

# **Fiduciary Duties in Insurance Trusts**

## **WHITE PAPER**

### **PROPOSED NEW FLORIDA STATUTE 736.0902**

Estate and Trust Tax Committee  
Real Property, Probate and Trust Law Section

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#### **I. SUMMARY**

The purpose of the proposed addition of new section 736.0920 F.S. to the Florida Statutes, to be titled "Prudent Investor Rule Not to Apply," is to relieve the trustee of an Irrevocable Life Insurance Trust (ILIT) from a duty to determine whether decisions made by the Settlor in the selection of a life insurance company, a particular type of life insurance policy, and the continuing payment of policy premiums from funds provided by the Settlor, are appropriate investments and in the best interest of the beneficiaries.

#### **II. CURRENT SITUATION**

The settlor of an ILIT selects the insurer and the applicable policy. The trustee has a continuing duty to the beneficiaries to make certain that the insurance company is financially sound and the policy is still a prudent and viable investment. However, it is the settlor who makes the initial choice of the insurer and the policy, and the one who contributes the funds to pay the annual premiums. It is also the settlor who chooses the trustee and with whom he/she has a client relationship.

Presently, s. 518.112 F.S. permits 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 monitoring the insurer and the policy, exercising policy options, tracking the health of the insured, and diversifying the investment. However, it is not appropriate to hold the trustee responsible for decisions made by the settlor, nor practical for the trustee to follow the formal delegation and notice procedure required by the statute in the following two activities: 1) the determination that an insurable interest exists in the policy, 2) selection by the settlor of the insurer or the policy upon creation of the trust, and 3) paying annual premiums from funds provided by the settlor.

Pursuant to s. 627.404 F.S., 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. close relationship) with the insured. However the trust settlor, not the trustee, selects the policy, selects the trustee, names the beneficiaries of the trust and provides the funds to pay the premiums. These choices are often made before the trust is created. The settlor then funds the trust with funds sufficient only to pay the premium on the policy, in most cases immediately before the premium payment is due. It is not reasonable to impose a duty on the

trustee to review these particular decisions made by the settlor or his advisors, nor practical to force the trustee to utilize the delegation process for these particular decisions.

### III. EFFECT OF PROPOSED CHANGE GENERALLY

The proposed change would create s. 736.0902 F.S. providing that in the absence of contrary language in the governing ILIT instrument, the trustee would have no duty to determine whether the trust has an insurable interest in the life of the insured where the insured or the insured's spouse provides funds to purchase the policy.

The new section also contains elective provisions that would release the trustee from any duty to determine whether any life insurance policy owned by the trust is a proper investment when the funds to acquire or carry the policy are provided by the insured or the spouse of the insured. To avoid any conflict of interest or self dealing, this new statute would not apply to any life insurance policy purchased from an affiliate of the trustee or from which the trustee or an affiliate receives any commission.

The proposal does not otherwise diminish the trustee's ongoing responsibilities to monitor all other types of life insurance. The proposal also corrects inconsistencies in the notice provisions of the Prudent Investor Act, Trust Code and Probate Code.

### IV. ANALYSIS

The primary purpose of an ILIT is to purchase and maintain insurance on the life of the settlor that will pay a highly leveraged amount at the settlor's death that will not be includible in the settlor's gross estate. Since the settlor chooses the insurance carrier, the policy, and whether to continue to make annual exclusion gifts to the trust to pay premiums on the policy, it is most appropriate and practical to relieve the trustee of the duty and liability for those decisions or to be forced to delegate those decisions to an agent. This would be accomplished by the proposed new s. 736.0902 F.S. which is attached.

V. FISCAL IMPACT ON STATE AND LOCAL GOVERNMENTS--None

VI. DIRECT IMPACT ON PRIVATE SECTOR--None

VII. CONSTITUTIONAL ISSUES—None apparent

VIII. OTHER INTERESTED PARTIES—None known at this time