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INSURANCE–INSURABLE INTEREST–ASSIGNMENT OF LIFE INSURANCE POLICY AS COLLATERAL SECURITY

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INSURANCE—INSURABLE INTEREST—ASSIGNMENT OF LIFE INSURANCE POLICY AS COLLATERAL SECURITY—The insured and a revocably designated beneficiary jointly assigned a life insurance policy as collateral security for a prior indebtedness of the insured. Another policy and first deed of trust notes were also assigned as collateral by the insured. Upon the death of the insured, who obtained the policy and paid all premiums, the bank applied a proportionate amount of the proceeds from this policy to the debt and paid the remaining sum to the beneficiary. Executors of the estate of the insured seek to recover the sum paid by the bank to the beneficiary, while executors of the beneficiary counterclaim for the amount of the policy proceeds applied to the debt of the insured. The trial court held that the beneficiary had no insurable interest in the life of the insured and possessed no right to any part of the policy proceeds. *Held*, affirmed, two judges dissenting. *Smith v. Coleman*, 183 Va. 601, 32 S.E. (2d) 704 (1945).[1]

In adhering to the much criticized Texas rule of insurable interest,[2] the Virginia court apparently is drawing a mistaken analogy between the facts at issue and the situation in which one person attempts to insure the life of another. A large majority of courts hold that the insured has an insurable interest in his own life and may designate anyone as beneficiary,[3] unless there is collusion equivalent to the beneficiary procuring the policy.[4] There is evidence of good faith in the principal case, however, since the insured obtained the policies and paid all premiums.[5] It might be said that the court wisely avoided

[1] Noted in 45 COL. L. REV. 662 (1945), and INS. L. J 243, (April 1945).

[2] Wilke v. Finn, (Texas App. Comm. 1931) 39 S.W. (2d) 836, noted in 16 MINN. L. REV. 569 (1932). The court required an insurable interest although the beneficiary was not aware of the policy until two years after its issuance. See also Finn v. Metropolitan Life Ins. Co., (Texas Civ. App. 1929) 16 S.W. (2d) 922. The Texas doctrine has been criticized consistently. See Lipscomb, "Necessity of Insurable Interest in the Beneficiary of a Life Insurance Policy," 10 TEXAS L. REV. 51 (1931); 39 MICH. L. REV. 165 (1940).

[3] Grigsby v. Russell, 222 U.S. 149, 32 S.Ct. 58 (1911). See cases cited in 2 APPLEMAN, INSURANCE LAW AND PRACTICE, § 761 (1941). Generally, see Patterson, "Insurable Interest in Life," 18 COL. L. REV. 381 (1918); 73 A.L.R. 1038 (1931); 108 A.L.R. 449 (1937).

[4] Equitable Life Ins. Co. of Iowa v. Cummings, (C.C.A. 3d, 1925) 4 F. (2d) 794.

[5] Hess' Admr. v. Segenfelter, 127 Ky. 348 at 352, 105 S.W. 476 (1907).

treading the confusing path leading to consideration of the problems arising where the policy is assigned as collateral security. Several theoretical propositions have been propounded by the courts to meet such a situation,[6] and it is important that the distinguishing features of these theories be recognized.[7] The usual result has been to hold that the assignee takes an interest in the proceeds to the amount of the debt secured, leaving the balance to the designated beneficiary.[8] The mere expectancy theory [9] and the proposition that the assignment in itself effects a change of beneficiary [10] support this view. But where the beneficiary

[6] For an analysis of these theories and numerous citations, see Grismore, "The Assignment of a Life Insurance Policy," 42 MICH. L. REV. 789 at 796 (1944); 135 A.L.R. 1040 (1941); 85 UNIV. PA. L. REV. 203 (1936), 11 N.C.L. REV. 169 (1933); Vance, "The Beneficiary's Interest in a Life Insurance Policy," 31 YALE L. J. 343 (1922).

[7] Little difficulty is caused by the minority view that a conditional right to the proceeds vests in the beneficiary upon designation, and that this interest can be affected only by acts of the insured or his assignee which are done in accordance with the provisions of the policy. But the mere expectancy theory, holding that the beneficiary has no property right in the policy during the insured's lifetime, should be distinguished from the theory that the assignment effects a change of beneficiary, which assumes that the beneficiary has a contingent interest of which he must be divested. See TAIT, ASSIGNMENT OF LIFE INSURANCE POLICIES AS COLLATERAL SECURITY (1939). The author, in chapter three, combines cases supporting both of these theories in a single category, as opposed to the more strict view that requires consent of the beneficiary or a change of beneficiary in the manner prescribed. The New York court in Davis v. Modern Industrial Bank, 279 N.Y. 405, 18 N.E. (2d) 639 (1939), noted in 24 CORN. L. Q. 607 (1939), fails to recognize the view that the assignment amounts to a change of beneficiary.

[8] But there is no balance where the assignee's claim exceeds the amount of the policy. Whether intended or not, a change of beneficiary has thus been effected. See Andrew v. Banker's Life Ins. Co., 214 Iowa 573, 240 N.W. 215 (1932). And the assignee may pay the premiums and thus augment the debt if the assignor fails to continue payments. Mercer National Bank of Harrodsburg v. White's Executor, 236 Ky. 128, 32 S.W. (2d) 734 (1930).

[9] A typical case following this view states: "The named beneficiary had no vested right, only an expectancy. The insured had the right to assign the policy as security for his indebtedness and reserved full control to that end. . . . The debt, being in excess of the amount of the policies, left nothing for the beneficiary. Had there been a surplus, her rights as the named beneficiary would have been unaffected. There was no occasion for a change of beneficiary." Taylor v. Southern Bank & Trust Co., 227 Ala. 565 at 569, 151 S. 357 at 361 (1933). See Petty v. Mutual Benefit Life Ins. Co., (Iowa 1944) 15 N.W. (2d) 613; Morrison v. Mutual Life Ins. Co., 15 Cal. (2d) 579, 103 P. (2d) 963 (1940); Lemley v. McClure, 122 Pa. Super. 225, 185 A. 878 (1936).

[10] A leading case supporting this view is Merchant's Bank v. Garrard, 158 Ga. 867 at 872, 124 S.E. 715 at 718 (1924), in which the court said: "When the insured in this life policy, with the consent of the insurer, assigned the policy to the bank, the assignment purporting to convey all right, title, and interest of the insured . . . was a change of beneficiary as well as if there had been a substitution of the assignee for the beneficiary in that part of the policy in which the name of the beneficiary appeared." Other cases include Carnes v. Franklin Life Ins. Co.,

is considered to have a vested defeasible interest, the courts usually hold that the beneficiary has a superior right to the proceeds, unless there has been a formal change of beneficiary following the procedure prescribed by the policy.[11] And under this view, if the beneficiary joins in the assignment, as in the principal case, he is subrogated to the assignee's claim against the estate of the insured.[12] This is on the assumption that until there is a formal change, the previously designated beneficiary is entitled to the proceeds, and thus property of the beneficiary was used to discharge the debt of the insured. The "mere expectancy" courts arrive at the same conclusion, holding that title to the surety fund, or policy proceeds, vests in the beneficiary on the death of the insured.[13]

(C.C.A. 5th, 1936) 81 F. (2d) 800; Shay v. Merchant's Banking Trust Co., 335 Pa. 101, 6 A. (2d) 536 (1939). This theory is often criticized as being legally amiss for its failure to distinguish between an assignment and the appointment of a beneficiary, which are recognized as distinct powers by most policies. See 85 UNIV. PA. L. REV. 203 (1936), where the writer asserts that if there is a change of beneficiary to the extent of the assignee's claim, and the insured pays the debt during his lifetime, the estate of the insured would replace the assignee as beneficiary, thus requiring a re-designation of the original beneficiary.

[11] This is sometimes called the New Jersey view. The gist of this conception was stated in Sullivan v. Maroney, 76 N.J.Eq. 104 at 110, 73 A. 842 at 844 (1909): "I think it is entirely clear from the authorities that where a contract of insurance is made payable to certain beneficiaries, their interests therein can only be divested in favor of other beneficiaries by changing the contract in the manner in which the contract points out that it must be changed to effect that result." See Grismore, "The Assignment of a Life Insurance Policy," 42 MICH. L. REV. 789 at 800 (1944), where the author states that this view is in accord with fundamental legal concepts. It is there recognized that the use of insurance policies as collateral security is increasing rapidly, and the author suggests that the policies expressly provide the insured with power to transfer the beneficiary's interest without his consent, and without cumbersome formalities.

[12] Barbin v. Moore, 85 N.H. 362, 159 A. 409 (1932), noted in 32 COL. L. REV. 1071 (1932), where the court held that the beneficiaries were entitled, as against the creditors of the estate of the insured, to other security held by the assignee. See Douglass v. Equitable Life Assur. Society, 150 La. 519, 90 S. 834 (1922). But where the assignee is the insurer, subrogation is not allowed; the court considering the loan as an advance on the policy rather than a debt of the insured. Wagner v. Thieriot, 203 App. Div. 757, 197 N.Y.S. 560 (1922). See also, Walker v. Penick's Executor, 122 Va. 664, 95 S.E. 428 (1918). See Finegan v. Prudential Ins. Co. of America, 300 Mass. 147, 14 N.E. (2d) 172 (1938), to the effect that where the beneficiary joins in the original assignment, her interest cannot be affected by a subsequent agreement between the insured and the assignee.

[13] Katz v. Ohio National Bank, 127 Ohio St. 531, 191 N.E. 782 (1934); Farracy v. Perry, (Texas Civ. App. 1928) 12 S.W. (2d) 651; Russell v. Owen, 203 N.C. 262, 165 S.E. 687 (1932). It would seem to be inconsistent for the two theories which arrive at the same conclusion concerning the rights of the beneficiary against the assignee, to reach different results when considering the rights of the beneficiary against the estate of the insured. The result here seems to be inequitable where the beneficiary is a volunteer, for these cases grant him precedence over the creditors of the insured. See 11 N. C. L. REV. 169 at 171 (1933), where the writer states that the beneficiary's interest should be held to vest only in the difference between the

But jurisdictions regarding an assignment as equivalent to a change of beneficiary refuse subrogation on the theory that the beneficiary takes title only to the proceeds in excess of the assignee's claim.[14] It is impossible to know how the court in the principal case would have dealt with these difficulties had it decided the question of insurable interest according to the majority view. It is submitted, however, that none of the theories currently utilized by the courts for the solution of such problems would have reached a conclusion depriving the beneficiary of all right to the proceeds.

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policy proceeds and the assignee's claim. See Mutual Life Ins. Co. of N.Y. v. Ill. National Bank of Springfield, (D.C. Mich. 1940) 34 F. Supp. 206 and Froman v. Froman's Executor, 293 Ky. 1, 168 S.W. (2d) 361 (1943), where the intent of the insured is considered the primary factor in determining the question of subrogation. In Chamberlin v. First Trust & Deposit Co., 172 Misc. 472, 15 N.Y.S. (2d) 168 (1939), the executor paid the debt out of the general assets of the insured's estate, but was denied the right to be reimbursed out of the proceeds of the pledged insurance.

[14] Kash's Executor v. Kash, 260 Ky. 508, 86 S.W. (2d) 273 (1935); Baldwin v. Wheat. 170 Ga. 449, 153 S.E. 194 (1930). See Annotation on Subrogation in 83 A.L.R. 77 (1933). But where no subrogation is allowed, and other security is assigned as collateral without an agreement as to precedence, the beneficiary's interest may be subject to the caprice of the assignee. It probably may be presumed, however, that the assignee will utilize the most liquid security.