



Senate Fiscal Agency
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Senate Bills 31 and 32 (as passed by the Senate)
Sponsor: Senator Tonya Schuitmaker
Committee: Judiciary

(as enrolled)

Date Completed: 4-15-13

RATIONALE

As amended in 2009, the Michigan Trust Code (Article 7 of the Estates and Protected Individuals Code) substantially reflects the Uniform Trust Code that was promulgated in 2000 by the Uniform Law Commission (the National Conference of Commissioners on Uniform State Laws). In 2010, the Commission completed an amendment to the Uniform Trust Code, called the Insurable Interests Amendment. This amendment pertains to situations in which a trustee owns an insurance policy on the life of the person creating the trust, the "settlor". In addition to clarifying that a trustee has an insurable interest in the settlor, the amendment identifies the categories of beneficiaries who are allowed to receive insurance proceeds from the policy. This aspect of the amendment is designed to address issues involving stranger-owned or -originated life insurance, which have been controversial or problematic in some jurisdictions. To ensure that these issues do not become a concern in this State, it has been suggested that the Insurable Interests Amendment be codified in the Michigan Trust Code.

CONTENT

Senate Bill 32 would add Section 7114 to Article 7 of the Estates and Protected Individuals Code (the Michigan Trust Code) to define the conditions under which a trustee would have an insurable interest in the life of the individual who created the trust, and include a requirement that the beneficiaries meet certain criteria.

Senate Bill 31 would amend the Insurance Code to specify that a trustee

of a trust would have an insurable interest in the life of an individual as provided in Section 7114 of the Estates and Protected Individuals Code.

The bills are tie-barred. Below is a more detailed description of Senate Bill 32.

The bill specifies that a trustee of a trust would have an insurable interest in the life of an individual insured under a life insurance policy that was owned by the trustee acting in a fiduciary capacity or that designated the trust itself as the owner if, on the date the policy was issued, both of the conditions described below were met.

First, the insured would have to be one of the following:

- A settlor of the trust.
- An individual in whom a settlor had, or would have had if living when the policy was issued, an insurable interest.

In addition, the life insurance proceeds would have to be primarily for the benefit of one or more beneficiaries who had one of the following:

- An insurable interest in the life of the insured.
- A substantial interest engendered by love and affection in the continuation of the life of the insured.

If the beneficiaries fell into the second category and did not have an insurable interest in the life of the insured, they would have to be one of the following:

- Related to the insured by blood or affinity within the third degree or closer, as measured by the civil law system of determining degrees of relation.
- Stepchildren of the insured.

Proposed MCL 500.2210a (S.B. 31)

Proposed MCL 700.7114 (S.B. 32)

BACKGROUND

The language quoted below is from the summary of the Insurable Interests Amendment prepared by the Uniform Law Commission.

"Personal life insurance trusts are a key component of most modern estate plans, and trust and estate planners create them routinely. The trustee is typically designated as the owner, and usually also acts as the beneficiary, of one or more insurance policies held on the life of the trust's creator (i.e., the 'grantor' or 'settlor'). These trusts are extremely useful devices for ensuring that life insurance proceeds are managed competently for the beneficiaries of the trust, and, in the case of irrevocable life insurance trusts ('ILITs'), for removing life insurance proceeds from an insured's gross estate.

"Until recently, it was widely assumed that a trustee who owns insurance on the life of the trust's settlor has an insurable interest in the life of the insured. This is important because every state requires, either as a matter of statutory or common law, a purchaser of life insurance on another individual to have an insurable interest in the life of that person. This assumption, however, was called into question by a Virginia federal court decision in 2005, where the court [applying Maryland law] held that a trust did *not* have an insurable interest in the life of the insured who was the settlor and the creator of the trust. [Emphasis added.] See *Chawla ex rel Giesinger v. Transamerica Occidental Life Insurance Co.*,...

"An insurable interest is generally based on either a close familial relationship, sometimes referred to as the 'blood or affection' test..., or on the presence of an economic interest in the insured's life. For example, the close family relationship is satisfied by one spouse's relationship to another, or a parent's insurable interest in

the life of their children, or a child's insurable interest in the life of a parent, and vice versa. As for examples of the economic interest, a creditor has an insurable interest in the life of the debtor, because the debtor's continued well being is essential to the debtor being able to pay the debt owed the creditor, and a partner has an insurable interest in the life of his or her partner, and so on. An individual is held to have an unlimited insurable interest in his or her own life, but to purchase insurance on the life of another, either the close family relationship or an economic interest must provide the insurable interest."

Following the *Chawla* decision, Maryland and several other states enacted statutory amendments clarifying the circumstances under which a trustee or trust has an insurable interest in the life of another person. During this process, the American College of Trust and Estate Counsel, and others, expressed the opinion that it would be best if a uniform approach could be fashioned. The Uniform Law Commission then decided to clarify the issue with respect to the Uniform Trust Code, and established a drafting committee for that purpose.

According to the Commission's summary, an amendment could simply have made it clear that a trustee or trust possesses an insurable interest in the life of the settlor, or in the life of an individual in whom the settlor has, or would have had, an insurable interest. This language, however, involved the interaction of two different insurance law principals.

The first principal relates to state laws that prohibit a person from taking out insurance on the life of another when the person does not have an insurable interest in the other's life. This principal addresses the fundamental concern that the purchaser may have an incentive to hasten the insured's death in order to recover the proceeds.

A different body of rules, however, treats insurance policies as property that may be sold or transferred. This means that, as an owner of insurance on his or her own life, an individual settlor is free to name any person he or she wishes as the beneficiary entitled to receive the proceeds upon the individual's death, even a person who lacks an insurable interest in the settlor's life. At the same

time, if the owner of a policy on one's own life can name any beneficiary or he or she wants, presumably this owner should be allowed to assign the policy to anyone he or she wants. This body of law led to a controversial business practice called "stranger-owned life insurance", or STOLI. Essentially, an individual takes out insurance on his or her own life, usually in the millions of dollars, and then assigns the policy to investors who pay the individual a large cash settlement in exchange for the ownership rights to the policy, including the right to receive the proceeds upon the insured's death.

According to an article in *Life Settlement Review*, "[T]his formulation of insurable interest for [irrevocable life insurance trusts] addresses both the Chawla 'problem,' as well as concerns that ILITs have been used to promote STOLI schemes" ("NCCUSL Work on Insurable Interest and Trusts...", www.lifeselementreview.com, February 2010).

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

As discussed above, the Insurable Interests Amendment both 1) clarifies that a trust has an insurable interest in the life of the insured who is the settlor and creator of the trust; and 2) allows only certain categories of beneficiaries to receive insurance proceeds from a policy owned by a life insurance trust. These are beneficiaries who have an insurable interest in the life of the insured, as well as a limited class of individuals are related to the settlor. Adopting this amendment would address the concerns identified by the Uniform Law Commission, and would keep the Michigan Trust Code consistent with the Uniform Trust Code. As a matter of practice, the Insurable Interests Amendment would clarify, rather than substantively change, Michigan law.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills would have no fiscal impact on State or local government.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.