supra note 21, at 609-10.

24 See Vance, supra note 21, at 609.

25 The 1905 Armstrong investigation by a committee appointed by the New York Legislature is an important event in the history of life insurance and its regulation in the United States. The labors of the committee and its examining counsel, Charles Evans Hughes, prompted extensive legislation in New York relative to government regulation, insurance company investments and the cost of life insurance.

26 The New York enactments were tremendously influential in other states. See J. MacLean, Life Insurance 590-96 (9th ed. 1962); Vance, supra note 21, at 609-10.
tract, they indicated two distinct but imperfectly defined objectives: Protection of the beneficiary's interest in death benefits and protection of the investment interest of the investor. The judicial addition of the vested interest notion lent a faintly ambivalent quality to the whole picture, since under this theory the beneficiary owns both sets of interests from the moment the contract is made.\textsuperscript{27} Rigorous adherence to the vested interest theory might have made life insurance a far less adaptable form of investment than it now is, but a simple drafting change in insurance contracts neutralized this potential for mischief. Policy forms were recast to include as a standard provision reservation of a right in the insured to change the beneficiary. In a majority of jurisdictions this change in contract terms converted the beneficiary's vested interest into a "mere expectancy" and left the ownership and the asset value of the policy in the insured—"investor."\textsuperscript{28} Even those jurisdictions that continued to recognize a technical vested interest in the beneficiary in the face of this policy reservation conceded the power of the insured to deal with the policy as an owner, but required closer attention to formalities when interests under the policy were to be altered.\textsuperscript{29}

In a sense, the legal principles governing ownership and transfer of interests in life insurance are the product of an effort to accommodate the two broad policy objectives—protection of the beneficiary's interest in death benefits and protection of the investment interest of the investor. The law's solicitude for widows or other natural objects of the insured's bounty is regularly reflected in court decisions as well as in exemption statutes.\textsuperscript{30} Yet at the same time, too many restrictions on the power of an insured to deal with his insurance investment can diminish the value of that investment.\textsuperscript{31} The versa-

\textsuperscript{27} A necessary consequence of the vested interest principle is ownership of the policy in the beneficiary. Finney v. Hinkle, 106 Ohio App. 89, 153 N.E.2d 699 (1958); Vance, supra note 21, at 665.


\textsuperscript{29} This position is sometimes referred to as the "New Jersey Rule" as well as the "vested interest" rule. Under this approach the interests of a beneficiary can be divested only by a formal change of beneficiary. An assignment is a transfer only of such rights as the insured has while he is alive and a right to take death benefits only if the insured survives the beneficiary. Sullivan v. Maroney, 76 N.J. Eq. 104, 73 A. 842 (Ch. 1909), aff'd, 77 N.J. Eq. 565, 78 A. 150 (Ct. Err. & App. 1910). But see Phoenix Mut. Life Ins. Co. v. Connelly, 188 F.2d 462 (3d Cir. 1951) (rule does not apply if policy reserves right of assignment to insured).


tility of the life insurance investment has been increased by a num-
ber of influences, both legal and extra-legal, and the extraordinary
increase in the amount of life insurance in force testifies to the fact
that more and more people are attracted to this method of saving
and investment. Present difficulties and uncertainties result from a
failure to recognize that the interests which the law seeks to protect
are not only different, but also sometimes inconsistent, and some-
times even incompatible. An orderly scheme for regulating transfers
of interests in life insurance may require different methods for differ-
ent interests.

Transfer of the Right to Receive Death Benefits

Right to Change Beneficiary

Reservation to the insured of the right to change the beneficiary
has produced a kind of backlash in many courts. Policies containing
this reservation specify a procedure by which such changes are to be
accomplished and usually stipulate that such changes are not to take
effect until this procedure is fully carried out. Courts in many cases
made strict adherence to these contract terms a condition of the
effectiveness of any attempted change. This approach undoubtedly
was prompted in part by a desire to provide some protection to
beneficiaries whose interests had been so easily reduced from a vested
interest to a mere expectancy. Subsequently, however, the strict
compliance approach produced a counterreaction as courts, uncom-
fortable with a dogma requiring them at times to disregard the plain
intention of the insured, evolved a “substantial compliance” principle
rendering effective any attempted change in which the insured had
done all he reasonably could do to accomplish it.

The strict compliance versus substantial compliance controversy
has been amply documented. While it is possible to talk of two
views (majority and minority, strict and liberal), it is impossible to
make any geographic assignment of the different approaches. Those

32 The growth of the industry brought considerable competition among
insurers. Settlement options, conversion privileges and termination options
have become more favorable as a result of that competition. The modern
life policy, of course, may also include endowment and annuity provisions.
33 The total amount of life insurance in force has more than doubled in
in the last decade. INSTITUTE OF LIFE INSURANCE, LIFE INSURANCE FACT
BOOK 21 (1968).
34 E.g., Lewis v. Reed, 48 Cal. App. 742, 192 P. 335 (1920). See generally
35 VANCE, supra note 21, at 683-91.
36 E.g., Warren v. Prudential Ins. Co., 138 Fla. 443, 189 So. 412 (1939);
37 E.g., VANCE, supra note 21, at 683-91; Annot., 19 A.L.R.2d 5 (1951).
who examined the problem exhaustively found that almost all courts were strict in some cases and liberal in others, depending upon how each court's sympathy was engaged by collateral factors. The necessity for litigation in such instances is the regrettable result of this uncertainty. The insurer does not contest its obligation to pay, and yet a fund readily available to pay expenses frequently accompanying the death of a breadwinner is tied up, sometimes forcing liquidation of other assets under unfavorable conditions. Something thought to be certain and available is rendered uncertain and unavailable at the time it is needed most.

The discomfort of the courts is easily appreciated. The revocable beneficiary has no claim of right while the insured is alive. If the contracting parties agree to a change in the policy, there is no doctrinal ground on which a court can disregard their plainly evidenced intention. On the other hand, the life insurance policy in most cases is popularly and properly viewed as a family asset, paid for with family resources and long regarded by the law as primarily a means of financial protection for dependents. It is not surprising that courts acknowledge and give effect to "a policy to forestall belated, informal treatment of these serious economic affairs, which is generally suspicious in appearance and nearly always confusing and litigious in result." In a society that provides elaborate regulations for transfer of interests in automobiles, television sets, yard goods and accounts receivable, judges understandably are moved to insist on a modicum of orderliness and regularity in the transfer of interests in such an important form of family wealth.

Right to Assign

When policy forms were changed to include a reservation of right in the insured to change the beneficiary, a reservation of right to assign the policy customarily was added. If the first reservation reduces the interest of the beneficiary to an expectancy, the second is probably unnecessary except in those jurisdictions still holding to the idea that the beneficiary has a modified vested interest. Inclusion of the express reference to assignments probably reflected an

38 See, e.g., Vance, supra note 21, at 684; Annot., 19 A.L.R.2d 5, 28-34 (1951).
increasing awareness of the asset value of life policies\textsuperscript{43} and a desire on the part of insurers to maintain a measure of control over transfers for value. Whatever their reasons, insurers were issuing policies stipulating two methods for altering or shifting interests. The methods were different, and courts treated them differently.\textsuperscript{44} Assignment and limitations on power to assign are matters strictly between the parties to the agreement. If an assignment by an insured does not conform to policy procedures, only the insurer is in a position to protest.\textsuperscript{45} If a beneficiary objects that an assignment diminishes or extinguishes his interest and that procedures for changing the beneficiary have not been followed, the answer is that assignment and change of beneficiary are different acts affecting a transfer of interest.\textsuperscript{46}

Once the idea is accepted that an assignment of a life policy is a contract matter involving only the contracting parties, it follows that such a transfer is to be governed by the rules and principles governing any other transfer of a chose in action. Motives of the assignor are usually immaterial. Gratuitous assignments, properly executed, are as effective as assignments for value. “Properly executed” in this situation means executed in conformance with the requirements of the \textit{Restatement of Contracts}\textsuperscript{47} as opposed to the requirements stated in the policy for accomplishing a change of beneficiary.\textsuperscript{48} The curious result is that many of the same courts that have wrestled mightily with strict compliance versus substantial compliance in change of beneficiary situations have had little difficulty enforcing parol inter vivos gifts of life policies executed in the most informal and ambiguous manner.\textsuperscript{49} Since assignment passes title in the chose

\textsuperscript{43} As early as 1911, Mr. Justice Holmes cautioned against rigid rules that might diminish the value of “one of the best recognized forms of investment and self-compelled saving.” \textit{Grigsby v. Russell}, 222 U.S. 149, 156 (1911).

\textsuperscript{44} \textit{VANCE, supra} note 21, at 681 & n.22.


\textsuperscript{47} \textit{RESTATEMENT OF CONTRACTS} §§ 157, 158 (1932). These sections state generally that rights can be assigned in writing or orally and that a gratuitous assignment of rights in a life insurance policy is effective and irrevocable if accompanied by a delivery of the policy.


in action to the assignee, the donee of an inter vivos gift steps into a position at least as strong as that of the irrevocable beneficiary, though the face of the contract is innocent of any indication of his "vested interest."

In one sense this development was a natural, if not inevitable result. Recognition of a life policy as an asset, a form of investment, carried with it ideas of ownership. Incidents of ownership of choses in action such as life policies take many forms and may be conferred or relinquished by agreement, rescission, renunciation, assignment or the versatile and elastic concept of equitable assignment. But one who invests in such an asset should be entitled to enjoy the benefits accruing from it and to deal with it in the manner in which he chooses. The law has no broad franchise either to take or to diminish the value of one's investment merely on the basis of its form, in order to enforce a vaguely defined public policy in favor of dependents.69 It should be noted as well that incidents of ownership in life policies frequently are inconsistent and contradictory. This is due in part to the nature of the interests and in part to the fact that few transfers of interest in property are conducted at a higher level of ignorance and inattentiveness. The ordinary citizen has only a dim notion of the nature of a life insurance contract and the implications of his acts affecting it. Professionals who should know more about these considerations than does the layman too often pay little attention to his actions.

Consider the following: Husband applies for a life insurance policy in which his wife is to be the named beneficiary. The application offers him the option of reserving the right to change the beneficiary, which option he elects more or less intelligently. He may, fleetingly, acknowledge the possibility that his wife will leave him, in which case he may wish to make his aging mother or spinster daughter his beneficiary. He probably knows that, if in need of money he can make a policy loan or, as a last resort, "cash in" the policy and take its cash surrender value. He might know that the policy can be acceptable collateral for a bank loan, and that it might be saleable to a third party, conceivably for a larger amount than the cash surrender value. Having made this commendable investment, he takes the policy home, presses it into his wife's hands, and says, "Here, my sweet, this is for you. If anything happens to me, it will take care of you and the children." His wife responds, "Thank you, dear. You're so thoughtful. Now you take it back for safekeeping." The skeptical mind cannot but wonder what the husband's reaction would be if his wife responded, "Thank you, dear, for your parol inter vivos gift that vests

title to this chose in action in me and, therefore, extinguishes your
independent power to change the beneficiary,\textsuperscript{51} encumber the policy
with a policy loan,\textsuperscript{52} assign it for value\textsuperscript{53} or take the cash surrender
value."\textsuperscript{54} When the result of this transaction is the protection of
the wife against her husband's late-life foolishness,\textsuperscript{55} it would appear
that justice has been done. When parol gift analysis is used to favor
adult children over a second wife-widow,\textsuperscript{56} it raises some doubts.
When it is used as a complete bar to the claim of a subsequent assignee
for value, it produces genuine misgivings.\textsuperscript{57}

Present intention to make a gift must, of course, accompany the
transfer of the policy, but "intention" in such a setting is tricky.
Ordinary citizens do not think or "intend" in sophisticated legal con-
cepts.\textsuperscript{58} The hypothetical husband understood and believed he had
inaugurated a sound investment for the benefit of his wife. He
probably had no present intention to take lifetime benefits for him-
self. But if he had been fully aware of what he was doing, and
consciously intended to surrender control of the policy and its life-
time benefits, it would have been simpler, cleaner and surer for him
to have designated his wife as an irrevocable beneficiary in the policy
itself. A parol gift of life insurance to the named beneficiary is sus-
picious simply because it is such a clumsy way for an insured to carry
out his presumed intention.\textsuperscript{59}

A parol gift of the policy to someone other than the named
beneficiary is equally a source of unfortunate consequences. There
is less reason to doubt that the insured intends to transfer the right to


\textsuperscript{53} Munn v. Robison, 203 F.2d 778 (8th Cir. 1953).


\textsuperscript{57} E.g., Munn v. Robison, 203 F.2d 778 (8th Cir. 1953).

\textsuperscript{58} See L. FULLER & R. BRAucher, BASIC CONTRACT LAW 67 (1964).

\textsuperscript{59} Borchert v. Metropolitan Life Ins. Co., 84 N.Y.S.2d 529 (Sup. Ct. 1948),
is an example of the confusion often surrounding informal assignments. The
wife alleged that her husband obtained possession of a previously assigned
policy by fraudulently representing that he wished to make a policy loan.
What the wife plainly did not understand was that if the policy had been as-
signed to her, only she was entitled to use the policy for such a purpose; sim-
ple surrender of possession is meaningless. The court concluded she was the
owner, apparently giving no weight to her inconsistent actions.
the death benefits in these cases, but this change of beneficiary not only fails to conform to specified policy procedures but may be totally undocumented. Of course, more than a change of beneficiary is involved. Since the parol gift transfers title and gives the donee a vested interest, the donee will prevail not only against a beneficiary named before the gift, but also against one named thereafter in even the most meticulously executed change of beneficiary. The insured's intention to surrender lifetime benefits and control is no more clear in these cases than in gifts to the named beneficiary, and the root problem of proving a particular intention is always present. Intention on the part of the insured-donor to make a present gift must be proved and the burden is on the one claiming as a donee. The job of divining this elusive intention is made no easier by the fact that the critical actions were usually taken long before by one who is now dead, and intent is frequently found by a rather selective marshalling of facts and circumstances. The fact that the donee paid all or some of the premiums may prove that he regarded the policy as his property, or it may prove only that he regarded his interest as beneficiary worth preserving. The fact that the donee has possession of the policy may indicate delivery, but it is not markedly probative when the donor (husband) and donee (wife) lived together and the policy was found in their residence. If it appears that the policy was in fact in possession of the donor, such possession can be explained by testimony that it was returned to him for safekeeping.

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60 See, e.g., Clark v. Edwards, 261 Ala. 544, 74 So. 2d 912 (1954).
64 The respective Dead Man's Statutes rendering inadmissible testimony of transactions with one presently deceased have been of little effect in these cases. The usual reason seems to be that in contests between two parties claiming death benefits, the estate of the deceased is not really involved, and in no event will the estate of the deceased be diminished. Grasso v. John Hancock Mut. Life Ins. Co., 206 Pa. Super. 582, 214 A.2d 261 (1965); cf. In re Estate of Sear, 182 Cal. App. 2d 525, 531-32, 6 Cal. Rptr. 146, 152 (1960). See generally Annot., 122 A.L.R. 1297 (1939).
66 See Munn v. Robison, 208 F.2d 778 (8th Cir. 1953).
or that he regained possession by stealth or trickery. In fact, other circumstances may make proof of actual delivery unnecessary, and the court's decision may be influenced by the fact that death benefits frequently will be sheltered from the claims of the deceased's creditors, or simply by sympathy for a dependent.

Conflicting Ownership Interests

As familiarity with the investment potential of life insurance has grown, so has its use in situations in which questions of conflicting interests may arise. Business organizations, wives, ex-wives, children, parents and other relatives all may depend in one way or another on the life of a single individual and wish to protect their interests by investment in insurance on his life. Incidents of ownership may be as varied as these interests.

Morrison v. Mutual Life Insurance Company is a leading illustration of the importance of the notion of ownership in connection with life insurance. The husband applied for and was issued a policy in which his wife was the named beneficiary and which by its terms reserved to him the right to change the beneficiary and to take the cash surrender value. When the husband died, his wife demanded the death benefits and was told that the husband had already surrendered the policy. In this action against the insurer, the evidence showed that the wife had wanted the policy and that the husband had applied for it only after the wife agreed to pay the premiums. In addition to paying all premiums, the wife had held the policy until her husband obtained possession of it by stealth. Admitting that, by the face of the policy, the wife's interest was only an expectancy, the court held that on the evidence presented the wife was the "owner" of the policy as against the husband. If she had known what was occur-

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70 E.g., Ratsch v. Rengel, 180 Md. 196, 201-02, 23 A.2d 680, 682 (1942).
72 In Katzman v. Aetna Life Ins. Co., 309 N.Y. 197, 202-05, 128 N.E.2d 307, 309-11 (1955), the New York Court of Appeals upheld the interests of the donee under a parol inter vivos gift in the face of a statute, N.Y. Prop. Law § 31 (McKinney 1962), providing "a contract to assign or an assignment . . . of a life insurance policy, or a promise . . . to name a beneficiary of any such policy is void unless in writing, signed by the party to be charged." (Emphasis added).
73 15 Cal. 2d 579, 103 P.2d 963 (1940).
74 Id. at 583, 103 P.2d at 966.
75 Id. at 586-87, 103 P.2d at 967.
ring, she could have prevented him from surrendering the policy, and if the insurer had notice of her ownership, it was bound to recognize it. The lower court thus erred in excluding evidence that such notice had been given. The court saw no occasion for refined analysis. The policy was owned by the wife on any one of three grounds: By virtue of the agreement with her husband; because she was assignee of a chose in action assigned to her by her husband; or simply because it was property she had purchased and paid for.

From the transfer of an interest by assignment or parol inter vivos gift, it is only a short step to equitable assignment and the transfer, alteration, or extinguishment of an ownership interest by agreement outside the insurance contract. The increasing brittleness of the marriage relationship has made a singular contribution to this body of insurance jurisprudence.

Property Settlement Agreements

Transfer of Interest

It seems settled almost without dissent that a separation or other property settlement agreement in which one of the parties agrees to maintain a life insurance policy for the benefit of the other vests in the latter an "equitable interest" or "equitable right" that cannot be divested without his consent. Subsequent attempts to change the beneficiary are ineffective; taking the cash surrender value may be a conversion; allowing the policy to lapse is a breach of agreement for which damages in the face amount of the policy are allowed to the party aggrieved; and encumbering the policy has been indi-

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76 Id. at 589, 103 P.2d at 968.
77 Id. at 587, 103 P.2d at 967; accord, e.g., National Metropolitan Bank v. United States, 87 F. Supp. 773 (Ct. Cl. 1950); Ratsch v. Rengel, 180 Md. 196, 186, 23 A.2d 680 (1942).
81 E.g., Waxman v. Citizens Nat'l Trust & Sav. Bank, 123 Cal. App. 2d
cated to be a breach of agreement chargeable to the defaulting party or his estate.82

Difficulties, where they appear, proceed from the fact that while the separation agreement may be very formal and even incorporated into a divorce decree, the insurance contract remains unchanged. The policy continues to show an insured in whom the right to change the beneficiary is reserved, which in turn signifies that the insured still "owns" the policy. Since assignment in the strict sense is not involved, courts are less particular about delivery and possession.83 Indeed, the language of "waiver"84 and "estoppel"85 is sometimes used to describe or explain the consequences imposed. Only the intervention of third parties who claim to have given value for their interests prompts close attention to the character and extent of the equitable interests created.86

In the case of property settlement agreements, as with parol gifts, the intentions of the parties are often poorly formulated. Separation agreements commonly deal with two subjects: Support obligations of the husband and division of property. If the parties understand and intend that a life policy is an item of property to be allocated to one of them, they will deal with it in a manner appropriate to such a transfer of interest. If they understand and intend that life insurance is to be used to fortify support obligations, the arrangements will be quite different. If intention is unclear and the principals uninformed as to the nature of the interest with which they are dealing, the consequences may be completely unanticipated.

In Waxman v. Citizens National Trust and Savings Bank,87 for example, there is reason to believe the husband-insured understood that his obligations with respect to life insurance were coextensive with his support obligations. If he had realized that his promise to

83 Mutual Life Ins. Co. v. Franck, 9 Cal. App. 2d 528, 50 P.2d 480 (1935); Hasselberger v. Hasselberger, 102 N.Y.S.2d 520 (Sup. Ct. 1951). Contra, Cadore v. Cadore, 67 So. 2d 635, 638 (Fla. 1953), in which the court took particular notice of the fact that the beneficiaries of the contract promise permitted the insured to retain possession of the policy in such form as to lead third parties and the insurer to believe he retained all his rights in it.
keep life insurance in effect for the benefit of his daughter was a transfer of an interest to her, obligating him to pay premiums and keep the policy in force even after she was grown and married, he might have insisted on a more limited undertaking. On the other hand, in Cooper v. Cooper, a promise in a separation agreement to maintain insurance for the benefit of children was regarded as so intimately connected to the support obligation that since this promise was not "self-executing," and since the divorce decree stated that the support agreement had been fully consummated, the court concluded that the insurance promise had been abandoned.

Much misunderstanding and uncertainty would be avoided in transactions of this kind if the parties focused their attention on the insurance contract directly as well as on the separation agreement generally. If the parties intend that the husband is to undertake an unqualified obligation for the benefit of the (ex) wife or child, that intention can be manifested in the policy by making the beneficiary irrevocable. If they intend that this benefit is to extend only so long as the wife does not remarry or as long as a child is a minor, the policy can be made to reflect that intention. To effect such a result, the wife, for example, can be designated a conditional primary beneficiary with the estate of the insured as a secondary beneficiary. The very act of amending the policy will require the parties to address themselves to the issue of the precise disposition to be made of their common interest in the life insurance rather than permitting inaction to necessitate reliance on offhand references which some court must later interpret under the most difficult conditions. When the policy is amended, the insurer will be on notice of all interests if the insured later, through dishonest motive or simple misunderstanding, attempts to make a policy loan or surrender the policy. Similarly, third parties considering purchasing the policy or accepting it as collateral are in a position to see what they are getting if they merely take the simple precaution of looking at the face of the proffered item.

89 It might be noted that at least one commentator has suggested that an assignment of life insurance paid for by community property funds, pursuant to a separation agreement, may be a purchase for value by the assignee, rendering death benefits taxable as income in some circumstances under section 101(a)(2) of the Internal Revenue Code. R. Rice, FAMILY TAX PLANNING 454 (1968). Apparently some members of Congress agree. It is reported that since 1962, bills have been introduced each year designed to enlarge the class of persons to whom transfers for value of life policies can be made without resulting income tax liability. Osborn, Gifts of Life Insurance as an Element in Estate Planning, N.Y.U. 26TH INST. ON FED. TAX. 1335, 1349 n.52 (1968). This hazard is, of course, present whether the transfer is done well or clumsily, except to the extent that a carefully formalized transfer may be more noticeable.
Renunciation of Interest

Separation agreements in which one party (usually the wife) renounces existing interests have received much closer scrutiny than those creating vested interests in life policies. Understandably, most cases originate in community property states. If a life policy is community property and if the wife is the named beneficiary, reservation to the husband-insured of the right to change the beneficiary notwithstanding, a change of beneficiary without her consent and without valuable consideration is voidable, and the wife can maintain an action for her share of the death benefits at the husband's death. A wife may release her community interest and still be entitled to the death benefits if she continues as the named beneficiary; correspondingly, she can, by separate agreement, renounce her claim to the death benefits even though she continues to be named as beneficiary in the policy. The principal problem is: What did the parties intend when a property settlement agreement, which in one way or another indicates that the wife has renounced her interest in a life policy, contradicts the life policy which still names her as the beneficiary? A series of California decisions provides an interesting study in the public policy considerations felt by courts in this situation.

In 1931, in Jenkins v. Jenkins, the District Court of Appeals for the First District was confronted with a property settlement agreement in which the wife released and relinquished “all right, title and interest and claim of any kind or nature . . . in or to any property which shall be a part of the estate of [the husband] . . . or property of any kind acquired by [the husband] in which [the wife] but for this agreement might now or hereafter have any interest.” The agreement also provided, however, that it was based on representations that an attached list included all the property the husband possessed. Not listed was a life policy in which the wife continued to be named as beneficiary. The court held that by its terms the agreement did not apply to the insurance policy, and accompanied its decision with a strong statement of the policy favoring enforcement of life insurance policies according to their terms. If the terms of insurance contracts were susceptible to attack, the court indicated,

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91 Grimm v. Grimm, 26 Cal. 2d 173, 175, 157 P.2d 841, 842 (1945).
94 Id. at 406, 297 P. at 58.
delays and uncertainty would surely result. “The designation of beneficiary would mean nothing and the beneficent objects of life insurance would be thwarted.”

In 1940, in *Sullivan v. Union Oil Company*, the Supreme Court of California was faced with a similar problem with some interesting variations. The property involved was the husband’s contribution to a company-managed employee retirement fund. Rules of the plan directed that if, as happened here, the employee died before becoming eligible for retirement, his contribution was to be returned to the one named by the employee as beneficiary. The property settlement agreement provided that the wife relinquished all rights in her husband’s estate and in community property. It also specified that it was designed to settle the rights of the parties “in all respects” and to be a full and final settlement of all property rights. Nevertheless, the husband never changed the life policy designation of his wife as beneficiary. The supreme court held that *Jenkins* was distinguishable on the ground that the fund in this case was clearly within the contemplation of the parties at the time the agreement was made. The opinion proceeded to scold the district court of appeals for deciding *Jenkins* “for the express purpose of declaring what should be a good business policy” and thus departing from “the conceived functions of an appellate court.” Less emphasis was placed on the above mentioned distinction than on the fact that the separation agreement plainly expressed the parties’ intention to settle all their respective rights. An insurance policy, said the court, is a contract and as such, an item of property. When the parties state they are settling all their property rights, the court should take them at their word. Insurance policies and rights thereunder, it added, are not sacred or untouchable.

In 1945, in *Grimm v. Grimm*, the California Supreme Court repented its slighting remarks about insurance policies and the interests therein. Consequently, *Sullivan* plus-or-minus *Grimm* set in motion one of those lines of authority a lawyer can never explain to his clients. The property settlement agreement in *Grimm* identified certain items of property that were to be the separate property of the husband and as to these provided that the wife “hereby conveys,
relinquishes and releases . . . all right, title, interest and claim.\textsuperscript{103} The life policy was one of the items identified, and a particular reference to it stated that the wife "hereby transfers, releases and relinquishes [to the husband] all interest in and to said policy of insurance and the premiums paid thereunder and the avails thereof."\textsuperscript{104} The husband was to have the right to change the beneficiary and the wife agreed to execute any necessary or "convenient" documents.\textsuperscript{105} The husband lived more than two years after the execution of the agreement but never changed the beneficiary.

In its decision the court focused on the fact that a beneficiary's interest is an expectancy. Just as a wife may relinquish her rights of inheritance and still take under her husband's will, she may release her community share in a life insurance policy and still receive death benefits if her husband chooses to retain her as the named beneficiary.\textsuperscript{106} Starting with the broad proposition that the purpose of a property settlement is the segregation of "property" and that general expressions are not to be construed as assignments or renunciations of expectancies,\textsuperscript{107} the court found only an intention to release the wife's community share in the policy.\textsuperscript{108} A vigorous dissent noted the language of conveyance and transfer used in the agreement and insisted that a transfer of an interest in the "avails" of the policy is more than a relinquishment.\textsuperscript{109}

In 1953, \textit{Thorp v. Randazzo}\textsuperscript{110} presented a situation distinguishable from \textit{Grimm} only in that the wife waived all claim to benefits she might have at the time "or which may hereafter be derived from"\textsuperscript{111} the specified policies, and executed a blank change of beneficiary form, which the husband never used. This, said the court, constituted a \textit{present} divestment of claims she might otherwise have had.\textsuperscript{112} The emphasis on "present divestment" is interesting since the court obviously was influenced by events occurring between the time of the agreement and the time of the husband's death. All in all there was ample justification for the position asserted by a court.

\textsuperscript{103} \textit{Id.} at 178, 157 P.2d at 844.
\textsuperscript{104} \textit{Id.}
\textsuperscript{105} \textit{Id.}
\textsuperscript{106} It is interesting to note than in \textit{Sullivan} the analogue employed by the court was relinquishment of rights in an automobile, 16 Cal. 2d at 238, 105 P.2d 927, while in \textit{Grimm} the comparison was with surrender of a right to take under a will, 26 Cal. 2d at 179, 157 P.2d at 844.
\textsuperscript{107} In at least one case this generalization alone was sufficient reason for the decision. \textit{Mayberry v. Kathan}, 232 F.2d 54 (D.C. Cir. 1956).
\textsuperscript{109} \textit{Id.} at 180-81, 157 P.2d at 845.
\textsuperscript{110} 41 Cal. 2d 770, 264 P.2d 38 (1953).
\textsuperscript{111} \textit{Id.} at 774, 264 P.2d at 40.
\textsuperscript{112} \textit{Id.} at 776, 264 P.2d at 41-42.
ruling subsequent to *Thorp* that the controlling question in these cases is “What did the parties intend?” and that this is a question of fact.113

The “question of fact” approach makes available the whole range of extrinsic facts and the same opportunities for selective deployment of circumstances and inferences as in the parol gift cases.114 In *Thorp* the court clearly was influenced by evidence that the husband mistakenly believed the policy had terminated, that this mistaken belief explained his failure to change the beneficiary rather than a desire to give the benefits to his former wife.115 If facts indicate that husband-insured was familiar with procedures for changing the beneficiary, his failure to follow these procedures in the particular instance may show he did not intend that the beneficiary be changed.116 The amount of time elapsing between the separation agreement and the death of the insured may117 or may not118 indicate an intention to retain a former wife as the beneficiary. Specific references to policies may be more convincing than general references to life insurance.119 Continued friendly relations between the parties,120 the presence or absence of secondary beneficiaries121 and the relationship to the insured of the contending parties122 all may influence determination of this question of fact.

114 See text accompanying notes 33-56 supra.
115 41 Cal. 2d at 776, 264 P.2d at 42. The case is also an illustration of lay ignorance of the terms of life policies. The insured plainly assumed he had lost everything when he defaulted on premium payments. In fact, the automatic extended term option had been exercised, and he had several years of coverage at the face amount of the policy.
118 Baekgaard v. Carreiro, 237 F.2d 459 (9th Cir. 1956) (more than 2 years).
119 Compare Connecticut Gen. Life Ins. Co. v. Hartshorn, 238 F.2d 417 (9th Cir. 1956), with O'Brien v. Elder, 250 F.2d 275 (5th Cir. 1957), and Mayberry v. Kathan, 232 F.2d 54 (D.C. Cir. 1956). In the *O'Brien* case the dissenting judge objected to reliance on California cases on the theory that in community property states a wife clearly has a “claim” to surrender, a proposition not true in noncommunity property jurisdictions. 250 F.2d at 280.
121 Baekgaard v. Carreiro, 237 F.2d 459, 463 (9th Cir. 1956).
There is no talismanic phrase for property settlement agreements that will make intention plain and put all questions to rest. If, however, the parties are advised concerning the consequences of their activities, the policy can be made to speak clearly. Amendment of the policy to reflect the informed intention of the parties should be a part of the property settlement transaction. The problem is not getting any smaller. Group life insurance is growing at a faster rate than ordinary life insurance and may provide even more delicate problems of sorting out interests. Group policies frequently have standard beneficiary clauses stipulating that in the absence of a designated beneficiary, or in the event the designated beneficiary predeceases the insured, death benefits will be paid to the spouse, children, parents or brothers and sisters in that order. The failure of an insured to change the designated beneficiary of a group policy is a much less reliable index of intention. If the insured believes his former wife has renounced her right to death benefits, he may also believe that the standard beneficiary clause in the group policy results in the disposition he favors—death benefits to his children or to a later wife if he remarries.

**Business Interests**

Business organizations have a number of interests in individual lives for which life insurance can provide appropriate protection. Policies on the lives of key men and policies used to fund business purchase agreements are the most common forms of this type of coverage. In these situations courts have consistently looked both to the insurance policy and to the underlying agreement in the process of determining where ownership or beneficial interest lies. As often as not the terms of the policy obscure rather than illuminate the parties’ intentions.

*Wellhouse v. United Paper Company* concerned a policy issued on the life of a corporation executive (“key-man” insurance). Application had been made by the executive pursuant to an agreement with the corporation. The corporation paid the premiums and retained possession of the policy, but the right to change the beneficiary was reserved in the policy to the insured executive. When the insured

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125 See Vance, supra note 21, at 197-98.

126 E.g., Wellhouse v. United Paper Co., 29 F.2d 886 (5th Cir. 1929); Morgan v. E.J. Evans Co., 266 F.2d 423 (5th Cir. 1959).

127 29 F.2d 886 (5th Cir. 1929).
terminated his connection with the company, he attempted to change the beneficial interest to his wife. The court held he had no power to change the beneficiary. The corporation owned the policy and all its incidents and benefits. Any right held by the insured was by the terms of the policy held "in trust" for the corporation.

In *Morgan v. E.J. Evans Company* the situation was substantially the same as that in *Wellhouse* except that the policy was a combination endowment and life policy. If it matured as an endowment policy, benefits were to be paid to the insured. If he died before the endowment matured, death benefits were to be paid to the corporation. This, the court held, distinguished it from *Wellhouse*. Since the company was only a conditional beneficiary, ownership was not in it alone. The precise question, however, was whether the company could take the cash surrender value after the insured had left the organization and had given a release for value of "all debts, demands, claims of whatsoever kind and nature..."

The fact that in *Morgan* the executive was favored with an endowment feature in his policy makes it no less an investment in him by the company than was the policy in *Wellhouse*. If an effort to surrender the policy was made while the insured was still with the company, one might argue that this was a breach of contract or a violation of rights acquired under an "equitable assignment." Once he left, there seems little reason to deny the company the right to realize the asset value of its investment. The decision represents a dubious analysis of interests in the policy. Incidents of ownership were markedly in the corporation, and if ownership of life insurance as an asset means anything, it should mean power in the investor to withdraw his investment when it ceases to serve the purpose for which it was made. An unfortunate aspect of *Morgan* is that the problem need never have arisen. If this eventuality had been called to the attention of the parties at the time the arrangement was made, the policy (or the underlying agreement) could have specifically reserved to the company the right to take the cash surrender value in such circumstances as those which ultimately transpired. Sometimes even businessmen are not aware of the variety of interests reposing in life policies.

The subject of business purchase agreements funded by life insur-

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128 Id. at 887.
129 Id.
130 266 F.2d 423 (5th Cir. 1959).
131 Id. at 426.
132 Id. at 425. The court concluded that the interest in the policy was not a debt, demand or claim against the company and therefore was unaffected by the release. Id. at 27.
ance is beyond the scope of detailed treatment by this article. It should, however, be noted that this is an area in which careful coordination of the base agreement with the policy terms is of critical importance. Agreements of this kind are found most frequently in partnerships and closely held corporations, and they serve two distinct but complementary functions. An agreement among partners, for example, that if one dies the other can and shall purchase his interest from his estate helps to assure continuity of the organization with a minimum of disruption, and at the same time provides that his dependents will receive the value of his interest with a minimum of delay and inconvenience. Backing such an agreement with insurance on the partners' lives to provide the funds for this transaction advances both objectives.

Where insurance is procured pursuant to such an agreement, parties to the agreement probably have a "vested" interest in the policy which the insured cannot affect by independent action. However, reliance should not be placed entirely on this broad proposition. Common sense advises against tempting an insured with loan privileges and cash surrender value when attention to policy terms and control can preclude such complications. If the arrangement is one in which the organization pays the premiums and manages the insurance, there is every advantage in having the policies indicate this ownership as plainly as possible in the original terms or by endorsement.

Whether the parties use cross-purchase agreements (wherein each partner or stockholder has a policy on the life of every other partner or stockholder) or entity agreements (wherein the organization has a policy on the life of every partner or stockholder), whether each pays premiums on his own policy or premiums are paid by the organization, and whether other parties, the organization or dependents are named as beneficiaries, will depend upon and vary with the ages, financial status or particular condition of those interested.

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134 See First Nat'l Bank v. United States, 358 F.2d 625, 630 (5th Cir. 1966); cf. Brand v. Erisman, 172 F.2d 28 (D.C. Cir. 1948).


136 Many application forms now contain a blank where the "owner" of the policy may be named when the owner is someone other than the insured.


Among the major problems to be kept in mind are potential tax problems. We venture into that forbidding thicket only far enough to emphasize a single principle: It is the height of folly to invite unexpected and costly tax consequences by leaving meaningless incidents of ownership in life policies unexplained.139

Estate Tax Consequences of Ownership Concepts

If, as the court stated in First National Bank v. United States,140 a life insurance business purchase agreement vests in the parties to the agreement an interest that the insured cannot defeat by changing the beneficiary, even though the policy reserves that right to him, there is little reason for the policy to include such a reservation. If there is a chance, however slight, that reserving such an incident of ownership may result in both the proceeds of the policy and the value of his interest in the business being included in his estate for estate tax purposes, its reservation is rather clear evidence of poor business and tax planning.141 If the reservation is included inadvertently (because no one reads or pays attention to the standard terms in an insurance policy), it is a disgrace.

The focus of section 2042 of the Internal Revenue Code142 is on "ownership," but the term is used in a distinctive, almost equivocal sense. Certain "incidents" are the equivalent of ownership for these purposes, with only a passing regard shown for contrary incidents of equal or greater substance.143 Where a corporation executive

139 Int. Rev. Code of 1954 § 2042 provides that the proceeds (death benefits) of life insurance shall be included in a decedent's gross estate for estate tax purposes: "(1) RECEIVABLE BY THE EXECUTOR—To the extent of the amount receivable by the Executor as insurance under policies on the life of the decedent.

"(2) RECEIVABLE BY OTHER BENEFICIARIES—To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person." Under section 2042, the "incidents of ownership" are said to refer to any right in the insured or his estate to the "economic benefits" of the policy and include the power to change the beneficiary, to surrender or cancel the policy, to assign the policy or revoke an assignment, to pledge the policy for a loan or make a policy loan. Treas. Reg. § 20.2042-1(c)(2) (1958).

140 358 F.2d 625 (5th Cir. 1966); see text accompanying notes 134-37 supra.


143 Id. § 2042(2).
named the corporation as beneficiary of a life insurance policy but reserved the right to change the beneficiary, that "incident" made the death benefits includible in his estate even though the corporation paid the premiums, maintained possession of the policy, used it as collateral for a loan and collected and kept the death benefits.\textsuperscript{144} The court concluded that the insured acted deliberately, \textit{intending} to reserve this privilege for himself.\textsuperscript{145} That being true, it was immaterial that the corporation might have prevented him from changing the beneficiary on the policy it owned or that such a change, if made, would be ineffective against the corporation.

With some limited exceptions, courts have approached split-level ownership of life policies bluntly. In \textit{Rhode Island Hospital Trust Company v. United States}\textsuperscript{146} the court noted that section 2042 addresses itself to "powers," not to rights in a broad sense. If, for example, by the terms of the policy the insured has power to change the beneficiary or to surrender the policy, it is no answer that someone other than the insured could prevent him from exercising this non-Hohfeldian\textsuperscript{147} power by a proceeding in law or equity.\textsuperscript{148} In a contest between "policy facts" and "intent facts" the former will prevail\textsuperscript{149} absent some evidence that the existence of certain policy facts is attributable to the actions of someone other than the insured.\textsuperscript{150}

Ownership of life insurance and its effect on includability for estate tax purposes is another instance in which local property laws collide with federal tax laws.\textsuperscript{151} The problem warrants consideration when insurance is used for business purposes, when one with an insurable interest procures his own policy on the life of another, and when an insured attempts to make a gift of a policy on his own life. In situations involving a business use or a gift, the stern attitude of the Commissioner of Internal Revenue and the courts

\textsuperscript{145} Id. at 421; accord, Estate of Piggott v. Commissioner, 340 F.2d 829, 835-36 (6th Cir. 1965).
\textsuperscript{146} 355 F.2d 7 (1st Cir. 1966).
\textsuperscript{147} For a discussion of Hohfeld's definitions of "right" and "power," see Hohfeld, \textit{Some Fundamental Legal Conceptions as Applied in Judicial Reasoning}, 23 \textit{Yale L.J.} 16, 30-32, 44-54 (1913).
\textsuperscript{148} 355 F.2d at 11.
\textsuperscript{150} Lamade v. Brownell, 245 F. Supp. 691, 695 (M.D. Pa. 1965) (reservation of right to change beneficiary included inadvertently when policies were converted); National Metropolitan Bank v. United States, 87 F. Supp. 773, 775 (Ct. Cl. 1950) (insurance salesman inserted unauthorized answers in application).
\textsuperscript{151} For other examples see Commissioner v. Estate of Bosch, 387 U.S. 456 (1967); Plumb, \textit{Federal Liens and Priorities—Agenda for the Next Decade II}, 77 \textit{Yale L.J.} 605, 612-17 (1968).
is understandable. In both *Estate of Piggott v. Commissioner*152 and *Hall v. Wheeler*153 there was evidence that the insured wanted to make the policy available as an asset to his business but at the same time retain the power to add the policy to his personal insurance if the business need for such resources diminished. The Internal Revenue Code is designed to discourage such attempts to evade the consequences of one's acts. In the same way the incidents of ownership test of section 2042 is aimed at the donor who would like to have his beneficiary take life insurance death benefits free of estate tax liability, but would also like to be able to use the asset value of the policy during his life (with or without the concurrence of the beneficiary) in an emergency. These efforts at artfulness are usually misguided and futile. The business man in a Piggott situation cannot appropriate the policy for any purpose adverse to the interests of the corporation. Local law relative to questions of ownership will prevent it.154 All he has done is introduce “policy facts” producing adverse estate tax consequences. The ability of the Commissioner and the courts to spot imperfections in gifts is by now legendary.155

The suspicion persists that inadvertence frequently contributes to the unhappy tax result, particularly in those cases in which the insured actually has no interest in the policy. Anyone with an insurable interest in the life of another may procure a policy on the life of that person,156 but as a practical matter, cooperation of the insured is necessary. In most cases he will at least be required to submit to a physical examination and sign the application. If, however, the understanding of all parties is that the policy is to belong to the beneficiary, and if the beneficiary pays for it and keeps it, the beneficiary owns all interests in it.157 Reservation of the right to change the beneficiary by the nonowner insured gives him neither the right nor the power to act against the interests of the beneficiary-owner.158 But such a reservation is a “policy fact” that will make the death benefits a part of the insured's estate.159

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152 340 F.2d 829 (6th Cir. 1965).
156 E.g., CAL. INS. CODE § 10110; see Boyer v. United States Fidelity & Guar. Co., 206 Cal. 273, 279, 274 P. 57, 60 (1929).
157 Vance, supra note 21, at 765-66.
159 Rhode Island Hosp. Trust Co. v. United States, 355 F.2d 7 (1st Cir. 1966).
Not all local law, however, is disregarded for federal tax purposes. Treasury Regulations defining incidents of ownership under section 2042 include an admonition that as an additional step in the search for such incidents, "regard must be given to the effect of the State or other applicable law upon the terms of the policy."160 As the Piggott and Rhode Island Hospital Trust Company cases illustrate, this regulation does not compel the Commissioner to take account of rights and interests that may accrue by means of equitable assignment or contract obligations. It does require that attention be given to the disposition of interests made by state community property principles, and in that respect it may constitute still one more tax hurdle. Freedman v. United States161 involved a policy in which it was stipulated that all values, rights and privileges would belong to the person designated as "owner" in an appropriate line in the policy. The policy was on the life of Mrs. Freedman, and Mr. Freedman was named as owner at the appropriate place. Conceding that the insured retained no power to exercise incidents of ownership, the court nevertheless held that designation of the husband as owner on the policy was not sufficient to amount to an inter vivos gift of the half-interest in the policy which belonged to the wife by operation of Texas community property laws. One half of the death benefits were includible in Mrs. Freedman's estate for estate tax purposes.162 In some respects, therefore, the regulation directing that effect be given to state law in identifying incidents of ownership is a one way street.163

Transfer For Value

Assignments to Creditors

Like any other chose in action a life insurance policy is assignable for value. It can be sold outright164 or transferred as collateral for some other obligation.165 Unlike an account receivable, a life policy has both a present value (cash surrender) and a contingent future value (death benefits), so the precise understanding and intention of the parties to the assignment transaction is more difficult to determine. This uncertainty is compounded by the manifest reluctance of courts to award death benefits to anyone but dependents of the insured.

161 382 F.2d 742 (5th Cir. 1967).
162 Id. at 747.
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If a transfer of a life policy for value constitutes an assignment, it is a transfer of title and a transfer of the asset value of the policy. A purchaser-assignee certainly can deal with the policy as his own, e.g., hold it, surrender it or reassign it. The same should be true of an assignee who takes the policy as collateral, but one hesitates to suggest that such an assignee has complete freedom of action. If the assignor defaults on the principal obligation, the assignee should be in a position to recoup by taking the cash surrender value of the policy, and there is authority to that effect. The acceptability of life insurance as collateral will diminish if such assets cannot be used as such by those who hold them. On the other hand, it is predictable that some courts are going to view with disfavor hasty action by a creditor that destroys the contingent interest of a wife and children. Prudence dictates that a creditor not surrender a policy assigned as collateral without first giving the assignor every chance to redeem it, even though carefully drafted policies make it explicit that any assignment or pledge of the policy is a full transfer of all rights under the policy.

A knowledgeable assignee may anticipate challenges to his right to deal freely with an assigned policy by insisting that he be designated as the beneficiary. The beneficiary designation will probably be accompanied by a promise that no further changes will be made until the principal obligation is paid, or the creditor may be named as primary beneficiary accompanied by a secondary beneficiary whose

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168 As recently as 1938 the rights of a transferee of a life policy were still subject to considerable doubt. One student commentator sternly advised his readers that a pledged life insurance policy should never be surrendered without at least giving notice of such intention to the insured. 48 YALE L.J. 315, 319 (1938).
169 For example, "The Owner may assign this policy... An assignment by the owner, so long as it remains in force, shall exclude any and all rights of any other person referred to in this policy, except that if this policy is assigned or pledged as collateral only, any equity remaining at the maturity of this policy will accrue to the person or persons who, had there been no assignment then outstanding, would have been entitled to the amount then payable. Upon release of all outstanding assignments or upon reassignment to the Owner, the respective rights of the several persons referred to in this policy shall be as then stated in this policy." E. PATTERTON & W. YOUNG, CASES AND MATERIALS ON THE LAW OF INSURANCE app. L(I), at 734 (4th ed. 1964) (specimen Ordinary (Whole) Life Insurance Policy).
This may solve one kind of problem, but it introduces others.

One who procures insurance on his own life may name anyone he wishes as the beneficiary, and, by the same token, may make an absolute assignment of a policy on his life to any assignee of his choice. Courts, however, are reluctant to conclude that a debtor-insured intended to favor a creditor over his dependents to the extent of giving the creditor the death benefits even though the debt has been paid, or even giving him that portion of the death benefits exceeding the debt. In cases in which a creditor is named the beneficiary or is given an absolute assignment, courts are still disposed to search the record for evidence of an "intention of the parties" that a collateral undertaking is what they really had in mind. Cases apparently to the contrary usually stand on unmistakable indications that an unconditional commitment was intended, or are situations in which there is doubt that the beneficiary or assignee was a creditor in the first place. Even the strongest contrary authorities appear to stand for no more than the narrow proposition that the mere fact that one is or may have been a creditor does not automatically disqualify him from being an object of the insured's bounty.

Creditor-Procured Policies

A creditor may choose to protect himself by insuring the life of his debtor on his own initiative. Even in this situation questions arise as to the proper disposition of death benefits in excess of the debt thus secured. Professor Vance preferred the position that the debtor had no interest in the policy in this situation; that it was exclusively the investment of the creditor, and as such the policy benefits should belong to him. He acknowledged, however, that

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170 For an example of such a clause see In re Estate of Goldstein, 384 Pa. 1, 119 A.2d 278 (1956).
171 This statement is, of course, subject to the exception that an assignment cannot be used as a mask for a deliberate wagering transaction by one who does not have in insurable interest in the assignor's life. See Vance, supra note 21, at 768-71.
172 Amick v. Butler, 111 Ind. 578, 12 N.E. 518 (1887).
178 Vance, supra note 21, at 740.
this was not the prevailing view,\textsuperscript{179} and with the increased use of credit life insurance it is unlikely to become more popular.\textsuperscript{180} The pervasive public policy notion that it is improper for a creditor to receive death benefits beyond the amount of the debt is reflected by recent statutes enacted to regulate credit insurance. These statutes consistently direct that credit policies must provide that any excess over the unpaid indebtedness be paid either to a beneficiary other than the creditor or the debtor's estate.\textsuperscript{181}

In at least one state—Georgia—such a statute has effected a change in the result reached in this type of case. In an action\textsuperscript{182} decided prior to the enactment of the statute it was held that the debtor-insured could not state a cause of action against a recalcitrant insurer\textsuperscript{183} because the creditor was possessed of all legal and beneficial interest in the policy, even conceding that the debtor-insured had in fact and effect paid the premiums. Subsequent to the enactment of the statute, however, it was held that an administratrix of the estate of a debtor-insured who had paid the debt from other assets of the estate was entitled to reimbursement from the insurer.\textsuperscript{184} The policy, it was said, insured the life of the debtor, not the debt. The promise of the insurer was more than an assurance that the creditor would not suffer loss by reason of the death of the debtor.\textsuperscript{185}

The entry of an assuming grantee into the typical creditor-purchased insurance situation creates a most instructive illustration of the treatment of these situations by the courts. In this situation the debtor is insured by a life policy procured by the creditor-beneficiary. The original debtor conveys the property that created this debtor-creditor relationship to a grantee who assumes either a mortgage on the realty\textsuperscript{186} or a conditional sales contract on the chattel\textsuperscript{187} so pur-

\textsuperscript{179} Id.
\textsuperscript{180} For an example of a court determined to see that a creditor does not enjoy a double benefit see General Motors Acceptance Corp. v. Kendrick, 270 Ala. 676, 115 So. 2d 487 (1959).
\textsuperscript{183} The policy provided disability coverage that the company refused to honor. This was an action to compel payment of disability allowances. Id. at 546, 130 S.E.2d at 768.
\textsuperscript{185} Id. at 888, 140 S.E.2d at 213.
\textsuperscript{187} Hatley v. Johnston, 265 N.C. 73, 143 S.E.2d 260 (1965).
chased. Upon the death of the original debtor the insurer pays the proceeds to the creditor-beneficiary even though the obligation of this debtor has been assumed by the grantee. The recent decisions are not numerous, but they have consistently held that the death benefits of credit life policies belong, in the last analysis, to the estate or dependents of the original debtor. The mechanism used is that of subrogation of the representative of the debtor-insured to the creditor's claim against the assuming grantee. Several propositions emerge from these decisions. First, the cases adopt the position that the policy insures the life of the debtor and not the debt. The insurer must pay even if the debt has been paid. Secondly, if anyone is going to enjoy a windfall, the preference is for the dependents of the debtor-insured. A windfall to the creditor is contrary to the policy limiting creditors to indemnification, and a windfall to the assuming grantee results in giving benefits to one who does not even have an insurable interest in the life of the debtor. Finally, there is open recognition that the debtor indirectly pays for the credit life insurance. The statutes concerning credit life insurance recognize this explicitly. There is, then, little reason for pursuing distinctions based on insurance procured by a debtor for his creditor's benefit as opposed to insurance procured by the creditor for his own benefit.

Intent of the Insured—Subrogation

Even in those cases in which the beneficiary designation or assignment makes it perfectly clear that the insurance policy is serving as collateral for a principal debt and that any balance remaining after payment of the debt is to be paid to a secondary beneficiary, there may still be questions as to the ultimate disposition of the death benefits of the policy. If the policy is intended merely to secure payment of the debt, the debt remains an obligation of the insured’s estate, and the secondary beneficiary can be subrogated to the creditor’s claim against the estate if the policy benefits are used to pay the debt.\(^{195}\) If the policy is intended to stand as the primary source from which the debt is to be paid, however, the secondary beneficiary is entitled only to the balance remaining after the debt is paid out of the policy benefits.\(^{196}\) Here, as with similar problems, the popular rubric is that the intention of the insured controls.\(^{197}\) In some respects that intention is determined more mechanically in these situations than in many others,\(^{198}\) but the decisions are still influenced by the way particular courts feel about life policies, the interests therein and the contending parties.

At one extreme is the approach of the Maryland court in Blair v. Baker,\(^{199}\) in which the beneficiary was regarded as the owner of the life policy, subject to reserved powers of the insured to destroy that ownership interest.\(^{200}\) By this rule an assignment of the policy as collateral is merely an encumbrance on the policy, not an extinguishment pro tanto of the beneficiary’s interest.\(^{201}\) Courts of this dispo-


\(^{196}\) See, e.g., In re Estate of Cohen, 23 Ill. App. 2d 411, 418-19, 163 N.E.2d 533, 537 (1959); In re Kelley’s Estate, 251 App. Div. 847, 296 N.Y.S. 923 (1937); In re Estate of Kelekian, 1 Misc. 2d 886, 152 N.Y.S.2d 205 (Sup. Ct. 1952).


\(^{198}\) See, e.g., In re Estate of Cohen, 23 Ill. App. 2d 411, 163 N.E.2d 533 (1959); Walzer v. Walzer, 3 N.Y.2d 8, 143 N.E.2d 361, 163 N.Y.S.2d 632 (1957); In re Kelly’s Estate, 251 App. Div. 847, 296 N.Y.S. 923 (1937); In re Scheer’s Will, 1 Misc. 2d 899, 114 N.Y.S.2d 283 (Sup. Ct. 1952), aff’d 281 App. Div. 808, 118 N.Y.S.2d 752 (1953); In re Estate of Kelekian, 1 Misc. 2d 886, 152 N.Y.S.2d 205 (Sup. Ct. 1952).

\(^{199}\) 196 Md. 242, 76 A.2d 129 (1950).

\(^{200}\) In this connection it must be noted that Maryland is not a minority rule state with reference to the nature of a beneficiary’s interest. The beneficiary has only an “expectancy.” Durst v. Durst, 232 Md. 311, 315, 193 A.2d 26, 28 (1962).

sition may put the burden on the estate to prove that the insured did not intend the beneficiary to be subrogated to the creditor’s claim.\footnote{See In re Gallagher’s Will, 57 N.M. 112, 255 P.2d 317 (1953).}

At the other end of the scale is the position of the Georgia court in Ruis v. Bank of Albany,\footnote{213 Ga. 41, 96 S.E.2d 580 (1957).} in which the beneficiary was treated as holding only a divestible interest which an assignment divests. The beneficiary has no standing to complain if the creditor satisfies his claim out of the proceeds of the policy rather than by resorting to other collateral, and a fortiori he is not subrogated to the creditor’s claim.\footnote{Parramore v. Williams, 215 Ga. 179, 109 S.E.2d 745 (1959).}

The New York courts purport to start with a general rule that the life policy is deemed not to be the primary source of payment when it is assigned as collateral security,\footnote{205 Walzer v. Walzer, 3 N.Y.2d 8, 143 N.E.2d 361, 163 N.Y.S.2d 632 (1957).} but they also look for certain indications of a particular intent on the part of the insured.\footnote{206 Id.}

Apparently the clearest sign of an intention that the beneficiary is to take only the balance remaining after the debt is paid is a formal change of beneficiary accompanying the assignment in which the same beneficiary is renamed, but a stipulation is added that his rights are to be subject to the rights of the assignee.\footnote{In re Kelly’s Estate, 251 App. Div. 847, 296 N.Y.S.2d 923 (1937); see Fidelity Union Trust Co. v. Phillips, 5 N.J. Super. 529, 68 A.2d 574 (Ch. 1949), aff’d, 4 N.J. 28, 71 A.2d 352 (1950).}

The same intent was found in one case in which a new beneficiary was named simultaneously with the execution of the assignment.\footnote{In re Estate of Kelekian, 1 Misc. 2d 886, 152 N.Y.S.2d 205 (Sup. Ct. 1952).} But when the insured changed the beneficiary from his own estate to his daughters eight years after the assignment, the court of appeals concluded there was no evidence that the insured intended his daughters to take only the excess over that needed to satisfy the debt.\footnote{Walzer v. Walzer, 3 N.Y.2d 8, 143 N.E.2d 361, 163 N.Y.S.2d 632 (1957).}

In the latter two cases the change of beneficiary stipulated, at the assignee’s insistence, that the new beneficiaries took their interests subject to the rights of the assignee.\footnote{Walzer v. Walzer, 3 N.Y.2d 8, 143 N.E.2d 361, 163 N.Y.S.2d 632, 633-34 (1957); In re Estate of Kelekian, 1 Misc. 2d 886, 152 N.Y.S.2d 205 (Sup. Ct. 1952).}

The Pennsylvania court has determined the intent of the insured in this context with considerable freedom. In one case weight was
given to the language of the standard assignment clause in the policy.\textsuperscript{211} In another case, and one in which the beneficiary's cause was more appealing, this boilerplate was less weighty.\textsuperscript{212} Here a widow-beneficiary who had invested her own funds in the project for which the loan was made (secured by the policy assignment), established her right to undiminished death benefits on inconclusive circumstantial evidence.\textsuperscript{213} Yet, in a third case, a grandson with no demonstrated special claim was required to establish affirmatively that the insured intended that he be subrogated to the creditor's claim.\textsuperscript{214}

The results in some of these cases leave doubts that the intention of the insured has been read accurately. In \textit{Blair v. Baker},\textsuperscript{215} twenty pecuniary legacies in the insured's will went unsatisfied upon the determination that assigned policies payable to the insured's estate had to be fully applied to the debt before anything could be taken from the assigned policy payable to an individual beneficiary.\textsuperscript{216} On the other hand, six policies, all payable to individual beneficiaries, were assigned as collateral for the same debt in \textit{In re Scheer's Will},\textsuperscript{217} but the one policy in which the beneficiary had been changed simultaneously with the execution of the assignment\textsuperscript{218} was held fully subject to payment of the debt with no right of subrogation against the estate. If any balance of the debt remained unpaid, it was to be apportioned among the other five policies with the right of subrogation to those beneficiaries.\textsuperscript{219} These cases illustrate that it is important for all relevant documents to speak clearly if the insured's intention is not to be subverted. Since his intention in this regard is not fixed at any particular time, attention must be given to his will as well as to the assignment and the policy to make certain that all are clear and consistent.\textsuperscript{220}

**Conflicts in Interests through Dishonesty**

Easy transfers of interests of interest in life policies raise a small

\textsuperscript{211} \textit{In re Estate of Goldstein}, 384 Pa. 1, 119 A.2d 278 (1956). The clause was very close to the one quoted in note 169 supra.


\textsuperscript{213} Id. at 247, 191 A.2d at 381.


\textsuperscript{215} 196 Md. 242, 76 A.2d 129 (1950).

\textsuperscript{216} This beneficiary was not a relative or a "natural" object of the insured's bounty. \textit{In re Estate of Green}, 415 Pa. 161, 162, 202 A.2d 17 (1964).


\textsuperscript{218} This change of beneficiary is usually made at the creditor's insistence and for that reason alone is questionable evidence of the insured's intent. Moreover, it is probably unnecessary to the creditor's protection.


but nagging doubt whether purchasers for value of such interests are sufficiently protected in all situations. If a dishonest insured transfers interests for value to more than one person, the usual rules governing priorities among successive assignees of the same chose in action presumably will come into operation.\textsuperscript{221} Courts may deviate from these rules, however, when one of the competing interests is either a wife-donee of a parol inter vivos gift or an ex-wife who has acquired her interest by means of a separation agreement.

It is almost uniformly true that assignments of life policies can be made without any endorsement on the policy itself.\textsuperscript{222} Most insurers require that they be furnished with two copies of any assignment and stipulate that they will not be bound until such documents are received and filed.\textsuperscript{223} It is consistently held that these provisions are for the exclusive protection of the insurer and do not affect rights between competing claimants.\textsuperscript{224} Thus a promise in a property settlement agreement can make the wife an irrevocable beneficiary while the policy remains in the possession of the husband. In \textit{Shoudy v. Shoudy}\textsuperscript{225} the court intimated it might consider whether one who had given value for an interest in a policy previously transferred by property settlement agreement had a "superior equity," but found that no such situation was presented in the case before it. Similarly, in \textit{Campbell v. Prudential Insurance Company of America}\textsuperscript{226} the court suggested that in an appropriate case it might consider whether the actions of the true owner of a policy had misled the other claimant or contributed to his injury.\textsuperscript{227} In \textit{Fidelity Mutual Life Insurance Com-}


\textsuperscript{222} E.g., Herman v. Connecticut, 218 Mass. 181, 105 N.E. 450 (1914); Klebba v. Struempf, 224 Mo. App. 193, 23 S.W.2d 205 (1930).


The typical policy clause is quoted in Asphalt Paving Inc. v. Ulery, 149 So. 2d 370 (Fla. Dist. Ct. App. 1963): "No assignment of this policy shall be binding upon the Company unless filed in duplicate at the Home office, one [copy] to be retained by the Company and the other to be returned to the Insured. The Company assumes no responsibility for the validity of any assignment." Id. at 378.


\textsuperscript{225} 55 Cal. App. 344, 203 P. 433 (1921).

\textsuperscript{226} 73 Ohio L. Abs. 252, 137 N.E.2d 515 (Ct. App. 1955).

\textsuperscript{227} This possibility has existed at least since the leading case of Herman v. Connecticut Mut. Life Ins. Co., 218 Mass. 181, 105 N.E. 450 (1914). This sturdy precedent was undoubtedly part of the support used for the \textit{Restatement} by the American Law Institute. See \textit{RESTATEMENT OF CONTRACTS} § 173 (b)(iv) (1932). See also Cadore v. Cadore, 67 So. 2d 635 (Fla. 1953).
pany v. City National Bank,\textsuperscript{228} the husband assigned a policy to his wife to secure support payments to be made under a separation agreement. The wife gave notice of the assignment to the insurer, but did not furnish copies of the assignment. The court held she had a right superior to that of a subsequent assignee for value because her assignment was prior in time and also because she had given prior notice. The court also held she was not estopped on the facts to assert her claim, though she was in part responsible for the fact that her husband still had possession of the policy with no endorsements or attachments indicating the presence of the prior assignment.\textsuperscript{229}

The bothersome cases are those in which the courts disregard the "superior equity" problem (or perhaps do not have it called to their attention). In Munn v. Robison,\textsuperscript{230} the creditor-claimant produced a contract signed by the insured stating that the policy had been assigned to him to secure the obligation contained therein. The court, with no explanation, said this was not an assignment, and added that in any event it was immaterial since the insured had previously divested himself of title by a parol inter vivos gift of the policy to his wife.\textsuperscript{231} The fact that conflicts of interest produced by dishonesty are exceptional is not a great comfort. The conflict in the Munn case was probably the result of ignorance, and ignorance in these affairs is rather common.

**Group Life Insurance**

Group life insurance presents many of the same problems as does ordinary life insurance but in an exaggerated form. This insurance involves an employer, union or some other intermediary as the policyholder.\textsuperscript{232} The promise of the insurer is to pay benefits at the direction of various individuals who participate in this master policy held by the institutional insured. For a number of reasons both in-

\begin{itemize}
\item \textsuperscript{228} 95 F. Supp. 276 (N.D.W. Va. 1950).
\item \textsuperscript{229} The second assignee apparently had actual notice of the prior assignment and first assignee had made some effort to get possession of the policy. Id. at 278-81.
\item \textsuperscript{230} 203 F.2d 778 (8th Cir. 1953).
\item \textsuperscript{231} Id. at 781. In Borchert v. Metropolitan Life Ins. Co., 84 N.Y.S.2d 529 (Sup. Ct. 1948), the court stated that if the insured procured possession of the policy "fraudulently" (by representing that he wanted to get a policy loan), he could transfer "no better title even to a bona fide purchaser for value without notice than any possessor of goods without title." Id. at 532 (emphasis added).
\item \textsuperscript{232} Employee group life plans represent 85.8 percent of the total. \textit{Institute of Life Insurance, Life Insurance Fact Book} 30 (1968). Accordingly this discussion will focus on problems presented by this most common arrangement.
\end{itemize}
surer and insured may wish to limit the manner in which individuals can participate, and it is common for such policies to contain limitations on the disposition of benefits, most particularly a prohibition of assignment.

**Prohibition of Assignment**

It is again necessary to begin with generalities. Obligations that have matured are assignable just as any other claim for money. Contingent interests are choses in action and are assignable unless such assignment is prohibited by law or by contract. Statutory prohibitions of assignment of interests in life policies are effective, but there is some question of the enforceability of similar restrictions originating in insurance contracts.

*Bimestefer v. Bimestefer* is a leading example of the strict position. That is, if the policy contains an absolute prohibition of assignments, an attempt to assign it is ineffective. The insurer is not privileged to waive the provision because his are not the only interests involved. The employer-policyholder also has an interest. Group life insurance is one of the advantages the employer offers to induce employees to continue in his employ, an inducement that will be lost if the employee conveys away all his interest in the policy. An employer, and perhaps the insurer as well, additionally has an interest in seeing that the employee does not transfer his interest in his group policy indiscriminately. In most cases that danger is slight, as group insurance is generally term insurance with no loan or cash surrender value.

*Bimestefer* was not such a case. The contending parties were a son claiming as donee of an inter vivos gift and a second wife-beneficiary. Under the strict position, then, parol inter vivos gifts and equitable assignments by way of property settlement agreements, business purchase arrangements or collateral assignments are of no effect. The only method of making an effective transfer of an interest in a group life policy under this position is by a change of beneficiary in strict conformity with policy procedures.

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233 **VANCE, supra note 21, at 762-63.**


236 205 Md. 541, 109 A.2d 768 (1954).

INTERESTS IN LIFE INSURANCE POLICIES

There is authority contrary to this strict position, but the reasons for these decisions are varied. One case suggested that an equitable assignment arising out of a separation agreement is analogous to a change of beneficiary and as such does not contravene a prohibition of assignments.239 Others are content to leave the power to waive with the insurer.240 Finally, some courts have long taken the position that an insurer does not have unrestricted power to dictate to an insured what he may or may not do with his policy,241 and justify their decisions on this basis.

The matter deserves careful thought. Group life is no longer exclusively poor man's insurance available in minimal amounts242 and the absence of loan or cash surrender value does not necessarily make a life policy unmarketable as collateral. As a number of cases illustrate, term insurance is acceptable security for a variety of obligations.243 Group life policies represent the principal or only substantial assets of many persons. Allowing employer and insurer to prevent an insured from making use of his group policy as he desires runs against the developing hostility to contractual restraints on assignments generally.244 The middle-aged gentleman who wishes to use his group policy as collateral for the purchase of a retirement condominium in Orange County or Fort Lauderdale is likely to resent an agreement between his employer and group insurer that he cannot use it for such a purpose, particularly if the policy is one in which he

239 Kelly v. Layton, 309 F.2d 611, 614 (8th Cir. 1962).
242 Most state statutes authorizing issuance of group policies place limits on the amount of group life issuable to any one person. These ceilings have been increasing. See, e.g., Cal. Ins. Code § 10202.8(d) (increasing the limit from $20,000 to $50,000); Md. Ann. Code art. 48A, § 425 (1957) (a maximum as high as $100,000; an increase from $40,000).
244 See, e.g., Uniform Commercial Code § 9-318 (4), where it is stipulated that prohibitions of assignment of accounts or contract rights shall be ineffective. The Commissioners note laconically that this move will be regretted only by those who "cherish the hope that we may yet return to the views entertained some two hundred years ago by the Court of King's Bench." Uniform Commercial Code § 9-318(4), Official Comment. This section, of course, does not apply to transfers of interests in insurance policies. Uniform Commercial Code § 9-104(g).
has contributed to payment of the premiums. As already noted, recent statutes regulating credit insurance consistently reserve to borrowers the option to use insurance already in existence as an alternative to buying a new policy offered by lenders. This option is not particularly valuable to the borrower whose existing insurance consists of group policies containing enforceable nonassignment clauses.

A countervailing consideration is the fact that group life, even more than ordinary life, is regarded as "dependents" insurance. Both the form of beneficiary clause frequently used and the prohibition of assignments are calculated to prevent dissipation of the beneficiaries' death benefits. Commentators, concerned about the tax effects of the assignability or nonassignability of group policies, frequently assume that someone must serve as a check on the insured in the disposition of these assets. This concern is a natural one. The amount of coverage provided by most group policies is still relatively small, and an assignment of a term policy is necessarily a transfer of an interest in death benefits. Arguably, society does have an interest in preventing wage earners from using their group life policies—often their only substantial assets—as credit insurance. Enforcement of contract provisions is a simpler and less abrasive way of effecting this policy than direct regulation would be. However, just as some courts have objected to giving insurance companies the power to decide between competing claimants by electing to waive or not waive policy requirements on change of beneficiary and assignments generally, it is faintly unsettling to give insurers and employers uncontrolled discretion to decide which employees are sufficiently responsible to make assignments of their group policies.

The Effect of Pension Plans

There are distinct similarities between group life insurance and

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245 See note 194 and accompanying text supra.

246 The beneficiary clauses of many group policies stipulate that in the absence of a specifically designated beneficiary the death benefits shall go, in order, to spouse, children, parents, brothers and sisters, etc. Only if none of these persons are available will the benefits go to the insured's estate where it can be reached by his creditors. Such clauses are illustrated in many cases. See, e.g., Miller v. Miller, 94 Cal. App. 2d 785, 211 P.2d 357 (1949); Metropolitan Life Ins. Co. v. Woolf, 138 N.J. Eq. 450, 47 A.2d 340 (Ct. Err. & App. 1946).


248 Average employee coverage at the end of 1967 was $6,780. Institute of Life Insurance, Life Insurance Fact Book 30 (1968).

pension plans, and as far as transferability of interests is concerned, some cross-fertilization can be expected. The most direct comparison is with the death benefit provisions common to contributory pension plans under which an employee's contribution is payable to a beneficiary if the employee dies before becoming eligible for retirement. When the question was presented in *Sullivan v. Union Oil Company*, the California court looked to insurance cases for authority and has thereafter looked to *Sullivan* in insurance cases. In cases like *Sullivan*, in which the question is whether a beneficiary has renounced his interest through a property settlement agreement, the parallels are almost exact. The beneficiary has only an expectancy, and the employee has unrestricted power to change the beneficiary. The tendency to follow guides established by insurance decisions is understandable and seems sound. In other situations insurance principles do not fit quite so neatly, and in one case the California Supreme Court expressly disapproved uncritical adherence to insurance precedents when dealing with pension plans established by statute for public employees.

The question for the future is a political one. As things presently stand, courts and legislatures take a very protective attitude toward benefits payable under pension plans. Statutes creating public pension plans commonly provide the same shelter from the claims of creditors as has been long provided for benefits payable under life insurance policies. In addition, restrictions on the transfer or assignment of rights under public pension plans are usually absolute or at least very stringent. Starting with this express protective policy on public pensions, courts move easily to enforcement of provisions in private pension and annuity plans with the same objective in mind.

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250 16 Cal. 2d 229, 105 P.2d 922 (1940).
251 Id. at 234–35, 105 P.2d at 925.
256 E.g., *CAL. CODE CIV. PROC. § 690.22*; *CAL. GOV'T CODE § 21201*; *Md. ANN. CODE art. 73B, § 17* (1957); *TEX. REV. CIV. STAT. ANN. art. 6228a, § 9* (state and county employees) (1962); *TEX. REV. CIV. STAT. ANN. art. 6243* (city employees) (1962).
257 E.g., *CAL. GOV'T CODE § 21201*; *Md. ANN. CODE art. 73B, § 17* (1957); *TEX. REV. CIV. STAT. ANN. art. 6228a, § 9* (state and county employees) (1962); *TEX. REV. CIV. STAT. ANN. art. 6243* (city employees) (1962).
In *Thomas v. Thomas*,\(^{258}\) it was held that payments due under a private pension plan were not subject to garnishment to satisfy arrearages in support payments to an ex-wife (or for any other purpose). The employer-employee contract provided that benefits payable under the plan "shall be nonassignable whether by voluntary or involuntary assignment or by operation of law ..."\(^{259}\) The plan under examination was privately financed by the employer, but the court assumed that if it had been funded by insurance, individual benefits would be immune from process under a statute providing such shelter for the proceeds of group insurance policies.\(^ {260}\) Relying on public pension statutes, principles supporting spendthrift trusts, and cases like *Bimestefer v. Bimestefer*\(^{261}\) which sustain nonassignment clauses in group policies generally, the court found ample evidence that there was no public policy precluding enforcement of private prohibitions of "voluntary or involuntary" assignment.\(^ {262}\)

The only thing the *Thomas* and *Bimestefer* cases have in common is that in both instances the court was looking at a fund specifically designed for the benefit and protection of individuals whose power to sustain themselves had been reduced through retirement. If a pensioner is to be protected from his general creditors for the public good, it would be inconsistent to permit him to avoid that protection and favor one creditor by the simple device of making an assignment. Essentially this is also the underlying rationale of exemption statutes protectingbeneficiaries of life insurance. A blanket prohibition of assignments of life policies is impossible under modern conditions, but the inclination to place group policy benefits under the same protective umbrella as pension benefits is clearly present.\(^ {263}\)

### Assignment Provisions and Estate Planning

There is a small irony in the fact that refusal to allow manipulation of assignment provisions may complicate the use of group life insurance as an estate planning "tool." For the well heeled, group term insurance is a convenient and low-cost method of providing

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\(^{259}\) Id. at 775, 13 Cal. Rptr. at 874-75.


\(^{261}\) 205 Md. 541, 109 A.2d 768 (1954).

\(^{262}\) 192 Cal. App. 2d at 782-83, 13 Cal. Rptr. at 879-80.

\(^{263}\) **CAL. INS. CODE** § 10130 provides in broad terms that life insurance policies shall be transferable. There is dictum to the effect that contract prohibitions cannot frustrate this statutory policy. See, e.g., *Cook v. Cook*, 17 Cal. 2d 639, 645, 111 P.2d 322, 329 (1941). Group policies are, however, specifically excluded from the operation of section 10130. **CAL. INS. CODE** § 10129.
heirs with a substantial amount of ready cash, and if the insured can divest himself of all incidents of ownership in the policy by an absolute assignment, the death benefits will not be included in his gross estate for tax purposes. But how does one make an absolute assignment of a policy which by its terms is nonassignable? It is at this point that tax commentators urge a double standard of sorts: Non-assignment clauses to protect the dependents of wage earners coupled with a power in the employer and insurer to waive the restriction for high salaried executives. To the uninitiated there is something incomprehensible about a system under which, in theory at least, a private employer and a private insurer may decide who will pay an estate tax on his group insurance and who will not. In addition, since the sole function of group term insurance is to provide a sum of money for the dependents (or estate) of the insured, the reported hostile mutterings in the Internal Revenue Service about manipulation of group life insurance policies are understandable. Transfer to the named beneficiary (or other natural object of the insured's bounty) of a policy having no asset value can be said to be no transfer at all.

At present the matter is subject to considerable speculation and very little authority. Assignability, it is said, is determined by state law and the terms of the contract. The fifth circuit has applied this principle, but other segments of the federal judiciary have either denied state law the power to affect application of the federal tax acts significantly or have ignored it. Even assuming that an assignment blessed by employer and insurer is a sufficient transfer of ownership generally, there are some incidents of ownership that are difficult to shake off. For example, most group policies carry a conversion privilege under which an employee who is discharged or whose master policy is cancelled is entitled to convert to individual (non-term) coverage within a certain period, without proof of insurability. The statutes of 39 states now require group policies to in-

265 See authorities cited and text accompanying note 247 supra.
266 Policies payable to the estate of the insured are, of course, includible in the estate for tax purposes. Int. Rev. Code of 1954, § 2042(1).
270 See Vance, supra note 21, at 79-81.
271 Estate of Piggott v. Commissioner, 340 F.2d 829 (6th Cir. 1965); cf. Commissioner v. Estate of Noel, 380 U.S. 678 (1965). What the effect of Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), ultimately may be is almost impossible to predict at this juncture.
clude this option,\textsuperscript{272} but it is unclear whether the insured can divest himself of the privilege or transfer it to another. Also, employee-insureds may always terminate group coverage by quitting the job under which they are covered or by declining to pay premiums if the insurance arrangement is contributory. There is borderline authority for the proposition that this power to terminate is an incident of ownership,\textsuperscript{273} and it seems unlikely that an assignee can claim that he has received by transfer a right to keep the policy in force by paying the premium as a nonemployee individual.\textsuperscript{274} The Internal Revenue Service is not without weapons if it decides to attack assignments to named beneficiaries of group term policies as a means of avoiding the estate tax.\textsuperscript{275}

**Conclusion**

One cannot claim that a major problem has been created by existing inconsistencies in principles governing transfers of interests in life insurance policies. In comparison to the large number of insurance contracts in force, the incidence of disputes is still relatively small. Professional fastidiousness is offended by imprecision, but professional sensibilities are probably not reason enough to propose extensive reforms. The fact remains, however, that life insurance


\textsuperscript{273} Commissioner v. Treganowan, 183 F.2d 288, 292-93 (2d Cir.), cert. denied, 340 U.S. 853 (1950) (power to sell stock exchange seat was power to terminate interest in group plan).


\textsuperscript{275} See Int. Rev. Code of 1954, § 2035, which illustrates that transfers of life insurance in contemplation of death presents peculiarly difficult problems where group term life insurance is concerned. If the insured assignor lives for more than three years after the transfer, there is little danger that the total death benefits will be included in his gross estate. If he dies within the critical three year period, there is probably little chance of establishing a "life motive" for the transfer of ownership in a policy having no asset value. It is even difficult to argue that the transfer was made to relieve him of the temptation to encumber the policy, since he usually has no clear right to encumber a "nonassignable" policy in the first place. The matter has not been eased by the ruling of the Commissioner that when such a transfer is made by a husband to his wife and the husband thereafter pays the premiums, that proportion of the death benefits purchased with premiums paid in the last three years of the transferor's life is an interest transferred in contemplation of death and includible in his gross estate. Rev. Rul. 67-463, 1967-2 Cum. Bull. 327; see 46 N.C.L. Rev. 989 (1968). What the effect of this ruling may be on transfers of group term policies is an interesting speculation. In one sense each premium pays for the total amount of death benefits, since there is no accumulation of reserve as in ordinary life policies. Arguably, under this ruling the total death benefits of group term policies are always includible and the days of group life insurance as an estate planning tool are over.
in all its forms represents an enormous accumulation of assets, and is a method of investment employed by a growing number of families. The sheer weight of the total investment, coupled with the fact that larger numbers of individuals are choosing insurance as their principal method of saving, must ultimately produce questions and challenges.

There are those who argue, for example, that dependents of decedents who invest in life insurance are no more deserving of protection from creditors than dependents of decedents who choose to invest in securities, works of art, or real estate. Yet this is the effect of many state exemption statutes. Even the Internal Revenue Code in its provisions prescribing the reach of federal tax liens makes an effort to accommodate itself to state law with uneven and generally unsatisfactory results. The application of exemption statutes is particularly painful to those who believe these enactments owe their existence as much to the legislative muscle of insurance companies as to a concern for widows and orphans.

Part of the difficulty comes from the nature of the entity. A life policy, in different circumstances, can be assigned legal characteristics of everything from a bearer bond to a right of dower, and the influences working in any given case range from the apparent needs of particular parties to the broadest notions of public policy. The day may indeed be approaching when the allocation of interests in life policies can no longer be made simply by reference to sweeping concepts of freedom of contract, free alienability of choses in action and the claims of dependents upon the public interest. The proper ordering of priorities of interests in life policies may require a more rigorous differentiation between death benefits (and the rights of those who are to receive them) and lifetime benefits (and the rights of those with whom the insured deals as the owner of an asset). Correspondingly, it may be necessary to identify and characterize transfers according to their nature rather than the form they take. If a parol inter vivos gift or an equitable assignment by means of contract is a transfer of the right to receive death benefits, it is in the nature of a change of beneficiary and perhaps should be treated accordingly. Such transfers are "assignments" only in the most conceptual terms.

Considerable work also needs to be done on nomenclature, particularly as used in statutes. The excessively general language of an

277 E.g., CAL. CODE CIV. PROC. § 690.19.
earlier and simpler time may now be meaningless or actually inaccurate,\textsuperscript{280} and statutes using broad, simple terms to deal with increasingly involved contracts can produce some unexpected results.\textsuperscript{281} Terms like "proceeds and avails" have a nice 18th century ring to them, but frequently fail to do the job.\textsuperscript{282} In the final analysis, however, the major goal to be attained is an awareness of the pressing need for examination and reappraisal of theories and concepts in an increasingly complex but correspondingly important field of the law.

\textsuperscript{280} "A life or disability policy may pass by transfer, will or succession to any person, whether or not the transferee has an insurable interest. Such transferee may recover upon it whatever the insured might have recovered." \textsc{Cal. Ins. Code} § 10130. The final sentence of this section is hardly descriptive of the nature and extent of the interest taken by any and all transferees.

\textsuperscript{281} \textit{E.g.}, \textsc{Jackson v. Fisher}, 56 Cal. 2d 196, 363 P.2d 479, 14 Cal. Rptr. 439 (1961), in which it was held that the California exemption statute protected a beneficiary though he was not a dependent, but a creditor, under a policy taken out to secure a debt. \textit{14 Stan. L. Rev.} 599 (1962).

\textsuperscript{282} \textit{See, e.g.}, \textsc{Succession of Videau}, 197 So. 2d 655 (La. Ct. of Appeal 1967). \textit{See also 42 Tul. L. Rev.} 425 (1968) where the confusion created by use of the term "proceeds and avails" in the Louisiana exemption statute with reference to its application to cash surrender value is examined.