

Comment to 9-8-09 Draft

This draft (denominated the 9-8-09 draft) was prepared in consultation with an ad hoc committee of the drafting committee which was established at the Annual Meeting of the ULC in Santa Fe, New Mexico this past summer. It resulted from an idea that was discussed at that time with insurer representatives and which seemed to hold some promise for bridging the differences that exist between estate planners and the life insurance industry in resolving the so-called *Chawla* issue. Subsequently, the ad hoc committee had an opportunity to discuss the draft with the ACLI Task Force on Insurable Interests and other insurer representatives. The insurers indicated they would not favor such an approach; rather they preferred the solution that was adopted by the Maryland statute. Nonetheless, some estate planners still view it as a viable solution to the dilemma they feel they face in advising clients and establishing ILITs after *Chawla* and pursuant to the Maryland approach. First, the 9-8-09 draft does not alter the traditional bases for recognizing an insurable interest with regard to life insurance. Thus, it retains the language creating an insurable interest in a trustee of an ILIT which was in the 11-13-08 draft reviewed by the ULC in Santa Fe. That language is found in subsection (b) of the 9-8-09 draft and merely places the trustee in the shoes of the settlor, i.e., the trustee only has an insurable interest when the settlor would have such. However, that interest is conditional.

Second, it creates a rebuttable presumption along the lines discussed in Santa Fe that voids the trustee's insurable interest if a life insurance policy is "alienated" within (5) years from the time it is issued. See subsection (a) for the definition of the term.

Third, subsection (c) provides two alternative safe harbours for estate planners to use to defeat the presumption: (1) consent of the insurer to alienation may be obtained at the time the ILIT and insurance policy come into existence or later when a specific alienation is contemplated; and (2) absent consent, a trustee may still show that the ILIT was created for legitimate estate planning purposes.

As to the latter, three alternatives are provided for consideration for inclusion in paragraph (c)(2). Alternatives (A) and (B) are mirror images of each other. The first is worded in the negative and the second in the affirmative. Neither is specific, which clearly compounds the evidentiary issue of what is required to rebut the presumption. Alternative (C), however, is somewhat more specific in that it incorporates the insurable interest test from the Maryland statute.

It has been observed that a trustee of an ILIT will very rarely have occasion to alienate the life insurance policy that is used to fund the trust (and the same could be said for such action by beneficiaries). Arguably, estate planners could rest assured that there would be an insurable interest, as created under subsection (b), in the vast majority of ILITs. In those rare instances where an alienation is warranted, presumably insurers would not act arbitrarily in denying consent, at least as to a specific alienation. However, if consent is not given, all is not lost as long as the policy benefits are primarily for the trust beneficiaries having an insurable interest. Although there is a residual risk that a claimant may not be able to rebut the presumption, it would appear to be minimal where the ILIT was established for legitimate purposes.