

**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 Judiciary Committee

BILL: CS/CS/SB 926

INTRODUCER: Judiciary Committee, Banking and Insurance Committee, and Senator Richter

SUBJECT: Trusts

DATE: March 29, 2010                      REVISED: \_\_\_\_\_

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

<b>Please see Section VIII. for Additional Information:</b>	
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:**

This bill eliminates the application of the Prudent Investor Rule and the Prudent Trust Administration Rule with respect to a contract for life insurance acquired or retained on the life of a qualified person. The bill removes certain duties from the trustee in specified situations, provides that a trustee is not allowed to receive compensation for performing certain services, and eliminates liability of the trustee to the beneficiaries for a loss sustained with respect to certain life insurance contracts.

The bill also adds additional duties that a trustee may delegate to an investment agent.

This bill substantially amends section 518.112, Florida Statutes. The bill creates section 736.0902, Florida Statutes.

## II. Present Situation:

A trust is “property interest held by one person (the trustee) at the request of another (the settlor) for the benefit of a third party (the beneficiary).”<sup>1</sup> 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 the trustee is obligated to hold the property for the benefit of one or more individuals or entities, known as the beneficiaries.

### Irrevocable Life Insurance Trusts

An irrevocable life insurance trust (ILIT) is an irrevocable trust that consists of one or more life insurance policies payable to the trust when the insured dies.<sup>2</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.<sup>3</sup> Once the grantor contributes property to the trust, he cannot later reclaim ownership of the property or change the terms of the trust.

Many people create an ILIT to avoid paying estate taxes. In the absence of a trust, life insurance proceeds pass income tax free to the beneficiaries, but 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.<sup>4</sup> 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 percent<sup>5</sup> and with the uncertainty of future estate or gift tax laws.<sup>6</sup>

### Duties of a Trustee

Because of the considerable power given to the trustee, the Florida Trust Code requires trustees to uphold certain duties, including: the duty to administer the trust, the duty of loyalty, the duty of impartiality, the duty of prudent administration, the duty to ascertain marketable title of trust real property, the duty to inform and account, and the duty to distribute trust income.<sup>7</sup>

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, F.S., known as the prudent

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<sup>1</sup> BLACK’S LAW DICTIONARY (8th ed. 2004).

<sup>2</sup> *Id.* (see definitions for both “irrevocable trust” and “life-insurance trust”).

<sup>3</sup> James C. Shanley, *The Risks and How to Minimize Them*, 87 Ill. B.J. 569, 573 (2009).

<sup>4</sup> Paul S. Labiner and Seth R. Kaplin, *Qualified Retirement Plans, Trusts, and Life Insurance: The Formula for Creative Estate Planning*, 69 FLA. BAR J. 33 (Mar. 1995).

<sup>5</sup> Eva Rosenberg, *Beating the Estate Tax to Death*, Wall Street Journal (Dec. 18, 2009), available at <http://www.marketwatch.com/story/estate-tax-will-rise-from-the-dead-in-2010-2009-12-18> (last visited Mar. 23, 2010).

<sup>6</sup> Norma Stanley, *Strategies for Estates and Trusts in Florida Leading Lawyers on Monitoring Current Trends, Preventing Litigation, and Determining the Best Estate Planning Strategy*, 2009 WL 4864279, \*12 (2009).

<sup>7</sup> See part VIII, ch. 736, F.S.

investor rule, currently imposes a duty on trustees 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.”<sup>8</sup> 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.

Section 518.112, F.S., authorizes the trustee of an ILIT to delegate some responsibilities for life insurance held as an asset of the trust. After giving 30 days’ notice to the beneficiaries, the trustee may delegate to an agent the responsibility for:

- Determining whether any insurance contract is or remains a proper investment;
- Exercising policy options;
- Determining whether or not to diversify; and
- Inquiring about changes in the health or financial condition of the insured.

### **Duty to Determine Insurable Interest<sup>9</sup>**

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>10</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, or upon the destruction or damage of a piece of property. Thus, a person cannot purchase a life insurance policy on another person if the other person’s death will only have the effect of enriching the policyholder, because the policyholder may be tempted to bring about the demise of the 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.

Section 627.404, F.S., is the only statute dealing with insurable interests related to life insurance. Prior to 2008, the statute only had two provisions: one that provides that an insurer is entitled to rely on the statements made by an applicant related to whether the applicant has an insurable interest in the insured, and the other provision allows charitable organizations meeting certain requirements of the Internal Revenue Code to own or purchase life insurance on an insured who consents in writing to the purchase of the insurance. In 2008, the Legislature amended

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<sup>8</sup> Section 518.11(1)(d), F.S.

<sup>9</sup> The information contained in this portion of the Present Situation of this bill analysis is from the analysis for CS/SB 648 by the Senate Committee on Judiciary (Mar. 24, 2008), available at <http://www.flsenate.gov/data/session/2008/Senate/bills/analysis/pdf/2008s0648.ju.pdf> (last visited Mar. 23, 2010).

<sup>10</sup> *Life Ins. Co. of Georgia v. Lopez*, 443 So. 2d 947, 948 (Fla. 1983).

s. 627.404, F.S., to provide 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” with the insured.<sup>11</sup> An insurable interest exists in and insurance may be purchased on:

- Yourself;
- Family members and loved ones;
- Others if their health and life is of substantial benefit to you financially;
- Other parties to a contract for the sale of a business;
- Grantors of trusts, their relations, and others;
- Beneficiaries;
- Persons who consent in writing to a charity;
- Participants in a retirement or deferred compensation plan who consent in writing; and
- Owners, directors, officers, partners, managers, and key employees of a business.<sup>12</sup>

Section 627.404, F.S., prevents Stranger Oriented Life Insurance (SOLI) transactions. SOLIs are arrangements where investors pay elderly individuals to purchase life insurance policies and name the investor as the beneficiary.<sup>13</sup> These transactions are illegal and they create a public policy concern because they are essentially gambling transactions placed on human life.

A federal district court case, *Chawla v. Transamerica Occidental Life Insurance Company*,<sup>14</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*, Mrs. Chawla and her friend Mr. Giesinger sought to purchase a life insurance policy on Mr. Giesinger’s life with Mrs. Chawla as the beneficiary. However, the insurable interest statute in Maryland prevented that (she was not related to Mr. Giesinger, nor could she expect a financial benefit from his continued life). As a means of circumventing the insurable interest law, Mrs. Chawla and the patient agreed to create a revocable trust with the two of them serving as co-trustees. The plan was that the trust would own the life insurance policy (Mrs. Chawla, not Mr. Giesinger, applied for the policy). Mr. Giesinger would be the beneficiary of the trust as long as he lived, and Mrs. Chawla would be the beneficiary upon his death. The trust owned and was the beneficiary of the life insurance policy, with Mrs. Chawla the trust beneficiary after the patient’s death. The insurance company that sold the policy refused to pay its proceeds to the trust, and the court agreed, saying that a trust did not have an insurable interest under Maryland law because it did not have a familial relationship to the insured, nor would it gain from the insured’s continued life. 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 insurance interest issue. However, life insurers and estate planners remain concerned given the lack of clarity under current Florida law.

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<sup>11</sup> Chapter 2008-36, s. 1, Laws of Fla.

<sup>12</sup> See s. 627.404(2)(b), F.S.

<sup>13</sup> See generally, Shanley, *supra* note 5 at 569, n.1.

<sup>14</sup> *Chawla v. Transamerica Occidental Life Ins. Co.*, 2005 WL 405405 (E.D. Va. 2005), *aff’d in part, vac’d in part*, 440 F.3d 639 (4th Cir. 2006).

### III. Effect of Proposed Changes:

This bill creates s. 736.0902, F.S., which eliminates the application of the Prudent Investor Rule<sup>15</sup> and the Prudent Trust Administration Rule<sup>16</sup> with respect to a contract for life insurance acquired or retained on the life of a qualified person. The bill provides that a trustee does not have a duty to:

- Determine whether the contract of life insurance is or was procured or affected in compliance with Florida's insurable interest provisions;
- Determine whether any contract of life insurance is, or remains, a proper investment;
- Investigate the financial strength of the life insurance company;
- Determine whether to exercise any policy option available under the contract for life insurance;
- Diversify any such contract for life insurance or the assets of the trust with respect to the contract for life insurance; or
- Inquire about or investigate the health or financial condition of any insureds.

If a trustee is performing fiduciary or advisory services related to a policy where the trustee has been relieved of performing the above duties, then the bill provides that the trustee is not allowed to receive compensation for those services.

The bill defines a "qualified person" as someone who is insured or a proposed insured, or the spouse of that person, who has provided the trustee with the funds 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.

The bill eliminates liability of the trustee to the beneficiaries of the trust or any other person for any loss sustained with respect to a contract for life insurance to which this section applies.

In the absence of contrary language in the governing Irrevocable Life Insurance Trust (ILIT)<sup>17</sup> instrument, a trustee does not have a duty to determine whether the contract remains a proper investment, investigate the financial strength of the contract, determine whether to exercise policy options, diversity, or inquire about the health or financial condition of the insureds if:

- The trust instrument makes newly created s. 736.0902, F.S., applicable to contracts for life insurance held by the trust; or
- The trustee gives notice that this section applies to a contract for life insurance held by the trust.

Notice of the application of s. 736.0902, F.S., must be given to the beneficiaries and must contain a copy of the statutory language. The bill provides options for how notice may be given.

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<sup>15</sup> Section 518.11, F.S.

<sup>16</sup> Section 736.0804, F.S.

<sup>17</sup> Although the bill governs any life insurance owned by an irrevocable trust, 99 percent of the time it will be an ILIT. E-mail from Martha Edenfield, Real Property, Probate, and Trust Law Section of The Florida Bar, to professional staff of the Senate Committee on Judiciary (Mar. 24, 2010) (on file with the Senate Committee on Judiciary).

If any person objects in writing to the application of s. 736.0902, F.S., within 30 days after the date that the objector received the notice, then certain provisions of the bill do not apply (specifically, a trustee would still be required to abide by the Prudent Investor Rule and the Prudent Trust Administration Rule).

The bill creates a rebuttable presumption that any notice sent by United States mail is received three days after depositing the notice in the mail system.

Section 736.0902, F.S., created by the bill, does not apply to any contract for life insurance purchased from an affiliate of the trustee, unless duties have been delegated to another person under s. 518.112, F.S. The bill defines an “affiliate” as a “person who controls, is controlled by, or is under common control with the trustee.”

Additionally, the bill provides that the provision that a trustee does not have a duty to determine whether the trust has an insurable interest does not apply if the trustee had knowledge that:

- The benefits were not payable to a person specified in s. 627.404, F.S., when the contract was issued; or
- The contract for life insurance is or was purchased with resources or guarantees directly or indirectly provided by a person who, at the time of the inception of the contract, did not have an insurable interest, and at the time of the inception of the contract, there is a verbal or written arrangement, agreement, or plan with a third party to transfer ownership of the policy in a manner that would be in violation of state law.

Finally, the bill amends s. 518.112, F.S., to include the following among the duties that a trustee may delegate:

- A determination of whether the insurance contract was procured or effected in compliance with s. 627.404, F.S., relating to insurable interests; and
- The investigation of the financial strength of the life insurance company.

The bill also amends the notice provisions of s. 518.112, F.S., by implementing formal written notice requirements, taken from the Florida Trust Code and Florida Probate Code, which must be complied with in order to inform the beneficiaries when a fiduciary’s duty is delegated.

The effective date of the bill is July 1, 2010.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

None.

##### **B. Public Records/Open Meetings Issues:**

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Article I, section 21 of the Florida Constitution provides that “[t]he courts shall be open to every person for redress of any injury, and justice shall be administered without sale, denial, or delay.” The test for assuring the right of access to the courts was established in *Kluger v. White*, in which the Florida Supreme Court held that:

Where a right of access to the courts for redress for a particular injury has been provided by statutory law predating the adoption of the Declaration of Rights of the Constitution of the State of Florida, or where such right has become a part of the common law of the State pursuant to Fla. Stat. s. 2.01, F.S.A., the Legislature is without power to abolish such a right without providing a reasonable alternative to protect the rights of the people of the State to redress for injuries, unless the Legislature can show an overpowering public necessity for the abolishment of such right, and no alternative method of meeting such public necessity can be shown.<sup>18</sup>

Because the bill provides trustees with immunity from liability in situations where the newly created s. 736.0902, F.S., applies, it raises questions about possible infringements on the right of access to the courts. A beneficiary of a trust may argue that the limitation denies the person of his or her access to courts. To the extent that such a tort action may be pursued under Florida law, the immunity provision would have to meet the constitutional test established in *Kluger v. White*. The Legislature would have to: (1) provide a reasonable alternative remedy or commensurate benefit, or (2) make a legislative showing of overpowering public necessity for the abolishment of the right and no alternative method of meeting such public necessity.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

None.

C. Government Sector Impact

None.

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<sup>18</sup> *Kluger v. White*, 281 So. 2d 1, 4 (1973).

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

The insurable interest statute, s. 627.404, F.S., was substantially rewritten in 2008 and eliminating the application of it may allow a trustee to lawfully participate in the issuance of Stranger Oriented Life Insurance (SOLI) transactions. However, the bill provides that if the trustee has knowledge that the policy is a product of a SOLI transaction, then the protections of this bill will not apply.

**VIII. Additional Information:**

- A. **Committee Substitute – Statement of Substantial Changes:**  
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**CS/CS by Judiciary on March 26, 2010:**

The committee substitute prohibits the compensation of a trustee for performing fiduciary or advisory services related to a life insurance policy for which the trustee has been relieved of performing certain duties.

**CS by Banking and Insurance on March 10, 2010:**

The committee substitute deletes lines 30-95 of the original bill 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:**

None.