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## NOTES AND COMMENTS

### EQUITY'S ENFORCEMENT OF LIFE INSURANCE TRUSTS

The validity of life insurance trusts presents a modern problem for judicial consideration. In recent years such trusts have developed with astonishing rapidity into a popular mode of controlling the future disposition of funds. Since 1920 the use of life insurance trusts has grown so that at the present time over four billion dollars worth of life insurance is held in trusts.<sup>1</sup> The prominence which this use has achieved during these recent years is due largely to the fact that it furnishes an excellent means of providing for the maintenance and welfare of dependents after the death of the insured. In establishing this type of trust, the settlor, in effect, sets up the machinery whereby a fund will come into existence at his death to be disposed of by the trustee in accordance with the wishes of the settlor as specified in the trust agreement.

In the usual case, the insured enters into an agreement with a trustee, whereby the latter is appointed beneficiary under the policy of insurance, the premiums of which are in most instances paid by the settlor. The trustee agrees to hold the policy during the lifetime of the insured, and upon the latter's death to receive the proceeds of the policy from the insurance company for administration in accordance with the wishes of the insured. In some instances the trustee is provided with funds with which to pay the premiums on the policy, in which case a sufficient property interest is given to the trustee to support the trust. This type of trust agreement is referred to as a "funded life insurance trust." In the vast majority of cases, however, the insured agrees to pay the premiums, so that the only res upon which to predicate a trust, which the trustee receives, is the probability that a fund will come into existence upon the death of the insured. Where the insured does not possess the right to change the beneficiary without the consent of the trustee, the latter takes a vested interest, which is sufficient to support a trust, even though the insured can defeat it by failure to pay the premiums, thereby causing ultimately a cancellation of the policy and the consequent destruction of the trust. However, where the insured retains the right to change the beneficiary at will, a serious question arises as to whether the trustee, as beneficiary under the policy, possesses such an interest therein as can properly be called a property right. If the interest which the beneficiary possesses under

<sup>1</sup> Bogert on Trusts (West Pub. Co., 1935), II, 763.

a revocable life insurance policy does not possess any attributes of property, the trust must fail because of the inadequacy of a sufficient res, and the attempted disposition of funds by the settlor to take effect upon his death by the use of this device is invalid because the trust agreement was not executed in conformity with the requirements of the statute of wills.

The highly technical character of a life insurance contract; the innumerable forms into which it is cast, and the widely varying situations under which they have been made subject to examination by the courts have resulted in much confusion of thought where an attempt was made to define or characterize the nature of the interest which the insured and the beneficiary possess therein. In a great many cases it has been held that the beneficiary acquires a qualified vested interest, subject to being divested by the act of the insured.<sup>2</sup> The majority of the decisions appear to hold that the beneficiary under such a policy acquires no vested right, but only an expectancy.<sup>3</sup> However, most of the cases did not involve the validity of a life insurance trust, but arose under varying circumstances which justified the court's decision because of the nature of the facts presented. It has been held that a beneficiary has nothing which he can assign;<sup>4</sup> that he does not possess anything which would pass by operation of law to the trustee in bankruptcy;<sup>5</sup> that he does not possess any power to prevent a change of the beneficiary by the insured;<sup>6</sup> that he has nothing devisable or descendible;<sup>7</sup> that he has no right to maintain an action for anticipatory breach,<sup>8</sup> and that he has no such interest in the policy as to preclude pledge of the policy by the insured.<sup>9</sup> On the other hand, it is well settled that the insured has a prop-

<sup>2</sup> Vance on Insurance (2d ed., West Pub. Co., 1930), p. 562, sec. 147. See also *Indiana Nat. Life Ins. Co. v. McGinnis*, 180 Ind. 9, 101 N. E. 289 (1913); *Sullivan v. Maroney*, 77 N. J. Eq. 565, 78 A. 150 (1910); *Anderson v. Broad St. Nat. Bank*, 90 N. J. Eq. 78, 105 A. 599 (1918); *Kochaneck v. Prudential Ins. Co.*, 262 Mass. 174, 159 N. E. 520 (1928); *Allen v. Home Nat. Bank*, 120 Conn. 306, 180 A. 498 (1935).

<sup>3</sup> Vance on Insurance (2d ed., West Pub. Co., 1930), p. 562, sec. 147.

<sup>4</sup> *Carpenter v. Knapp*, 101 Iowa 712, 70 N. W. 764 (1897); *Mutual Benefit Life Ins. Co. v. Swett*, 222 F. 200 (1915); *Dorsett v. Thomas*, 152 La. 60, 192 So. 734 (1922); *Hicks v. Life Ins. Co.*, 166 Iowa 532, 147 N. W. 883 (1914).

<sup>5</sup> *In re Hogan*, 194 F. 846 (1912).

<sup>6</sup> *Citizen's Nat. Bank v. Pan American Life Ins. Co.*, 141 So. 481 (La. App., 1932).

<sup>7</sup> *In re Hammer*, 169 N. Y. S. 684 (1918); *Haskins v. Kendall*, 158 Mass. 224, 33 N. E. 495 (1893); *In re Burza's Estate*, 274 N. Y. S. 614 (1934).

<sup>8</sup> *Mutual Relief Ass'n v. Ray*, 173 Ark. 9, 292 S. W. 396 (1927).

<sup>9</sup> *Allen v. Gaar*, 160 So. 156 (La. App., 1935).

erty interest which he may assign,<sup>10</sup> that his right to the cash surrender value of the policy passes to the trustee in bankruptcy,<sup>11</sup> and that he can change the beneficiary without the latter's consent.<sup>12</sup>

Since it is a general rule that an expectancy cannot become the subject of a trust,<sup>13</sup> it might appear at first glance that a life insurance trust predicated on the interest which the trustee possesses as beneficiary under a revocable life insurance policy must fail for lack of a sufficient *res*. Nevertheless, where this question has presented itself, most courts have held that a valid trust is created. An expectancy which is based upon the probability that a devisee or legatee will ultimately receive a property interest from the estate of a living person, can be distinguished from the character of interest which a beneficiary possesses under a life insurance policy. In the former instance, the expectancy is founded upon an instrument which is ambulatory in nature, and is ineffective to pass any present interest in property. In the case of a life insurance policy, the interest of the beneficiary arises out of a subject matter which has a present existence. An insurance contract is effective to establish the relative rights of the parties thereto immediately upon execution thereof even though the right of enjoyment of the proceeds is postponed until after the death of the insured.<sup>14</sup> In treating a life insurance policy as a valid third party contract, the possibility of construing a life insurance trust as a testamentary disposition is effectively eliminated.<sup>15</sup>

No doubt the peculiar character of the life insurance contract is due to its multiple nature which embraces a tangible property right as well as an interest inchoate in nature. As one court has said, "While an insurance policy is property, it is peculiar property."<sup>16</sup> To the extent that it possesses a cash surrender or loan value available to the insured, it represents a tangible property right. However, in most insurance policies this right is only inci-

<sup>10</sup> *Martin v. Stubbings*, 126 Ill. 387, 18 N. E. 657 (1888); *Atlantic Mutual Life Ins. Co. v. Gannon*, 179 Mass. 291, 60 N. E. 933 (1901); *Moon v. Williams*, 102 Fla. 214, 135 So. 555 (1931); *Malone v. Cohn*, 236 F. 882 (1916).

<sup>11</sup> *Cohen v. Samuels*, 245 U. S. 50, 62 L. Ed. 143 (1917).

<sup>12</sup> *Causey v. State Life Ins. Co.*, 17 La. App. 545, 135 So. 747 (1931).

<sup>13</sup> *Bogert on Trusts* (West Pub. Co., 1935), II, 355; *In re Ellenborough*, [1903] 1 Ch. 697; *Matter of Gurlitz*, 172 N. Y. S. 523 (1918); *In re Lynde's Estate*, 175 N. Y. S. 289 (1919).

<sup>14</sup> *Johnson v. Scott*, 137 N.Y.S. 243 (1912).

<sup>15</sup> *Chase National Bank v. United States*, 278 U. S. 327, 73 L. Ed. 405 (1929); *Tyler v. Treasurer & Receiver General*, 226 Mass. 306, 115 N. E. 300 (1917); *Katz v. Witt*, 134 N.Y.S. 675 (1911).

<sup>16</sup> *Burlinghame v. Crouse*, 228 U. S. 459, 57 L. Ed. 920 (1913).

dental to the primary object of providing for the creation of a fund to arise upon the death of the insured. The creation of this right in the beneficiary, which admittedly possesses inchoate and ambulatory aspects, is what gives an insurance contract its distinctive personality and represents the primary motive in inducing the insured to enter into the contract. It is to be observed that the dual nature of life insurance policies was recognized by Congress in passing Section 70a of the Bankruptcy Act,<sup>17</sup> which gives the bankrupt the privilege of paying the loan value of the policy to the trustee and retaining the policy free from interference from creditors.

Irrespective of what descriptive label has been affixed by the courts in attempting to define the beneficiary's interest in situations not involving life insurance trusts, most courts have held such an interest, however slender, of sufficient substance to support a trust. The case of *Hirsh v. Auer*<sup>18</sup> is frequently cited in support of the validity of a life insurance trust. In this case the deceased, father of the plaintiff, held a certificate of insurance payable to his wife. Upon the latter's death, he made the policy payable to his sister, Clara, who promised him that she would divide fifteen hundred dollars of the proceeds equally between herself and the decedent's two children. The action was brought by the children to enforce the trust. In holding for the plaintiffs, the court said: "It was competent for Clara Auer to agree with her brother that she would receive the proceeds of his life insurance, subject to such a trust as he might create. The fact that the insured could have at any time changed the beneficiary named in his certificate has no bearing upon the question now presented. He did not as a matter of fact exercise that right, and his sister collected the insurance impressed with the trust created by the agreement which the trial court has found was made by the parties in interest. The fact that the trust dealt with a contingent interest of the insured in the certificate of insurance is of no moment; that interest became vested at the death of the insured, and since the beneficiary collected the insurance money, the trust under the agreement creating and acknowledging it, attached to the fund. "A trust of this nature is not to be distinguished from assignments of contingent interests which courts of equity recognize as valid."

A similar trust was sustained by the court in Massachusetts,<sup>19</sup>

<sup>17</sup> U. S. C. A., Tit. 11, § 110 (a), p. 277. See *Malone v. Cohn*, 236 F. 882 (1916); *Burlingame v. Crouse*, 228 U. S. 459, 57 L. Ed. 920 (1913).

<sup>18</sup> 146 N. Y. 13, 40 N. E. 397 (1895).

<sup>19</sup> *Kendrick v. Ray*, 173 Mass. 305, 53 N. E. 823 (1899).

although the facts as stated do not disclose whether or not the insured reserved the power to change the beneficiary. The New York court was again confronted with the problem in *Lauterbach v. New York Investment Company*.<sup>20</sup> There the insured held several policies which named his wife as beneficiary. Later, he changed the policies so as to make them payable to Alfred Lauterbach and enclosed them with a letter directing the beneficiary to make a disposal of the proceeds in accordance with the instructions contained in the letter. The policies and the letter were left with a clerk in Lauterbach's office and were not delivered to the latter until after the insured's death. An action was instituted by the wife of the deceased in an attempt to defeat the trust on the ground that it was invalid because of the insured's failure to have it executed in accordance with the statute of wills. The estate was insolvent and the creditors of the insured intervened. The court sustained the trust, holding that it was not an attempted testamentary disposition even though the insured retained the right to change the beneficiary.

In *Lashley v. Lashley*,<sup>21</sup> the insured was entitled to war risk insurance and proposed to his brother that the latter be named as beneficiary for the benefit of the latter and a brother and sister of the insured. This agreement was reached between the two and after the insured died the brother and sister started suit to compel the trustee to carry out the provisions of the trust. In sustaining the trust, the court held that the fact that the trust dealt with a contingent interest did not impair its validity, and quoted in support of its holding the language used by the court in *Hirsh v. Auer*.<sup>22</sup>

The case of *Bose v. Meury*<sup>23</sup> involves a set of facts which permits the court to pass upon the validity of a life insurance trust free from the influence of any circumstances creating equities in favor of those attempting to enforce the trust. In this case one Meury insured his life in several insurance companies in favor of his wife and children, retaining the right to change the beneficiaries. Thereafter he established a trust making a trust company beneficiary under the policies. The trust company agreed to hold the proceeds of the policies subject to a life interest in favor of Meury's wife, remainder to his children. The insured reserved the right to add to the trust or to withdraw policies already de-

<sup>20</sup> 117 N. Y. S. 152 (1909).

<sup>21</sup> 212 Ala. 255, 102 So. 229 (1924).

<sup>22</sup> 146 N. Y. 13, 40 N. E. 397 (1895). See also *Christensen v. Christensen*, 14 F. (2d) 375 (1926).

<sup>23</sup> 112 N. J. Eq. 62, 163 A. 276 (1932).

posited. The right to revoke the trust was reserved by the settlor. Meury withdrew several policies and pledged them with Bose as security for a five thousand dollar loan. The insured died before the loan was repaid, and the proceeds of the policies were paid to Bose, who filed a bill of interpleader after deducting the amounts due him on the loan. The parties interpleaded were the trust company and the insured's administrator. The estate was insolvent and the creditors of the decedent were allowed to intervene. The administrator and the creditors attacked the validity of the trust contending that it was not completed during the lifetime of the decedent, because the latter reserved the right to change the beneficiary under the policies as well as the right to revoke the trust and withdraw the policies. In upholding the validity of the trust, the court said: ". . . the res is the proceeds of the insurance in the life of the trustor which were never his property. The proceeds are the fulfillment of the promises by the insurance company to the Montclair Trust Company, Trustee, to pay the stipulated sums upon the death of the insured. The insured paid the consideration for the promise, and he had the right under the terms of the policy to change the promises at will, but when the day came—the insured's death—the obligations of the insurance company were due to the Montclair Trust Company, trustee. Its source of title was the promise in the policies, not the trust agreement."

This problem was presented to the Illinois Supreme Court for the first time in *Gurnett v. Mutual Life Insurance Company*.<sup>24</sup> The facts were as follows: Ames, the insured, deposited various life insurance policies in trust with the Central Trust Company under an agreement whereby the trustee agreed to hold the policies during the lifetime of the insured and after his death to collect the proceeds and administer them for the benefit of the wife and children of the insured. Ames reserved the right to change the beneficiary under the policies; to withdraw them from the trust, and to pledge the cash surrender value. In addition, he retained the right to modify or revoke the trust. Premiums on the policies were to be paid by the settlor. Ames died heavily indebted to the plaintiffs who brought an action attacking the validity of the trust, and praying that the trust be declared void and the proceeds of the policies be administered as assets of the insured's estate. No fraud was alleged. The main ground relied upon by the plaintiffs was that the trust failed, because the interest which a beneficiary owns under a revocable life insurance

<sup>24</sup> 356 Ill. 618, 191 N. E. 253 (1934).

policy is a mere expectancy which could not be the subject of a trust, and, since the trust was invalid from its inception, the proceeds of the policies became a part of the insured's estate. This view was rejected by the Illinois court in holding that a valid trust was established during the lifetime of the settlor. In effect the court held that the right of the beneficiary to receive the proceeds of the policies possessed sufficient attributes of property to serve as the res of a trust. The court said: "The date of the death of the insured merely fixed the time when the obligation of the insurer to pay and the right of the beneficiary to receive the proceeds of the policies became enforceable. The trust agreement and the change of the beneficiary, however, became effective during the lifetime of the settlor. The continuing right to receive the proceeds of an insurance policy is not impaired by the unexercised right or privilege of the insured to designate another beneficiary. The designation of a beneficiary in a policy of life insurance creates an inchoate gift of the proceeds of the policy, which if not revoked by the insured in his lifetime rests in the beneficiary at the time of the former's death. A policy of life insurance is not deemed an asset of the estate of the insured unless it is made payable to him, his executors or administrators. The mere fact that the insured may change the beneficiary does not make the policy or its proceeds part of the estate."

The court also held that the naming of a new beneficiary in the policies would produce the same result as the act of the settlor in revoking the trust. In support of its position, the court cited *Otis v. Beckwith*<sup>25</sup> where the insured, in making the settlement of the trust, executed an assignment of the policy, which assignment was registered on the records of the insurance company. After the insured died, the trustee filed a bill to compel the administrator to surrender the policy. The court upheld the validity of the trust, laying stress on the fact that it was the intention of the insured to establish a trust for his motherless children, and the acts of the insured in executing an assignment, causing the same to be recorded, and appointing the plaintiff trustee, were sufficient to establish the trust. It must be noted, however, that in this case the assured assigned the policy to the trustee, an act which is to be distinguished from the right of the insured to change the beneficiary. An assignment rests upon contract, while the power to change a beneficiary is in the nature of a power of appointment.<sup>26</sup> The effect of an assignment is to vest in the trustee all

<sup>25</sup> 49 Ill. 121 (1868).

<sup>26</sup> Vance on Insurance (2d ed., West Pub. Co., 1930), Ch. 10, pp. 564, 565, sec. 147.

the rights which the insured owns in the policy so that the trustee takes a vested interest therein, even though the insured may possess the right to revoke or cancel the assignment. Hence, an insurance trust which has for its res an assignment of the policy has long been recognized as valid.<sup>27</sup>

In the Gurnett case, the Supreme Court brushed this distinction aside, holding that the effect of the insured's acts in setting up a trust by assigning his interest in the policy or by changing the beneficiary thereunder are of the same practical effect, laying stress on the fact that the intention of the settlor is the same in both instances.

A divided Kansas court reached an opposite conclusion,<sup>28</sup> holding that a sufficient property interest was not passed to the trustee. *Fisher v. Donovan*<sup>29</sup> and *Bennett v. Rosborough*<sup>30</sup> are the only other cases found representing the minority view. In both of these, efforts were made by the creditors of the decedent to enforce a trust based upon the promise of the wife of the deceased to pay the latter's debts from the proceeds of insurance policies which would be paid to her as beneficiary. The decisions in both of these cases are influenced by the existence of a statute enacted for the purpose of protecting the beneficiaries of life insurance policies from the claims of creditors.

In *Chase National Bank v. United States*,<sup>31</sup> the court held the proceeds of a revocable life insurance policy subject to the death transfer tax imposed upon the estate of the insured, and stated that the termination of the power of the insured to control the disposition of the property is a legitimate subject of the tax. The court, however, recognized that the proceeds of the policies were not taxable as the decedent's property, saying: ". . . it is true as emphasized by the plaintiff . . . the interest of the beneficiary in the insurance policies effected by the decedent 'vested' in them before his death and that the proceeds of the policies came to the beneficiary not directly from the decedent but from the insurer."

The policy of the courts in sustaining the validity of life insurance trusts is not only consonant with sound principles of law but also is in accord with the best interests of public policy. This means of providing for the welfare, education, and support of dependents after the death of the insured is one that should be

<sup>27</sup> *Fortesque v. Barnett*, 40 Eng. Rep. 14, 3 My. & K. 36 (1834); *Jarvis v. Binkley*, 206 Ill. 531, 69 N. E. 582 (1904).

<sup>28</sup> *Staples v. Murray*, 124 Kan. 730, 262 P. 558 (1928).

<sup>29</sup> 57 Neb. 361, 77 N. W. 778 (1899).

<sup>30</sup> 155 Ga. 265, 116 S. E. 788 (1923).

<sup>31</sup> 278 U. S. 327, 73 L. Ed. 405 (1929).

encouraged. In most instances the trust agreement is a carefully prepared instrument in which the advice of experienced counsel is drawn upon in devising a satisfactory plan suitable to the individual needs of the settlor. Many of the perplexing problems which are inherent in the disposition of property by means of a will can be eliminated.

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