

**The Florida Senate**  
**BILL ANALYSIS AND FISCAL IMPACT STATEMENT**

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Banking and Insurance Committee

BILL: CS/SB 926

INTRODUCER: Senator Richter

SUBJECT: Trusts

DATE: March 10, 2010      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Messer	Burgess	BI	Fav/CS
2.			JU	
3.				
4.				
5.				
6.				

**Please see Section VIII. for Additional Information:**

- |                              |                                     |   |
|------------------------------|-------------------------------------|---|
| A. COMMITTEE SUBSTITUTE..... | <input checked="" type="checkbox"/> | Statement of Substantial Changes        |
| B. AMENDMENTS.....           | <input type="checkbox"/>            | Technical amendments were recommended   |
|                              | <input type="checkbox"/>            | Amendments were recommended             |
|                              | <input type="checkbox"/>            | Significant amendments were recommended |

**I. Summary:**

An Irrevocable Life Insurance Trust (“ILIT”) is a trust created for the primary purpose of purchasing and maintaining life insurance. The ILIT purchases insurance on the life of the trust’s creator, and at his death the payout passes directly to the ILIT, avoiding estate taxes. Since the creator of the trust chooses the insurance carrier, the policy, and whether to continue to pay premiums on the policy, it is unnecessary to charge the trustee with the duty to determine the appropriateness of those decisions. This bill provides that in the absence of contrary language in the governing ILIT instrument, a trustee does not have a duty to determine whether a life insurance policy owned by the trust is an appropriate investment. This change will only apply when the insured or the insured's spouse provides the funds to purchase the policy.

This bill substantially amends s. 518.112, F.S., and creates s. 736.0902, F.S.

## II. Present Situation:

### The Duties of a Trustee

A trust is an arrangement whereby property is held and managed by a person (or legal entity) for the benefit of another. A settlor is the person or entity that creates the trust by entrusting property to a "trustee." The trustee holds legal title to the trust property but he is obligated to hold the property for the benefit of one or more individuals or entities, known as the beneficiaries. Because of the considerable power given to the trustee, part VIII of the Florida Trust Code requires trustees to uphold certain duties, including: the duty of loyalty, the duty of impartiality, the duty of prudent administration, the duty to inform and account, and the duty to distribute trust income.

### Irrevocable Life Insurance Trusts

An irrevocable life insurance trust ("ILIT") is an irrevocable trust that is both the owner and the beneficiary of one or more life insurance policies.<sup>1</sup> Immediately upon the death of the insured, the ILIT becomes the owner of the insurance proceeds. The trustee is responsible for investing these proceeds and administering the trust for the benefit of the trust beneficiaries. An ILIT, like other irrevocable trusts, cannot be rescinded or modified after it is created. Once the grantor contributes property to the trust, he cannot later reclaim ownership of the property or change the terms of the trust.

The purpose for creating an ILIT is to avoid estate taxes. In the absence of a trust, life insurance proceeds pass to the beneficiaries income tax free, however they are generally subject to estate taxes. If an ILIT is properly structured, the death benefits paid to the trust will be free from inclusion in the gross estate of the insured; this occurs because by funneling the insurance proceeds through a trust at the moment of death, the insurance proceeds are never the property of the deceased and avoid ever becoming a part of the deceased's estate. Avoiding the deceased's estate creates a scenario where estate taxes are never levied on the insurance proceeds. This is a major benefit for wealthy estates where the estate tax can be as high as 45% in 2010.<sup>2</sup>

### Duty to Determine Insurable Interest

It is a basic tenant of life insurance that the purchaser of a policy must have an interest in the life being insured; Florida has adopted this principle.<sup>3</sup> This requirement is designed to combat the moral hazard that occurs if a person receives monetary payment and suffers no harm upon the death or injury of another party. If a policyholder stood only to gain by the death of the insured then the policyholder may be tempted to bring about the demise of the insured.

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<sup>1</sup> Blacks Law Dictionary 8<sup>th</sup> ed., page 1549.

<sup>2</sup> Rosenberg, Eva, *Beating the Estate Tax*, available at <http://www.marketwatch.com/story/estate-tax-will-rise-from-the-dead-in-2010-2009-12-18>, last visited on March 7, 2010.

<sup>3</sup> *Life Insurance Company of Georgia v. Lopez*, 443 So.2d 947 at 948 (1983), rehearing denied. noting that the Florida Supreme Court has stated: "Florida law prohibits issuance of an insurance policy to one who has no insurable interest in the thing insured."

An insurable interest exists for purposes of life insurance when, at the time the policy is entered into, the policyholder has a reasonable expectation that he or she will benefit from the continued life and health of the person the policy covers. The benefit is required to be either one of love and affection due to the relationship the policyholder has to the insured, or a pecuniary benefit such that the policyholder benefits financially from the continued life and health of the insured. Additionally, the insured must consent in order for the life insurance policy to be purchased.

In 2008, Senate Bill 648 created s. 627.404, F.S., which provides that an insurance policy purchased by a trustee is invalid unless the proceeds of the policy are primarily for the benefit of persons who have an “insurable interest” (i.e. family or pecuniary relationship) with the insured.<sup>4</sup> This provision prevents Stranger Oriented Life Insurance (STOLI) transactions. STOLIs are arrangements where investors pay elderly individuals to purchase life insurance policies and name the investor as the beneficiary. These transactions are illegal and they create a public policy concern because they are essentially gambling transactions placed on human life.

In the case of an ILIT, it is most often the trust settlor, not the trustee, who selects the insurance policy, names the beneficiaries and provides the funds to pay the life insurance premiums. These choices are often made before the trust is created. Section 518.11(d), F.S., known as the prudent investor provision, currently imposes on trustees a duty to “within a reasonable time after acceptance of the trust. . . review the investment portfolio and to make and implement decisions concerning the retention and disposition of original preexisting investments. . . .” Based on this requirement, some beneficiaries are able to sue a trustee if a life insurance policy that the trust owns was not initially written pursuant to s. 627.404, F.S. These suits may be brought effectively regardless of whether the trust was in existence at the inception of the policy, or whether the trustee had any involvement in the initiation of the policy. Imposing upon the trustee of an ILIT the duty to review the appropriateness of these decisions is considered by many to be impractical.

A federal district court case, *Chawla v. Transamerica Occidental Life Insurance Company*,<sup>5</sup> has caused concern as to whether the trustee of an irrevocable life insurance trust has an insurable interest in the life of the trust grantor and thus can collect the proceeds of the life insurance policy for distribution to beneficiaries. In *Chawla*, the issue was whether a life insurance policy could be validly purchased by a trust when the beneficiary of the policy did not have an insurable interest in the life that the policy was being written on. The insurance company that sold the policy refused to pay its proceeds to the trust because, the insurer argued, the trust did not have an insurable interest in the insured. On appeal, the U.S. Fourth Circuit Court of Appeals determined that the case could have been decided on a separate issue and vacated that portion of the district court opinion dealing with the insurable interest issue. However, life insurers and estate planners remain concerned given the lack of clarity under current Florida law.

### III. Effect of Proposed Changes:

This bill creates s. 736.0902, F.S., which provides that in the absence of contrary language in the governing ILIT instrument, a trustee does not have a duty to determine whether the trust has an

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<sup>4</sup> Section 1, ch. 2008-36, L.O.F.

<sup>5</sup> *Chawla ex rel. Giesinger v. Transamerica Occidental Life Ins. Co.*, Not Reported in F.Supp.2d, 2005 WL 405405, E.D.Va.,2005. 2005 WL 405405 (E.D. Va. 2005), *aff'd in part, vac'd in part*, 440 F3d 639 (4th Cir. 2006).

insurable interest in the life of the insured where the insured or the insured's spouse provides funds to purchase the policy. This provision does not apply in three situations: 1) when the trustee has knowledge that the life insurance beneficiary, at the time of the policy's origin, lacked an insurable interest in the insured, 2) when a beneficiary objects to the application of this statute, and 3) when the life insurance policy was purchased from an affiliate of the trustee or from an individual or entity from which the trustee or an affiliate receives a commission.

**Section one:** eliminates the application of the Prudent Investor Rule and the Prudent Trust Administration Rule<sup>6</sup> when a trustee is determining the appropriateness of a life insurance policy that was written on the settlor's life and purchased by either the settlor or the settlor's spouse. This provision eliminates the application of the Florida insurable interest statute as it applies to life insurance trusts. The insurable interest statute was substantially rewritten by the 2008 Legislature and eliminating the application of this statute, in any situation, may allow a trustee to lawfully participate in the issuance of STOLI transactions. However, the bill provides that if the trustee has knowledge that the policy is a product of a STOLI transaction then the protections of this bill will not apply.

In order for the provisions of this section to apply, this section provides that all beneficiaries of a trust must be notified of the applicability of this section. If any beneficiary objects to the application of this section then the insurable interest statute is still applicable and the trustee is required to abide by the Prudent Investor Rule and the Prudent Trust Administration Rule.

**Section two:** In situations where a trustee must still determine the appropriateness of a life insurance policy, or determine whether an insurable interest exists, this section permits a trustee to delegate the duty to make such determinations. This section also implements formal written notice requirements, taken from the Florida Trust and Probate Codes, that must be complied with in order to inform the beneficiaries when a fiduciary's duty is delegated.

#### IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

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<sup>6</sup> These rules are found in ss. 518.11 and 736.804, F.S., respectively.

**V. Fiscal Impact Statement:**

## A. Tax/Fee Issues:

None.

## B. Private Sector Impact:

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Additional Information:**A. Committee Substitute – Statement of Substantial Changes:  
(Summarizing differences between the Committee Substitute and the prior version of the bill.)**CS by Banking and Insurance on March 10, 2010:**

This committee substitute deletes lines 30-95 and makes the following changes:

- Provides technical changes to become more precise with respect to defining the scope of the relief to trustees by referring to the actual insurable interest statute rather than using the more generic term "insurable interest."
- Adds a proposed insured to the definition of "qualified person" in order to protect the trustee from liability in situations where the life insurance policy was not purchased until after the creation of the trust.
- Removes the trustee protections in the bill from situations where the trustee has knowledge of a violation of s. 627.404, F.S.

## B. Amendments: