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## Second Report to the ABA of the Proceedings of the NCCUSL Drafting Committee on the "Insurable Interests Relating to Trusts" Uniform Act

Reported by David Neufeld, ABA Advisor to the Committee

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The following comments are mine alone based on my observations. Nothing stated herein is intended to be taken as official commentary on these proceedings, which can only be issued by official channels within the NCCUSL. The background of this project was outlined in a report dated March 1, 2008.

At this, the second meeting of the drafting committee the discussion centered on resolving the expressed concerns of the Bar and those of the insurance industry. The Bar expressed a need to expeditiously resolve the issues that arose from the *Chawla*[1] case. The insurance industry felt that this vehicle should be crafted in a way that it also blocks (or at least does not promote) certain STOLI ("stranger owned life insurance") related transactions, in particular those transactions that depend on the assignment of beneficial interests in ILITs.

The Chair (Prof. Roger Henderson) and Reporter (Prof. Robert Jerry) expressed their goal that (1) the draft be STOLI neutral, that is not preventing nor promoting STOLI, (2) there be no conflict with or change to a state's existing insurable interest law and that this Act work as an overlay, and (3) that it be crafted in a way that it could easily be adopted by any state regardless of whether it already enacted the UTC, has not yet enacted the UTC, or will place this Act into its insurance code.

Discussion ensued about (1) the need to provide certainty for the estate planning community about the propriety of ILITs as a technical legal matter (the *Chawla* issue), (2) the desire of the Bar that the Act be drafted in a way that mitigates legislative roadblocks to expeditious passage, especially to avoid becoming entangled in the Insurable Interest War being waged between the insurance industry and the life settlement industry,[2] (3) the desire of the Bar to make sure that trust settlors are not prevented from achieving ends with life insurance acquired through a trust that they would otherwise

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[1] *Chawla, ex rel Geisinger v. Transamerica Occidental Life Insurance Co.*, 2005 WL 405405 (E.D. Va. 2005), *aff'd in part, vac'd in part*, 440 F.3d 639 (4th Cir, 2006)

[2] The NAIC and the NCOIL each have presented model legislation that would address STOLI concerns, either by amending the insurable interest law (the NCOIL approach, preferred by the life settlement industry) or more directly (the NAIC approach, preferred by the insurance industry). The committee felt that this issue was being adequately addressed in these venues as well as the courts and the instant Act need not also address it one way or another.

be permitted to achieve if the policy were owned directly, (4) the fact that this Act must work seamlessly with existing insurable interest law of each state, regardless of what that might be, and (5) the need to neither create new opportunities for abuse of the insurable interest law nor to deny opportunities to legitimate uses of premium financing or life settlements. After discussion and language modifications, the representative from the insurance industry concluded that it seems that the draft is being crafted in a way that was acceptable, and the insurance industry would likely take a neutral stance, instead looking to the NCOIL/NAIC bills to achieve its goals.

The remainder of the meeting was spent developing the appropriate language. What follows is the preliminary draft language preceded by my informal comments. The language is still in a state of flux and will continue to be so even after it receives final committee approval and is submitted to the style committee.

Comments about the language chosen:

1. We use the definition of settlor already in the UTC, but modify it to be limited to those who create the trust, excluding those who are settlors by virtue of contributing property.
2. We anticipated the occasional need of a custodian, conservator or other type of fiduciary to create an insurance trust and did not want to foreclose that possibility.
3. The term "person" was chosen over the term "individual" to avoid foreclosing the ability of non-natural trust settlors to settle insurance trusts and acquire policies.
4. As this Act is "subject to" other applicable law, such as insurable interest laws, employee benefit laws, etc., it simply acts as an overlay. Thus, it solves the *Chawla* problem but does not create an insurable interest if state law specifically provides otherwise in any given context.
5. Specifically addressing the *Chawla* question, the Act turns on the fundamental approach that the settlor is deemed to step into the shoes of a direct policy owner, and therefore the trustee's insurable interest is derived from whatever interest the settlor has. Furthermore the trust beneficiaries are irrelevant to this inquiry. Of particular concern to most of those in attendance are those existing "anti-*Chawla*" laws that require an examination of the trust beneficiaries to determine insurable interest, particularly those laws employing the term "primarily." In some legitimate planning it may be impossible to determine who the ultimate beneficiaries will be or their relative shares, let alone whether any one beneficiary or group of beneficiaries possess more than 50%. It is feared that this might lead to crippling litigation rather than to calm the issue.
    a. If the insured and the settlor are one and the same the trustee has insurable interest in an insured, following the universal rule (among states which address this) that a direct policy owner has insurable interest in himself/herself. Just as an insured who acquires a policy on his own life can designate anyone as a beneficiary of the policy, so too can a settlor designate anyone as a beneficiary of the trust without destroying insurable interest.

b. If the insured is not the settlor the trustee will be deemed to have insurable interest in that insured if state law (legislative or common) gives the settlor insurable interest in the insured if the settlor had directly owned the policy.
c. The clause in (b)(2) "or would have if living at the time of the issuance of the policy" acknowledges that existing ancient dynasty trusts might find it appropriate to acquire a policy on a descendant of a pre-deceased settlor. That settlor's death does not prevent trust assets from being deployed to insure the life of a distant descendant, i.e. someone the settlor would have an insurable interest in were the settlor alive today.

The following is a preliminary draft of the language approved by the Committee at the meeting. It is subject to change.

**SECTION [_]. INSURABLE INTEREST; APPLICABILITY.**

(a) For purposes of this section, the term settlor is limited to a person who executes the trust instrument. If a trust instrument is executed by a fiduciary or agent, the person for whom the fiduciary or agent is acting is the settlor.

(b) Subject to other applicable law of this state, a trustee of a trust has an insurable interest in the life of an individual insured under a life insurance policy owned by the trustee of the trust if on the date the policy is issued the individual whose life is insured is:

(1) a settlor of the trust; or

(2) an individual in whom a settlor of the trust has, or would have had if living at the time of the policy was issued, an insurable interest.

*[ALTERNATIVE A (for states that have not yet enacted the UTC)]*

(c) Subsection (a) applies to any life insurance policy, owned by a trustee, issued before, on, or after the effective date of this [Code], if the policy is in force and an insured is alive on or after the effective date of the [Code].

*[ALTERNATIVE B (as an amendment to the UTC for states that have previously enacted the UTC or as an amendment to a state's insurance code]*

(c) This section applies to any trust existing before, on, or after the effective date of the section, regardless of the effective date of the governing instrument under which the trust was created, but only as to a life insurance policy that is in force and for which an insured is alive on or after the effective date of the section.

**Request for input and suggestions**

The role of the ABA Advisor is to be a resource to the Drafting Committee as well as a conduit of information between interested parties within the ABA and the Chairman of the Drafting Committee. In that regard I am soliciting input from interested Sections and Committees concerning the issues outlined herein. Our next meeting will likely be the first reading in June, 2009.

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