

**Fiduciary Duties in Insurance Trusts
WHITE PAPER**

PROPOSED NEW FLORIDA STATUTE 518.113

Insurance Trust Subcommittee
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 518.113 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) selection by the settlor of the insurer or the policy upon creation of the trust, and 2) 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 make the new s. 518.113 F.S. the default provision in the absence of contrary language in the governing ILIT instrument. Thus, when the policy insures the life of the person providing the funds to acquire the policy or on that persons spouse, the trustee would have no duty to determine whether the trust has an insurable interest in the life of the insured. The trustee would also have no 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. 518.113 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

518.113. Prudent Investor Rule Not to Apply –

(1) Notwithstanding the provisions of s. 518.11, with respect to any contract of life insurance acquired or retained on the life of a qualified person, a fiduciary shall have no duty to:

- (a) Determine whether the account has an insurable interest in the life the insured.
- ✓ (b) Determine whether any contract of life insurance is, or remains, a proper investment.
- (c) Investigate the financial strength of the life insurance company;
- (d) Determine whether to exercise any policy option available under the contract of life insurance;
- (e) Diversify any such contract of life insurance, or diversify the account with respect to the contract of life insurance; or
- (f) Inquire or investigate the health or financial condition of the insured or insured's relative to the contract of life insurance.

(2) For purposes of this section the following definitions shall apply:

(a) "Account" means the trust, estate or other account administered by the fiduciary.

(b) "Qualified Person" is any person, or the spouse of any person, who has provided the fiduciary with funds that are used to acquire or pay premiums with respect to a policy of insurance on the life of that person, or on the life of the spouse of that person, or on the lives of that person and the spouse of that person.

(3) In all cases where this section shall apply, the fiduciary shall not be liable to the beneficiaries of the account or any other person for any loss sustained with respect to such contract of life insurance.

(4) Unless otherwise provided in the governing instrument, this section shall apply:

(a) to any contract of life insurance acquired or received after the effective date, and

(b) to any contract of life insurance acquired or received prior to the effective date, but only if the fiduciary has given notice that this section shall apply to the contract.

1. The notice of the application of this section shall be given to the insured and to those persons who must be notified of a delegation pursuant to s.518.112(3).

2. Notice given to a person who represents the interests of any of the persons set forth in subparagraph 1, pursuant to any of the provisions of Part III, Chapter 736, Florida Statutes, shall be treated as notice to the person so represented.

3. Notice shall be given in the manner provided in s. 736.0109.

4. If any person notified pursuant to this paragraph objects to the application of this section in a writing delivered to the fiduciary within 30 days of the date such notice was received, then this section shall not apply until the objection is withdrawn.

5. The fiduciary may notify each or any person who objects to the application of this section, that the fiduciary intends to delegate the investment functions set forth in subsection (1) to that person or persons as investment agent pursuant to s. 518.112(2). Unless the objection is withdrawn within 30 days of receiving the notification, then that person or persons shall be deemed to have accepted the appointment, and thereafter shall be the investment agent for those functions pursuant to s. 518.112 upon the completion of the notification requirements set for therein. The fiduciary shall thereafter be subject to the protections set forth in s. 518.112 and shall have no liability for having selected the investment agent or agents.

6. There shall be a rebuttable presumption that any notice sent by United States Mail is received three days after depositing the notice in the United States Mail system with proper postage prepaid.

(5) This section shall not apply to any contract of life insurance purchased from any affiliate of the fiduciary, or with respect to which the fiduciary or any affiliate of the fiduciary receives any commission unless the duties have been delegated to another person in accordance with s 518.112. An "affiliate" of the fiduciary is any person who controls, is controlled by or is under common control with the fiduciary.

518.112. Delegation of investment functions -

(1) A fiduciary may delegate any part or all of the investment functions, with regard to acts constituting investment functions that a prudent investor of comparable skills might delegate under the circumstances, to an investment agent as provided in subsection (3), if the fiduciary exercises reasonable care, judgment, and caution in selecting the investment agent, in establishing the scope and specific terms of any delegation, and in reviewing periodically the agent's actions in order to monitor overall performance and compliance with the scope and specific terms of the delegation.

(2) (a) The requirements of subsection (1) notwithstanding, a fiduciary that administers an insurance contract on the life or lives of one or more persons may delegate without any continuing obligation to review the agent's actions, certain investment functions with respect to any such contract as provided in subsection (3), to any one or more of the following persons as investment agents:

1. The trust's settlor if the trust is one described in > s. 733.707(3);
2. Beneficiaries of the trust or estate, regardless of the beneficiary's interest therein, whether vested or contingent;
3. The spouse, ancestor, or descendant of any person described in subparagraph 1. or subparagraph 2.;
4. Any person or entity nominated by a majority of the beneficiaries entitled to receive notice under paragraph (3)(b); or
5. An investment agent if the fiduciary exercises reasonable care, judgment, and caution in selecting the investment agent and in establishing the scope and specific terms of any delegation.

(b) The delegable investment functions under this subsection include:

1. A determination of whether any insurance contract is or remains a proper investment;
2. A determination of whether or not to exercise any policy option available under such contracts;
3. A determination of whether or not to diversify such contracts relative to one another or to other assets, if any, administered by the fiduciary; or
4. An inquiry about changes in the health or financial condition of the insured or insureds relative to any such contract.

(c) Until the contract matures and the policy proceeds are received, a fiduciary that administers insurance contracts under this subsection is not obligated to diversify nor allocate other assets, if any, relative to such insurance contracts.

(3) A fiduciary may delegate investment functions to an investment agent under subsection (1) or subsection (2), if:

(a) In the case of a guardianship, the fiduciary has obtained court approval.

(b) In the case of a trust or estate, the fiduciary has given written notice, of its intention to begin delegating investment functions under this section, to all beneficiaries, or their legal representative, eligible to receive distributions from the trust or estate within 30 days of the delegation unless such notice is waived by the eligible beneficiaries entitled to receive such notice. This notice shall thereafter, until or unless the beneficiaries eligible to receive income from the trust or distributions from the estate at the time are notified to the contrary, authorize the trustee or legal representative to delegate investment functions pursuant to this subsection. This discretion to revoke the delegation does not imply under subsection (2) any continuing obligation to review the agent's actions.

1. Notice to beneficiaries eligible to receive distributions from the trust from the estate, or their legal representatives shall be sufficient notice to all persons who may join the eligible class of beneficiaries in the future.

2. Additionally, as used herein, legal representative includes one described in > s. 731.303, without any requirement of a court order, an attorney-in-fact under a durable power of attorney sufficient to grant such authority, a legally appointed guardian, or equivalent under applicable law, any living, natural guardian of a minor child, or a guardian ad litem.

3. Written notice shall be given as provided in Part III of Chapter 731, Florida Statutes as to an estate, and as provided in s. 736.0109, and Part III of Chapter 736, Florida Statutes as to a trust. Written notice shall be:

~~_____ a. By any form of mail or by any commercial delivery service, approved for service of process by the chief judge of the judicial circuit in which the trust has its principal place of business at the date of notice, requiring a signed receipt;~~

~~_____ b. As provided by law for service of process; or~~

~~_____ c. By an elisor as may be provided in the Florida Rules of Civil Procedure.~~

~~Notice by mail or by approved commercial delivery service is complete on receipt of notice. Proof of notice must be by verified statement of the person mailing or sending notice, and there must be attached thereto the signed receipt or other satisfactory evidence~~

~~that delivery was effected on the addressee or on the addressee's agent. Proof of notice must be maintained among the trustee's permanent records.~~

(4) If all requirements of subsection (3) are satisfied, the fiduciary shall not be responsible otherwise for the investment decisions nor actions or omissions of the investment agent to which the investment functions are delegated.

(5) The investment agent shall, by virtue of acceptance of its appointment, be subject to the jurisdiction of the courts of this state.

(6) In performing a delegated function, the investment agent shall be subject to the same standards as the fiduciary.