

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 501 Estates and Trusts
SPONSOR(S): Insurance, Business & Financial Affairs Policy Committee; Hukill
TIED BILLS: IDEN./SIM. BILLS: SB 926

Table with 4 columns: REFERENCE, ACTION, ANALYST, STAFF DIRECTOR. Row 1: Insurance, Business & Financial Affairs Policy Committee, 12 Y, 1 N, As CS, Reilly, Cooper.

SUMMARY ANALYSIS

An irrevocable life insurance trust (ILIT) is an estate planning tool that is used to exclude a life insurance policy from the insured's estate. With an ILIT, a trust owns the life insurance policy, which is payable to the trust upon the insured's death.

A trustee's duties are set forth in ch. 736, F.S. A trustee has a duty to administer the trust solely in the interests of the beneficiaries. A trustee is subject to the prudent investor rule, s. 518.11, F.S., and must invest and manage trust assets as a prudent investor would.

The bill creates s. 736.092, F.S., "Nonapplication of prudent investor rule." The section relieves trustees of ILITs from certain duties relating to life insurance policies insuring the life of a "qualified person," and exempts trustees from liability to trust beneficiaries for losses sustained as to these policies.

- To determine whether any life insurance contract is or remains a proper investment.
To investigate the financial strength of the life insurance company.
To determine whether to exercise any policy option available under the life insurance contract.
To diversify any life insurance contract or diversify the trust assets with respect to the life insurance contract.
To inquire about or investigate the health or financial condition of any insured.

When a qualified beneficiary objects in writing within 30 days, the trustee remains responsible for all duties listed in s. 736.092, F.S., except for determining whether the life insurance contract complies with insurable interest requirements, until the objection is withdrawn.

The bill also expands the list of investment functions that fiduciaries that administer life insurance contracts can delegate under s. 518.112, F.S., to include all duties specified in s. 736.092, F.S., and corrects inconsistencies in the notice provisions of the Prudent Investor Act, the Trust Code, and the Probate Code.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h0501a.IBFA.doc
DATE: 3/5/2010

## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

#### Trusts

A trust is generally defined as:

a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it....<sup>1</sup>

A valid trust involves specific property, reflects the settlor's intent, and is created for a lawful purpose.<sup>2</sup> There must be a trustee, a beneficiary, and trust property.<sup>3</sup> The Florida Trust Code, ch. 736, F.S., defines a "settlor" as a person who creates or contributes property to a trust, and includes a testator; a "beneficiary" as a person who has a present or future beneficial interest in a trust or who holds a power of appointment over trust property in a capacity other than trustee; and "trustee" as the original trustee, any additional trustee, any successor trustee, and any cotrustee.

#### Duties of Trustees

A trustee has a duty to administer the trust solely in the interests of the beneficiaries.<sup>4</sup> Specific duties include the duty of loyalty; to administer the trust impartially when there are multiple beneficiaries; to administer the trust prudently; to incur only reasonable expenses; and to use special skills.

As fiduciaries,<sup>5</sup> trustees are subject to the prudent investor rule, s. 518.11, F.S., which details a fiduciary's duty to invest and manage investment assets.<sup>6</sup> Briefly, the prudent investor rule requires a fiduciary to:

---

<sup>1</sup> 55A Fla. Jur. 2d Trusts s. 1.

<sup>2</sup> Black's Law Dictionary 1647 (9th ed. 2009).

<sup>3</sup> *Id.* at 1648, citing Restatement (Third) of Trusts s. 2 cmt. f (2003).

<sup>4</sup> See generally s. 736.0802(1), F.S.

<sup>5</sup> A fiduciary is defined as a person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor. See Black's Law Dictionary, *supra* note 2, at 702.

<sup>6</sup> See generally s. 518.11(1), F.S.

- Invest and manage investment assets as a prudent investor would.
- Diversify investments, unless it is reasonably believed that diversification is not in the beneficiary's interests and does not further the purposes of the trust.
- Review the investment portfolio within a reasonable time after acceptance of the trust, and make and implement decisions concerning preexisting investments.
- Pursue an investment strategy that considers both the reasonable production of income and safety of capital, consistent with the fiduciary's duty of impartiality and the purposes of the trust.

In making investment decisions, fiduciaries may consider factors such as general economic strategies, the role each investment plays within the overall portfolio, the expected total return, and the duty to incur only reasonable and appropriate costs. These decisions are to be judged in terms of the fiduciary's reasonable business judgment concerning the anticipated effect on the investment portfolio as a whole based on prevailing facts and circumstances at the time of the action or decision.

## Irrevocable Life Insurance Trusts

An irrevocable life insurance trust (ILIT) is a common estate planning tool that can be used to exclude a life insurance policy from an insured's estate for tax purposes. With an ILIT, a trust, rather than the insured, owns the life insurance policy, which is payable to the trust upon the insured's death.<sup>7</sup> The settlor of the trust selects the insurance company, the specific type of life insurance policy to be purchased, the trustee, the beneficiaries of the trust, and pays premiums for the policy through the trust.<sup>8</sup> An ILIT can be funded by the transfer of existing life insurance policies to the trust<sup>9</sup> or the trustee may apply for the policies as the original owner.<sup>10</sup> When the trustee applies for the policy, premiums are paid through the trust by funds provided by the settlor.

Pursuant to s. 518.112(2)(a), F.S., fiduciaries that administer insurance contracts on the lives of others are authorized to delegate certain investment functions with respect to these insurance contracts to an investment agent and do not have a continuing obligation to review the agent's actions. With respect to trusts, upon providing 30 days' written notice to trust beneficiaries eligible to receive distributions from the trust (or their legal representatives),<sup>11</sup> a trustee may delegate the responsibilities for:

- Determining whether any insurance contract is or remains a proper investment.
- Determining whether or not to exercise available policy options.
- Determining whether or not to diversify such contracts relative to one another or to other assets administered by the fiduciary.
- Inquiring about changes in the health or financial condition of the insured or insureds relative to any such contract.

## Life Insurance Policies Insuring a Person Other than the Owner

### Insurable Interest Requirement

A person with legal capacity may insure his/her life for the benefit of any other person. However, when a person seeks to insure the life of another person, benefits under the policy must be payable to the insured, the insured's personal representative, or a person with a sufficient interest, known as an

<sup>7</sup> 13 Brian V. McAvoy et al., *Florida Estate Planning* 463 (2007-08 ed.).

<sup>8</sup> Estate and Trust Tax Committee, Real Property, Probate and Trust Law Section of the Florida Bar, "Fiduciary Duties in Insurance Trusts" (2009). A copy of the white paper is on file with the Insurance, Business & Financial Affairs Policy Committee.

<sup>9</sup> When life insurance policies are transferred to an ILIT, the insured must live for at least three years after the transfer for the proceeds of any transferred policy to be excluded from the insured's estate. See McAvoy et al., *supra* note 7, at 464. See also 26 USC 2035.

<sup>10</sup> See McAvoy et al., *supra* note 7, at 463.

<sup>11</sup> Unless notice is waived by the beneficiaries.

“insurable interest,”<sup>12</sup> in the continued life or health of the insured. The insurable interest must exist at the time the contract is made, but can subsequently cease to exist without affecting the validity of the policy.<sup>13</sup> The insurable interest requirement prevents a person from purchasing a life insurance policy on the life of another when the only effect of the policy would be to enrich a beneficiary who is disinterested in the continued life or health of the insured; thus, creating an incentive for the beneficiary to bring about the demise of the insured. Such transactions are considered “wagering contracts,” and are void as contrary to public policy.<sup>14</sup>

Section 627.404, F.S., lists interests that create an insurable interest for purposes of life, health, and disability insurance policies. Among these,

- A trust, or the trustee of a trust, has an insurable interest in the life of an individual insured under a life insurance policy owned by the trust, or the trustee of the trust acting in a fiduciary capacity, if the insured is the grantor<sup>15</sup> of the trust; an individual closely related by blood or law to the grantor; or an individual in whom the grantor otherwise has an insurable interest, if... the life insurance proceeds are primarily for the benefit of trust beneficiaries having an insurable interest in the life of the insured.
- A guardian, trustee, or other fiduciary, acting in a fiduciary capacity, has an insurable interest in the life of any person for whose benefit the fiduciary holds property, and in the life of any other individual in whose life the person has an insurable interest so long as the life insurance proceeds are primarily for the benefit of persons having an insurable interest in the life of the insured.

Individuals also have an insurable interest in themselves; in close family members in whom they have a substantial interest engendered by love and affection; and in another person if there is the expectation of a substantial pecuniary advantage in the continued life, health and safety of that other person or that the individual will have a substantial pecuniary loss upon the death, illness or disability of that other person. Parties to the contract for the purchase or sale of a business entity have an insurable interest in the lives of other parties to the contract solely for purposes of the contract. Charitable organizations have an insurable interest in the life of any person who consents in writing to the organization’s ownership or purchase of insurance on that person, and employee benefit and retirement plans have an insurable interest in the life of any plan participant who consents in writing to issuance of a policy insuring that participant. Business entities have an insurable interest in owners of the business and key employees if the person’s written consent is obtained before the insurance is purchased.

### Stranger-Originated Life Insurance (STOLI) Policies<sup>16</sup>

In a STOLI transaction, a person with no insurable interest in another persuades the other person (generally a senior citizen) to obtain life insurance with the understanding that after a certain time the insured will sell the policy to the stranger. In Florida, STOLI promoters generally wait two years before selling the policy in the secondary market.<sup>17</sup> Typically, STOLI promoters and investors will establish an irrevocable trust to obtain a premium finance loan, obtain an insurance policy on the senior citizen, and

---

<sup>12</sup>A detailed history of the insurable interest requirement is provided in the Florida Office of Insurance Regulation’s report, “Stranger-Originated Life Insurance (‘STOLI’) and the Use of Fraudulent Activity to Circumvent the Intent of Florida’s Insurable Interest Law” (January 2009). Available at: <http://www.floir.com> (last accessed February 8, 2010).

<sup>13</sup> Accordingly, viatical settlement transactions are permissible. In these transactions, a person who has purchased life insurance in good faith as life insurance, with no prearrangement to sell the policy to another, later decides to sell the policy to another for less than the expected death benefit under the policy.

<sup>14</sup> Florida Office of Insurance Regulation, *supra* note 12, at 7.

<sup>15</sup> Grantor is defined in s. 731.201(19), F.S., as one who creates or adds to a trust, and includes “settlor” or “trustor” and a testator who creates or adds to a trust.

<sup>16</sup> Florida Office of Insurance Regulation, *supra* note 12, at 12.

<sup>17</sup> Section 626.99287, F.S. provides that viatical settlement contracts entered into within two years of when the insurance policy was issued are void and unenforceable by either party (subject to certain exemptions).

pay the life insurance policy premiums for two years. Additionally, the person to be insured may be offered a significant cash payment when they allow the policy to be sold to a viatical settlement provider.

The Office of Insurance Regulation (OIR) held a public informational hearing on STOLIs on August 28, 2008 and issued its report in January 2009.<sup>18</sup> Based on the testimony presented at the hearing, the OIR reported that STOLI transactions may involve varying degrees of insurance fraud and the violation of laws that were intended to protect consumers. Further, STOLI transactions were found to harm senior consumers<sup>19</sup> as follows:

- Seniors may exhaust their life insurance purchasing capability.
- The incentives used to lure seniors to participate in STOLI schemes are taxable as ordinary income.
- Seniors may subject themselves or their estates to potential liability if the life insurance policy is rescinded by an insurer who discovers fraud.
- Seniors may encounter unexpected tax liability from the sale of the life insurance policy.
- The premiums paid by the promoters, which may be represented as providing the senior with “free” insurance, may subject the senior to tax based on the economic value of the coverage.
- Seniors have to give the purchaser, and subsequent purchasers, access to their medical records when they sell their life insurance policy in the secondary market.
- STOLIs may lead to an increase in insurance rates for the over 65 population.

## Effect of the Bill

The bill creates s. 736.092, F.S., of the Florida Trust Code, “Nonapplication of prudent investor rule.” The section relieves trustees of ILITs from certain duties relating to life insurance policies acquired or retained by the trust that insure the life of a “qualified person,”<sup>20</sup> and exempts trustees from liability to trust beneficiaries and others for losses sustained with respect to life insurance policies to which the section applies. Specifically, unless otherwise provided in the trust instrument, when the insured or proposed insured or that person’s spouse has provided the trustee with funds that are used to acquire or pay premiums for life insurance policies that insure such person and/or their spouse, the trustee does not have a duty to determine whether the life insurance contract is/was procured or effected in compliance with insurable interest law.

Further, if the trust instrument, by reference, makes s. 736.092, F.S., applicable to these life insurance contracts or the trustee provides notice to qualified beneficiaries<sup>21</sup> (or their representatives) of the section’s applicability, the trustee may also be relieved of the following duties, unless the trust provides otherwise:

- To determine whether any life insurance contract is or remains a proper investment.
- To investigate the financial strength of the life insurance company.
- To determine whether to exercise any policy option available under the life insurance contract.
- To diversify any such life insurance contract or diversify the trust assets with respect to the life insurance contract.
- To inquire about or investigate the health or financial condition of any insured or insureds.

---

<sup>18</sup> Florida Office of Insurance Regulation, *supra* note 12.

<sup>19</sup> 17.6% of Floridians are 65 years of age or older. See U.S. Census Bureau, “The 65 Years and Over Population; 2000,” Census 2000 Brief, issued October 2001. Found at: <http://www.census.gov> (last accessed February 11, 2010).

<sup>20</sup> A “qualified person” is a person who is either insured or a proposed insured, or the spouse of that person, who has provided the trustee with funds that are used to acquire or pay premiums with respect to a policy of insurance on the life of that person or the spouse of that person, or on the lives of that person and the spouse of that person.

<sup>21</sup> A “qualified beneficiary” is a living beneficiary who, on the date the beneficiary’s qualification is determined: (a) Is a distributee or permissible distributee of trust income or principal; (b) Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in paragraph (a) terminated on that date without causing the trust to terminate; or (c) Would be a distributee or permissible distributee of trust income or principal if the trust terminated in accordance with its terms on that date. See s. 736.0103(14), F.S.

Notice must be provided pursuant to s. 736.0109, F.S. (which permits notice to be sent by first-class mail, personal delivery, delivery to the person's last known place of residence or place of business, or a properly directed facsimile or other electronic message, among other means). The bill also creates a rebuttable presumption that notice sent by United States mail is received 3 days after it has been mailed with proper postage.

If a qualified beneficiary (or their representative) objects in writing within 30 days of receiving notice, the trustee remains responsible for all duties listed in s. 736.092, F.S., except for determining whether the life insurance contract is/was procured or effected in compliance with insurable interest law, until the objection is withdrawn.

Section 736.092, F.S., does not apply to any life insurance policy purchased from an affiliate of the trustee<sup>22</sup> or from which the trustee or an affiliate receives any commission, unless the trustee's duties have been delegated to another person in accordance with s. 518.112, F.S. Additionally, a trustee remains responsible for determining whether he/she has an insurable interest in a life insurance policy insuring a qualified person if the trustee purchases or accepts ownership of the policy with knowledge that insurable interest standards have been violated.

The bill also expands the list of investment functions that fiduciaries that administer life insurance contracts on the lives of others are authorized to delegate to an investment agent under s. 518.112, F.S., without a continuing obligation to review the investment agent's actions. The bill includes as delegable investment functions responsibility for determining whether the insurance contract was procured or effected in compliance with s. 627.404, F.S., the insurable interest statute, and for investigating the financial strength of the life insurance company. Thus, all duties from which a trustee may be relieved under s. 736.092, F.S., are also delegable under s. 518.112, F.S. Additionally, the notice provisions of s. 518.112, F.S. have been amended to eliminate inconsistencies in existing law and to require fiduciaries to provide written notice of their intention to begin delegating investment functions as provided in part III of ch. 731, F.S., as to estates and in accordance with s. 736.0109, F.S., and part III of ch. 736, F.S., as to trusts.

#### B. SECTION DIRECTORY:

**Section 1.** Amends s. 518.112, F.S., to expand the list of investment functions that may be delegated by fiduciaries.

**Section 2.** Creates s. 736.092, F.S., "Nonapplication of prudent investor rule."

**Section 3.** Provides for the bill to take effect upon becoming law.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

#### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

---

<sup>22</sup> Under the bill, an "affiliate" of the trustee is defined as any person who controls, is controlled by, or is under common control with the trustee.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

To the extent that the bill encourages the formation of trusts in Florida, it may have a positive financial impact.

D. FISCAL COMMENTS:

None.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to spend funds or take an action requiring the expenditure of funds. The bill does not reduce the percentage of a state tax shared with counties or municipalities. The bill does not reduce the authority that municipalities have to raise revenue.

2. Other:

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

### IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES

On March 3, 2010, the Insurance, Business & Financial Affairs Policy Committee adopted five amendments, which made the following changes:

- Amends the bill title to read “an act relating to estates and trusts.”
- Clarifies the scope of a trustee’s authority to delegate responsibility for determining whether a life insurance policy complies with insurable interest requirements by making specific reference to the insurable interest statute, s. 627.404, F.S.
- Clarifies a provision that relieves a trustee of the duty to determine whether he/she has an insurable interest in a life insurance policy insuring a “qualified person” by making specific reference to the insurable interest statute, s. 627.404, F.S.
- Expands the definition of “qualified person” to include a proposed insured.
- Provides that a trustee remains responsible for determining whether he/she has an insurable interest in a life insurance policy insuring a qualified person, if the trustee purchases or accepts ownership of the life insurance policy with knowledge that insurable interest standards have been violated.