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Important Precedent for Issuers of Universal Life Insurance Policies in New York

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In 2020, BSF client Lincoln Life & Annuity Company of New York (LLANY) was hit with a first-of-its-kind class action lawsuit. Relying on a 100-year-old New York statute requiring the return of premiums paid for a period of insurance after the death of the insured, the plaintiff policyholder claimed he was entitled to a prorated refund of the "planned premium" he paid on his universal life insurance policy. The policyholder's argument was simple: he paid a yearly annual planned premium and the insured died before the year was over, so the insurer owed him a refund under New York Insurance Law § 3203(a)(2). If that theory held up, it could have been the next wave of policyholder litigation against life insurers in New York.

Before the suit had been brought, no federal or state court had ever considered whether the refund statute applied to universal life insurance policies, where the premiums do not pay for insurance coverage but instead fund a policy account from which monthly deductions are taken. Against this backdrop, BSF filed a motion to dismiss. As a result, there are now three decisions—from the Southern District of New York, the New York Court of Appeals on a certified question, and the Second Circuit—squarely rejecting the plaintiff's theory and stopping a potential wave of litigation in its tracks.

On August 8, 2024, BSF achieved a complete victory at the Second Circuit affirming the dismissal of claims against LLANY. The Second Circuit decision followed a unanimous New York Court of Appeals decision in LLANY's favor on a certified question of New York law to the Court of Appeals on a matter of first impression.

New York Insurance Law § 3203(a)(2) requires an insurer to refund a portion of a life insurance premium "if the death of the insured occurs during a period for which the premium has been paid." The plaintiff policyholder, who owned a universal life insurance policy, sued LLANY in the Southern District of New York, alleging that LLANY's failure to refund a portion of the "annual planned premium" paid during the year of the insured's death was a breach of contract. The plaintiff sought to represent a class of all New York policyholders who were allegedly entitled to a statutory refund.

The statute has been in the books for almost one hundred years, but prior to this suit, no court had ever addressed whether the refund provision applied to planned premiums under a universal life insurance policy. The statute contains two exceptions but neither involves universal life. BSF convinced the district court (Judge Cronan) on a motion to dismiss that "planned premiums" in a universal life policy are discretionary payments that do not actually pay for insurance coverage and thus do not trigger the refund provisions of the statute. The Second Circuit, focusing on the lack of any decisional law from any state or federal court, certified the question to the New York Court of Appeals.

The certified question was whether a planned premium of a universal life insurance policy constituted a "premium actually paid for any period" under § 3203(a)(2). If the answer were yes, the policy would have been entitled to a refund of approximately half of the planned premium paid in the year that the insured died. But the New York Court of Appeals agreed with the District Court that the refund provision of the statute does not apply to planned premiums in a universal life insurance policy.

The Court of Appeals recognized the important substantive difference between term and whole life insurance policies and universal life insurance policies. To maintain coverage under a term or whole life insurance policy, the policyholder must pay fixed, periodic premiums. By contrast, as stated by the Court of Appeals, "[a] universal life insurance policy does not have a fixed premium—instead, the policyholder can make a payment in any amount, at any time, subject to certain conditions specified in the policy." *Nitkewicz v. Lincoln Life & Ann. Co. of New York*, 40 N.Y.3d 349, 352 (2023). Those payments are deposited into a "cash value account," which earns interest and is administered by the insurer. The insurer deducts the cost of insurance ("COI") from that cash value account, "which varies from month to month based on variables including the insurer's total exposure, any administrative fees, and

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other required payments from the policy account." *Id.* Critically, "policyholders often choose—but are not required—to pay a 'planned premium,' which is a periodic payment often designed, but not guaranteed, to keep the policy in force." *Id.* Indeed, a policyholder's failure to pay a planned premium does not result in termination or lapse of the policy so long as the funds in the cash value account are sufficient to cover the deductions.

In this case, Plaintiff paid its last annual planned premium for the policy at issue on May 7, 2018. On October 6, 2018, the insured died. LLANY paid out the $1.5 million death benefit but declined to refund any portion of the planned premium from earlier that year. Plaintiff subsequently filed a putative class action suit against LLANY for breach of contract, alleging that its refusal to refund a prorated portion of the final year's planned premium violated § 3203(a)(2). BSF moved to dismiss the complaint for failure to state a claim. The District Court granted LLANY's motion, and Plaintiff appealed.

As noted by the Second Circuit in its opinion affirming the dismissal, "[t]he Court of Appeals held that planned premiums were not 'actually paid' for insurance under New York law because 'such payments would not necessarily keep the Policy from termination'; rather, 'it was defendant's monthly deductions that actually 'paid' for the insurance because those deductions kept the policy in force for another month.'" *Nitkewicz v. Lincoln Life & Ann. Co. of New York*, No. 21-1830-CV, 2024 WL 3708531, at *2 (2d Cir. 2024), quoting *40 N.Y.3d 349* at 356. Additionally, the Court of Appeals explained that planned premiums were not paid "for any period" beyond the end of the policy month in which the insured's death occurred, because "the amount of any given Planned Premium may or may not have been used to cover the monthly deductions." *40 N.Y.3d 349* at 356.

Notwithstanding the unanimous Court of Appeals decision answering the certified question in the negative, the plaintiff policyholder continued to argue that the planned premium qualifies for statutory refund because a no-lapse rider allegedly rendered his premium "actually paid." In supplemental briefing to the Second Circuit, LLANY argued that this potential backstop—which was never triggered—does not change the result. The Second Circuit ruled again in favor of BSF's client, affirming the District Court judgment, and holding that "the final Planned Premium does not qualify for a statutory refund even with the Coverage Protection Guarantee Rider." 2024 WL 3708531, at *2 (2d Cir. 2024)*

Before the New York Court of Appeals, the American Council of Life Insurers ("ACLI") filed an amicus brief in support of LLANY's interpretation of the statute. The ACLI explained that BSF's victory in the District Court is important to the insurance industry for a variety of reasons, including because Plaintiff's position would have increased the cost to most policyholders of universal life insurance policies in New York.

Thus, after a successful motion to dismiss and victories before both the New York Court of Appeals and the Second Circuit, it is now settled law that insurers in New York do not need to refund portions of planned premiums in universal life insurance policies under § 3203(a)(2).

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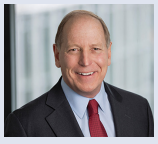

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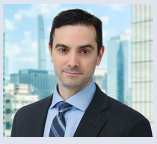

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