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Trusts - Life Insurance Trusts - Contingent Unfunded Life Insurance Trust as Testamentary Disposition

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TRUSTS—LIFE INSURANCE TRUSTS—CONTINGENT UNFUNDED LIFE INSURANCE TRUST AS TESTAMENTARY DISPOSITION—Settlor named defendant bank beneficiary of eight insurance policies on his life. At the same time he entered into a trust agreement with the bank under which the bank was to hold the policies until the death of the settlor and, upon his death, collect the proceeds and distribute them according to one of two alternate methods of distribution. If his wife elected to reject the provisions made for her in his will and insisted on her statutory share of his estate, then the insurance proceeds were to be divided into four equal parts and paid to his four daughters. If, however, the wife elected to take under the will (under which she received about one-fifth of the estate), the insurance money was to be divided into five equal parts to be paid to his wife and four daughters. Settlor died some two and a half years later leaving both the will and trust agreement still in force although he had reserved the right to revoke the trust at any time. His widow attacked the trust agreement as testamentary and prayed that the trustee be ordered to pay over the proceeds of the policies to the executor of the settlor's estate. A demurrer by the trustee and other defendants was sustained, and the widow appealed. *Held,* three justices dissenting, since during the life of the settlor no legal interest passed to the trustee and no equitable interest passed to the beneficiaries of the trust, the instrument was void as a testamentary disposition not executed in accordance with the statute of wills. *Bickers v. Shenandoah Valley Nat. Bank,* (Va. 1955) 88 S.E. (2d) 889.

In view of the widespread use and undoubted value of the insurance trust in the field of estate planning,[1] the cloud which this decision casts on the validity of such trusts in Virginia is to be regretted. The statement of the court that no interest passed to the trustee during the life of the settlor is certainly an anomaly in view of the fact that the trustee was named beneficiary of the life insurance policies. Though often referred to as a "mere expectancy,"[2] and having few of the earmarks of a property interest, the interest which the beneficiary of a life insurance policy has in the proceeds has always been recognized as sufficient to keep such policies out of the category of testamentary dispositions. In support of its holding on this point the court cited language in the trust agreement which seemed to indicate that the trustee did not have any rights in the policies prior to the death of the settlor.[3] The fallacy in this, of course, is that the trust agreement was in no way concerned with any transfer to the trustee. That had already been accomplished the moment the trustee was made beneficiary of the policies. The trust agreement dealt only with the duties of the trustee toward this "expectancy," which the court readily conceded could have been made the subject matter of a trust if it had been transferred to the trustee.[4] The second ground upon which the decision rested is equally open to criticism. The court took the view that since the trust was dependent on the existence of a valid will (and thus the beneficiaries

1 For interesting discussions of the practical advantages of life insurance trusts from the insurance man's point of view, see Nippert, "Contingent Life Insurance Trusts," 5 J. AM. Soc. C.L.U. 166 (1951); Stephenson, "Reappraising Insurance Trusts," 4 J. AM. Soc. C.L.U. 218 (1950).

2 Smith v. Coleman, 184 Va. 259, 35 S.E. (2d) 107 (1945); Walker v. Penick's Executor, 122 Va. 664, 95 S.E. 428 (1918); Davis v. Modern Industrial Bank, 279 N.Y. 405, 18 N.E. (2d) 639 (1939). A minority of courts speak of the beneficiary's interest as vested subject to defeasance. See, e.g., Indiana Nat. Life Ins. Co. v. McGinnis, 180 Ind. 9, 101 N.E. 289 (1913).

3 "The trustee's only rights in the trust and policies placed in safekeeping prior to the death of the settlor, are to hold the policies in safekeeping until and unless they are withdrawn by the settlor." Principal case at 893-894, n. 1.

4 Principal case at 892. The proposition that the right of the beneficiary of a life insurance policy to recover the proceeds may be held in trust has been uniformly affirmed. See, e.g.: Gurnett v. Mutual Life Ins. Co., 356 Ill. 612, 191 N.E. 250 (1934); Gordon v.

could not be ascertained until after the death of the settlor), no equitable interest in the corpus of the trust passed to anyone in the lifetime of the settlor. As the dissenting opinion forcefully pointed out, the trust instrument transferred "contingent springing limitations" to the wife and four daughters of the settlor.[5] The overwhelming weight of authority recognizes a contingent interest passing to the beneficiary as sufficient to support an inter vivos trust,[6] and the fact that the contingency will not take place until after the death of the settlor should not make the interest any less a present one. It is true that possession and enjoyment of the insurance proceeds by the beneficiaries of the trust was dependent on the existence of a will, but if a contingent interest is recognized as a subject of present ownership, it is misleading to say that the trust itself was dependent on the will.

As several authorities have pointed out, any insurance trust is at least very similar to a testamentary disposition, but due to the fact that the danger of fraud is almost non-existent, the policy of the law has uniformly been to uphold such trusts as useful and legitimate devices for disposing of insurance proceeds.[7] There is nothing in the court's opinion which indicates a different view of the insurance trust per se. On the contrary, the court went to some length to limit its holding to the facts of the case.[8] The fact that the trust was designed to avoid the operation of the Virginia statute giving a surviving spouse a one-third share of a decedent's estate[9] may have played some part in the result reached, although the court specifically reserved this question.[10] If, in a later case, the Virginia court does decide that a revocable trust is void when attacked by a surviving spouse, it will be going against the result reached in the great majority of the jurisdictions which have encountered that situation.[11] Considering these factors along with the strong dissent by three justices, it is not likely that this decision will mean the end of the insurance trust in Virginia. In the future, however, draftsmen of such trust instruments, in Virginia as elsewhere, would do well to express clearly the intent to transfer (1) a present interest to the trustee and, (2) a present, equitable interest to designated beneficiaries. In addition, if alternate methods of distribution are desired, as in the principal case, one of them should be definitely prescribed with the alternative plan phrased in terms of condition subsequent.

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Portland Trust Bank, 201 Ore. 648, 271 P. (2d) 653 (1954), noted in 27 ROCKY MT. L. REV. 240 (1955).

5 Principal case at 902.

6 SCOTT, LAW OF TRUSTS §56.5 (1939); BOGERT, LAW OF TRUSTS §38 (1952).

7 SMITH, PERSONAL LIFE INSURANCE TRUSTS 75 (1950); SCOTT, LAW OF TRUSTS §57.3 (1939); Phillips, "The Testamentary Character of Personal Unfunded Life Insurance Trusts," 82 UNIV. PA. L. REV. 700 (1934).

8 Principal case at 895-896.

9 Va. Code (1950) tit. 64, §§64-13, 64-16.

10 See note 8 supra.

11 See 40 GEO. L.J. 109 (1951).