Module 8

Trusts used in Financial Services Part 1

Learning objectives

This module covers:

- the operation, benefits and risk factors in using a trust with life insurance policies
- the Statutory Trust and Revocable Nominations under the Insurance Act
- Insurable interests in the context of trusts

1. Introduction to Life Insurance Trusts

This module looks at the role of life assurance, where the life insurance policy is settled into a trust for purposes of estate planning, asset protection and succession planning. When a trust is designed with the ownership of a policy and its benefits as its principal or only function, it is usually referred to as a "life insurance trust".

Often one of the reasons a person will buy a policy of life insurance is to give his or her beneficiaries liquidity, that is, ready cash for the maintenance for the family; since it might be difficult or undesirable to sell some of his other assets, such as his residential home or a family business.

On the other hand, it may be unwise for some family members to benefit from the policy proceeds at a time when they may be financially immature. A life insurance trust helps.

2. Life Insurance and Estate Planning

To begin, let us explore why a life insurance policy can be an integral component of estate and succession planning:

- It can provide liquid funds to meet liabilities of the deceased's estate that would otherwise have to come from selling the assets of the estate when it is not timely or where the assets are mainly illiquid.
- It makes available a sum of money upon maturity, the occurrence of death or other event such as critical illness that might not otherwise be available.
- The proceeds of a life policy could provide a lump sum payment for the benefit of family members and dependants in the untimely demise of the insured.
- The proceeds of a traditional life policy are typically free from Singapore income tax (as it is capital in nature) and now free from estate duties (since 15th February 2008).

- The sums assured could be paid by the insurer to executor of the estate of the insured or to the proper claimants upon his death without waiting for probate or letters of administration, subject to the prescribed amount pursuant to s 61 of the Insurance Act (see 8.7.6).
- When a life policy is settled into a trust and under certain conditions, it is an asset that can be protected against creditor claims.
- A life policy settled in trust could prevent minor beneficiaries from having control of the proceeds under the policy until such time when they are financially competent to manage such funds. In the meantime, the trustee could invest the proceeds or to distribute the same prudently for the maintenance and advancement of the beneficiaries in accordance with the terms of the trust.

For those in financial services who liaise with lawyers and accountants, this module is important. We have already seen from the glossary in Module 4 that the various professionals involved in estate planning do not all "talk the same language", and for the types of trusts encountered in this module, this problem is particularly acute. Let's be honest about the barriers to understanding here:

- Financial services trusts often use marketing names, which do not refer to the critical tax/legal words which would clarify the tax behaviour of the trust, resulting in a communication barrier.
- The trust wordings encountered can be written in a very different style to that which most lawyers will be familiar with, when compared to their own office styles, resulting in a communication barrier.
- The intricacies of term policies, whole of life, critical illness benefit and terminal illness benefit will be known to those who have studied for financial services exams, but only forms a small part of the training of lawyers (if at all), resulting in a communication barrier.

This module is intended to give an insight to further support good working relationships between all those who deal with private clients and their trusts and estate planning needs.

This module will look at the most frequently encountered trusts used with life policies, and takes as its starting point the client need which is being addressed. Being able to show how the trust (and the asset which sits inside it) meets a client need is essential if you are to communicate effectively with those outside financial services and overcome the barriers set out above.

3. Scope of client need in using Trusts with Insurance Policies

3.1 Term Policy

The client need intended to be met by a term policy is where a capital sum is required in the event of death within a specified time period (e.g. $250,000 in the event of death within 25 years). There is usually no investment content or surrender value to this "pure life assurance policy", so the estate planning focus is on who should receive the sum assured when the life assured dies.

Depending on the wording of the life policy contract, there may also be two other types of benefit offered under the contract, either of which leads to the sum assured being paid out and the life policy ending at that earlier point:

- **Critical illness:** on diagnosis of one of the listed conditions, the sum assured is paid out.
- **Terminal illness:** on diagnoses of a terminal illness, the sum assured is paid out. The reason why the capital sum is required will drive what type of trust will meet the client's needs.

3.2 Using a Trust with a Term Policy

It is almost easier to ask the question "why not use a trust with a life policy?", rather than try to find reasons why the sum assured should be paid to the deceased's estate. There are both estate planning and tax points to consider here. If we assume that the life policy is assigned to a discretionary trust, with the beneficiaries listed as widow, children and remoter issue, then the benefits can be summarised as:

- Speedier pay out of sum assured. Without a trust, the life insurer would generally only pay out when probate or confirmation is granted, which could be many months after date of death. If instead the life policy is owned by trustees, there is no need to wait until probate or confirmation is granted and the trustees can send the death certificate to the life insurer and make the claim without delay. The trustees can then consider whether they wish to make any distributions from the trust, and indeed review all their other options (e.g. Making a loan to a beneficiary). At that point, the trustees will also need to consider their investment duties if the trust assets are not being distributed.
- Control over destination of sum assured: if the client does not have a Will, the rules of intestacy will govern the distribution of his estate. Without a trust, the term policy proceeds would be paid to his administrators in due course, and distributed in line with the relevant intestate succession rules. In contrast, with a trust, the client can ring fence the policy proceeds which are then placed under the control of the trustees, not the administrators of his estate.
- Asset preservation. The points here arise when looking at the choice for a client e.g. leaving his estate outright to spouse, or using a will trust. In the event of the client's death and the life policy proceeds being paid to a discretionary trust (rather than to the deceased's estate), payments can be made to the surviving spouse. It also means that the trustees control the payments from the trust. This could be important in the event of re-marriage and the ability to prioritise the deceased's children over the needs of the spouse who has now re-married.

3.3 Split trust

The client need intended to be met by this trust is where the client wishes the death benefits to be held by the trustees, but wishes to retain one or more other benefits arising under the policy. In this way, the benefits are "split", hence the marketing name for this trust. For example, with a critical illness benefit, whilst the client may have been ill and may find his employment affected, a critical illness may not be fatal. It is easy to see therefore why the client may wish to retain the critical illness benefit, as an essential source of a capital sum after what could be a life-changing medical event.

The terminal illness benefit may or may not fall into this category. On one view, if the client has a very short life expectancy after diagnosis of a terminal illness, receiving a large capital sum into his estate would be unnecessary. On the other hand, it may provide funds which can be put to good use for that period. Whether or not to retain the terminal illness benefit will be a personal decision for the client. Any proforma trust wording should be read carefully to check the position for each of the possible benefits arising. The creation of a Split Trust involves a carve-out where the settlor retains certain benefits whilst gifting others away. The end result is that the trustees are the named policyholders, but they hold some rights under the policy absolutely for the settlor, whilst other rights are held according to the terms of the trust for the beneficiaries.

3.4 Where statutory policy trusts are concerned (see further at 8.6)

These refer to the statutory trusts, namely section 73 Conveyancing and Law of Property Act (Cap 61) and the s.49L provisions under the Insurance Act. In the context of what is achievable in the modern forms of discretionary trust wordings, the statutory trusts look to be restrictive and don't meet the needs of many clients in terms of flexibility.

One benefit of the statutory trust is that it is simple to create, for example under the s.73 trust policy, a full trust wording is not strictly required to create the trust as the policy wording can simply contain a paragraph which states that the policy is being issued under the terms of the relevant Act, to be held for the benefit of person x. There are also some creditor protection benefits in certain instances. There are however a number of disadvantages which explain why statutory trusts fall short in comparison to the non-statutory trust:

- It is similar to a bare trust in that if a beneficiary dies, there is an asset/right inside the beneficiary's estate, which gives a poor asset protection result. It would however be preferable for many clients to "ringfence" the policy through a discretionary trust where beneficiaries do not have an absolute interest.
- The restricted class of beneficiaries of spouse and children does not meet the needs of many clients today, who prefer to include a wider class of beneficiaries using a discretionary trust (e.g. named friends, co-habitees, nephews, nieces, grandchildren, godchildren or charities).

3.5 Probate Trust

The description is a misnomer as such a trust is designed to in fact avoid probate. The client need intended to be met by this type of trust enables speedier access to the life policy proceeds after death. The law marketing name for this trust refers to the point that the trustees can approach the life company after the life assured has died, without having to wait for the grant of probate, which avoids delays. The end result can be a speedier payout, as the trustees can then distribute the funds to the beneficiaries. The funds could however be retained by the trustees for asset protection reasons, depending on the position of the beneficiaries.

3.6 Business protection

A specific client scenario which can involve a term policy is where a group of people are in business together, either as a partnership or a company. The client need here relates to the position on death, where the deceased business owner's family inherit a business asset (but would probably prefer the cash equivalent) and the surviving business owners ideally want to consolidate their business and buy-out the family's inherited share of the business. A term policy can be used to create funds for the business owners to achieve that outcome, which can also achieve the desired result for the family. As this topic is itself extensive and has its complexities, this is covered separately in Module 9.

4. Using Life Insurance Trusts and Appointment of Trustees

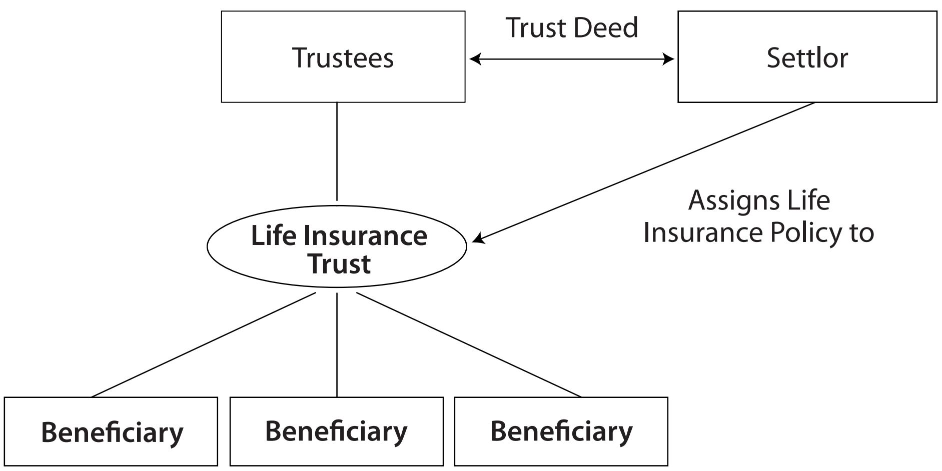
There is always the potential risk that during the lifetime of the insured, his life policy could be assigned to creditors to satisfy the liabilities of the insured. A strong motivation to set up a life insurance trust would be to ensure that such proceeds when paid out are kept intact and protected for the benefit of his family members.

For such purposes, a life insurance policy can easily be transferred (by assignment) to professional trustees like a trust company. The appointed trustees will then own and hold the policy under an irrevocable trust, under such terms as determined by the insured. The ultimate beneficiaries of the trust will be whoever the insured chooses, usually the spouse, the children, grandchildren, etc., and various contingencies such as the early death of children can be dealt with under the trust deed.

Where the insured have no pressing issues to safeguard the policy from potential creditor action, one option for the insured is to create the life insurance trust on a revocable basis. Alternatively, the insured could decide to only create the trust at a future date, by assigning his policy to the trustee at any time before death.

One other alternative is to have the insured set up a life insurance trust to include himself as a beneficiary; where proceeds are paid out to him on critical illness. On death, the proceeds or the balance could be paid out to other specified beneficiaries.

5. Structure of a Life Insurance Trust



6. The Statutory Trust

6.1 The CLPA Section 73 Policy

In Singapore, the use of statutory trusts, namely section 73 Conveyancing and Law of Property Act (Cap 61) insurance policies had historically an important role in estate planning. With the amendments to the Insurance Act (Cap 142), the concept of the s.73 policy had been replaced with a new concept of a trust nomination but it continues in force for policies written prior to pre-amendments of the Insurance Act. So for the next couple of decades, advisers will continue to deal with both the s.73 CLPA policy (until the last of them finally matures) and the replacement trust nomination which for convenience, is referred to as the s.49L trust policy (named after the proposed section which creates such policy). This (irrevocable) trust nomination is discussed at 7.1.

7. Changes to the Insurance Act (Cap 142)

Since 2009, under the Insurance Act (Cap 142), new forms of insurance policy nominations have been created (known in the industry as the Nomination of Beneficiaries (“NOB”) framework).

The amendments to the Insurance Act in 2009 implemented a new framework in allowing a policy owner to make nominations of beneficiaries (“NOB”) to the proceeds from insurance policies. The new framework is intended to ensure the expeditious payment of death claims on all life and personal accident policies. At the same time, it was to standardize some of the diverse practices that were previously carried out by insurers.

Covers all life and personal accident policies

The policies under the NOB framework cover all life and personal accident (“PA”) policies effected on the life of the policy owner. Group and individual life policies, as well as PA policies will be eligible for nomination. Motor policies with PA benefits and hospital & surgical policies with death benefits will not be eligible for nomination under the framework (as only non-indemnity life policies are allowed).

Forms of Nomination

The NOB framework allows the insured to make two forms of nominations:

1. The (irrevocable) trust nomination or
2. The revocable nomination.

The policy owner must be 18 to make either of the above nominations. The legal effect differs, depending on the form of nominations and policy owners are given a choice to decide what is best in their interests and for their beneficiaries.

7.1 The (irrevocable) trust nomination

The (irrevocable) trust nomination is substantially a s.73 CLPA policy with some statutory modifications. The details of the trust nomination are spelt out in section 49L of the amended Insurance Act (Cap 142). Like a s.73 policy, it is also a statutory trust where the eligible beneficiaries are limited to the spouse and children, or any of them, of the insured (hereinafter referred to as the "s.49L Policy"). The s.49L policy also mirrors the s.73 policy in that the policy monies will not form part of the estate of the policy owner or be subject to his debts (see s.49L(4)). If it was proved that the s.49L policy was effected with intent to defraud creditors, like the s.73 policy, the creditors will be entitled to receive out of the policy monies, a sum equal to the premiums paid (see s.49L(5)).

The statutory modifications include:

- A requirement that nominations must be made in such prescribed forms and according to such directions as may be issued by the Authority.
- Each nominee's portion of the policy monies is to be indicated accordingly.
- For a valid nomination, it must provide for the disposition of all policy monies under the relevant policy.
- On the death of any nominee, the nominee's interest in the policy moneys shall, subject to any encumbrance created over, or any disposition of, the nominee's interest while the nominee was alive, form part of the nominee's estate.

A nomination can only be revoked subject to stringent requirements:

- Every nominee is alive.
- Prior written consent to the revocation is obtained from each nominee and if the nominee is below 18, then from his parent or legal guardian, not being the policy owner.
- The revocation complies with such requirements prescribed and directions (as may be issued) by the Authority.

When the trust has been revoked, the policy owner can create another fresh trust nomination or revocable nomination.

Unlike the s.73 policy where the insured himself is the default trustee in the absence of appointing a trustee, in the trust nomination, the s.49L policy holder does not automatically become a trustee. Instead, the s.49L policy holder may, in such manner prescribed by the Authority and in accordance with such directions as may be issued by the Authority appoint one or more of trustees (including the policy holder) to be trustees of the policy monies. A person below 18 shall not be appointed as trustee.

7.2 Proceeds of s.49L policy belong to beneficiaries and estate of a beneficiary predeceasing the policy holder

All proceeds from a trust nominated policy, whether paid out while the policy owner is alive or after his death, will belong to the beneficiaries. If the policy owner wishes to retain for himself non-death benefits; e.g. in the event of critical illness, a trust nominated policy may not be appropriate.

Another issue that needs to be addressed is the situation where a beneficiary might predecease the policy owner. In this event, the deceased beneficiary's portion of the benefits will form part of the deceased beneficiary's estate. An unintended result could arise. For example, the chances are that a minor beneficiary or a young adult who predeceases the s 49L policy holder is not likely to be married, perhaps newly married and did not leave any issue. The intestacy rules would apply in the case of the minor beneficiary as he needs to be 21 to draw up a valid Will. Few young adults draw up a Will. The portion of the s 49L policy proceeds could end up being passed under intestacy rules on to persons whom the policy holder did not wish to benefit. MAS has also stated that the personal representative acting for a beneficiary who has predeceased the policy owner will not be able to give consent to revoke a trust nomination. Various scenarios that could possibly arise would need to be worked out by the adviser and his client and this could have results that may or may not be acceptable to the client.

Part of the problem arising from the proposed trust nomination is that it is in effect, a fixed trust. It requires the s 49L policy holder to specify the portion of each nominee's portion of the policy monies. The results arising from the deaths of nominated beneficiaries could certainly have bizarre results that may not be acceptable.

Exercises on Section 49L

1. Judy nominated her husband (50%) and daughter aged 13 (50%) as nominees of her s 49L policy. Her husband passed away recently. Discuss the status of the policy with regard to the 3 separate scenarios:

    a. Judy had divorced her husband
    b. Husband died intestate
    c. Husband left a will giving the residuary estate to be divided and shared equally among the survivors of his parents, his wife, daughter and the Community Chest.

2. Fred is twice divorced. He has a child from his first marriage. After marrying his second wife, the couple adopts a child. He divorces again and lives with a new girlfriend who bears him a baby girl. Can he name all of the children in a s.49L policy?

7.3 Alternative to the statutory trust policy

In many circumstances, it may be more appropriate for the insurance policy to be held as a non-statutory trust rather than the creation of a s.49L policy; the latter which is a trust that creates fixed beneficiaries interests in the policy proceeds. In the non-statutory trust, the entitlements of each beneficiary could be held on a discretionary basis. Hence upon death of a beneficiary, no interest or any portion of the policy proceeds will form part of the deceased's beneficiary's estate. The proceeds could be divided amongst the surviving beneficiaries at the discretion of the trustees or with the trust deed providing a default term that the proceeds are to be given in equal shares to the surviving beneficiaries.

The statutory protection of the proceeds against potential creditors from the inception of the s.49L policy has its merits; but this could also be achieved in the form of the non-statutory trust coupled with some planning within the boundaries of Bankruptcy law.

Some of the advantages of the non-statutory life insurance trust include the following:

- Any person other than the spouse and children could be included as beneficiary. In the s.49L policy, the beneficiaries are limited to the spouse and children only.
- The substitution, addition or exclusion of beneficiaries can be easily made; this would allow the inclusion of a child who was not yet born at the inception of the policy. There is little flexibility in the case of the s.49L policy.
- The administration and management of the trust are comprehensively dealt with in the Trust Deed. There is no requirement to follow the prescribed forms or the directions that may be issued in the creation of the statutory trust.
- No need to specify each beneficiary's shares in the policy moneys; this could be held on a fixed or discretionary basis as the insured requires.
- Ability to avoid a situation where policy proceeds becomes owned by the estate of a beneficiary who predeceases the insured.
- Ability to plan and control payment to the beneficiaries; as opposed to the outright lump sum payments to the beneficiaries of their shares in the s.49L policy.
- Special instructions could be attached to ensure that insurance proceeds could be used for the purposes intended by the insured.
- A protector could also be appointed. This is not possible with the s.49L policy.

7.4 Revocable Nominations

The details of the revocable nomination are spelt out in section 49M Insurance Act (Cap 142).

To make a revocable nomination, the policy owner may nominate any person as a beneficiary of the whole or any portion of the **death benefits** under the relevant policy, with indication of each nominee's portion thereof. The nomination must be made in prescribed forms, and in accordance with such directions as may be issued by the Authority.

For a valid nomination, it must provide for the disposition of all death benefits under the relevant policy. In the revocable nomination, nominees are entitled to benefits paid out on death of the insured.

Payments made upon events other than on death belong to the policy owner. As owner, the policy owner could assign, encumber or otherwise deal with the relevant policy or any interest therein. The effect of such actions will revoke any prior nominations. The other ways in which the policy owner can revoke an existing nomination are by:

- making a subsequent will that provides for the disposition of all death benefits under the relevant policy (and also complying with other prescribed formalities) or
- Simply making another nomination or a trust nomination (s.49L policy).

Nominations are accorded the same legal standing as wills in relation to the disbursement of policy proceeds. Thus the proceeds of the 49M policy could eventually well be payable in accordance with a trust nomination, a revocable nomination that has not been revoked or a valid will, whichever is the latest properly executed instrument of which an insurer has been notified at the time of the policy owner's death.

A situation could arise where upon the nomination having been revoked by a will, the will is then subsequently revoked; with the result that the death benefits become distributable in accordance with the Intestate Succession Act.

Where beneficiary predeceases the policy owner

When a beneficiary predeceases the policy owner, his portion of the benefits will automatically be distributed proportionately among the surviving beneficiaries (s.49M(6) of the Insurance Act). If there is no surviving nominee, the nomination shall be deemed to be revoked.

Exercises on Section 49M

1. James created a s 49M policy and nominated the following persons as the nominees:

   a. Jane, his spouse
   b. Jim, 14
   c. June, 23
   d. His mum
   e. His Dad

   Q1 What are the consequences when his father passes away?
   Q2 June gets married and James wants to remove her as nominee. What can he do?

2. Jessica is single and she created a s 49M policy, nominating her mother as sole nominee. Her mother passes away. What are the consequences?

3. Gerry, 28 created a s 49M policy and nominated the following persons as his nominees:

   a. Gina, 29
   b. Frank, 25
   c. Greg, 35
   d. Helen, 38

   All 5 persons were on a holiday trip together when their car crashed and all except Greg survived the accident.

   Q What is the effect regarding the distribution of Gerry's death benefits under the policy?

7.5 Alternative to the revocable nominations policy

In many circumstances, it may be more appropriate for the insurance policy to be held as a non-statutory trust rather than the creation of a s.49M policy. Some of the reasons are as follows:

- The s.49M policy does not offer any protection against potential creditors during the insured's lifetime and should any nominated beneficiary receiving the proceeds be at that time, a bankrupt.
- Should the insured become mentally incapacitated, the ability to change the nominations because of changing family situations would be a challenge. This could also affect the redirection of payment of living benefits where the mentally incapacitated insured had made prior nominations to other persons.

Some of the advantages of the non-statutory life insurance trust over the s.49M policy nomination include the following:

- The substitution, addition or exclusion of beneficiaries can be easily made. In the s.49M nomination, fresh nominations using the prescribed forms would have to be made.
- Subject to the 5 year claw back period under the bankruptcy laws, the non-statutory trust can avoid claims against the policy by future creditors of the insured.
- In the non-statutory trust, the entitlements of each beneficiary could be held on a discretionary basis. Hence upon bankruptcy of a beneficiary, no interest or any portion of the policy proceeds will be available to creditors.
- The non-statutory trust could cater to any change in distributions of the beneficiaries' portions of the policy proceeds because of changing family situations even if the insured becomes mentally incapacitated.
- The client need intended to be met by use of a split trust (see Section 3.3) could be achieved where the death benefits are held by the trustees, but where he retains one or more other living benefits arising under the policy.
- The administration and management of the trust are comprehensively dealt with in the Trust Deed. There is no requirement to follow the prescribed forms or the directions that may be issued in the creation of the revocable nomination.
- Ability to plan and control payment to the beneficiaries; as opposed to the outright lump sum payments to the beneficiaries of their shares in the s.49M policy nomination.
- Special instructions could be attached to ensure that insurance proceeds could be used for the purposes intended by the insured.
- A protector could also be appointed. This is not possible with the s.49M policy nomination.

7.6 Other Aspects

Effect of marriage and divorce on nominations

Marriage and divorce will not affect prior nominations in the s.49L policy as an irrevocable trust is created in favour of the nominated beneficiaries. A spouse who is named as beneficiary in the s.49L policy will not cease to be a beneficiary of the life policy when he or she is divorced from the policy holder.

Marriage and divorce will not have any automatic effect on a revocable nomination. The s.49M policy owner can always revoke his nominees, if he so chooses. Thus on a divorce, the policy owner may decide to revoke the nomination of his ex-spouse as a beneficiary. It is likely that in future divorces relating to the matrimonial division of assets, the revocation of the divorced spouse's interest as a nominated beneficiary may be an important issue for the Court's consideration.

Under the current law, in a divorce, under section 106 of the Women's Charter, the Court can adjust the proprietary interests of the parties as long as these interests were acquired during marriage; such interests can include one spouse's interest in a policy. When a divorce is granted, the Court has power to divide up the parties' matrimonial assets and a policy could be a significant asset for division. The Court may, if it finds in the circumstances just and equitable to do so, remove the spouse's interest in a policy under its powers under section 106. In ***Cheng Kwee Eng v Hong Khai Soong***, Divorce No. 1911 of 1989, the Court divided assets that included an insurance policy between the parties.

Responsibility of Insurers to keep a Register of nominees

Under s.49(N) of the Insurance Act, every insurer shall maintain, in such manner as may be prescribed by the Authority and in accordance with such directions as may be issued by the Authority, a register of every person who has been nominated as beneficiary under the framework. When the insurer receives written notification of revocation, this has to be recorded in the register.

Co-operative Societies Act (Cap. 62)

Section 49O states the circumstances in which the Co-operative Societies Act (Cap. 62) will cease to apply to a relevant policy issued by a co-operative society registered under that Act. On the occurrence of any of those circumstances, the nomination of beneficiaries under a relevant policy will be governed by the statutory framework under the Insurance Act (Cap. 142), and not the nomination framework under the Co-operative Societies Act. A policy holder of such a relevant policy can therefore make the s 49L(2) or 49M(2) nomination under the NOB framework.

S.49M policies as concern Muslim Persons

Under section 111 of the Administration of Muslim Law Act (Cap. 3) no Muslim domiciled in Singapore shall dispose of his property by any nomination under the section 49M(2) of the Insurance Act except in accordance with the provisions of and subject to the restrictions imposed by the school of Muslim law professed by him. In a decision by MUIS's (Islamic body) *Fatwa* Committee, they ruled that the revocable insurance nomination is a contemporary form of *hibah (i.e.* lifetime gift) which is in accordance to Islamic principles and is acceptable.

Payment of Proceeds Without Probate

Section 61 of the Insurance Act (Cap 142) enables the life office to make a payment of up to a prescribed amount (currently at $150,000) to the proper claimants such as the executors (or proper claimants) of the deceased insured without production of any probate or letters of administration.