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PERSONAL LIFE INSURANCE TRUSTS IN NEW YORK

HENRY S. FRASER*

INTRODUCTORY

The well-known danger of placing a large lump sum of money in the hands of an inexperienced widow is perhaps the greatest contributing factor to the phenomenal spread of the personal life insurance trust idea. By such a trust many a husband is arranging for the proceeds of his life insurance to be paid to a local trust company and administered by it after his death according to a plan outlined in the trust instrument. In this way the money is scientifically invested and the income paid to the widow and children at convenient intervals according to the terms of the trust agreement. The trust instrument will also provide for the ultimate disposition of the principal, and it may contain special features dealing with advancements of principal to meet emergencies, the expenses of an edueation, etc.

In order to create such a trust the insured may either name the bank as the trustee-beneficiary in the policies, or he may assign the policies to the bank. At the same time that the policies are delivered to the bank, an instrument is prepared and executed by the parties in which the manner of administering the proceeds of the insurance is set forth. On occasion the insured also transfers to the trust company securities of an income-producing nature and directs in the instrument that the bank shall hold such securities in trust during his lifetime and use the income to pay the premiums on the policies. the instrument will also provide for the disposition of the income-producing property after the death of the insured. This last stated trust is known as a funded trust. The vast majority, however, of personal life insurance trusts are unfunded, *i. e.*, no income-producing property is transferred to the bank during the lifetime of the insured, the insured continues to pay the premiums although the possession of the policies may be given to the trust company.

I. THE NATURE OF PERSONAL LIFE INSURANCE TRUSTS

(a) *Unfunded trust where policies are not assigned.*

Resolved into its essential parts and irrespective of the labels and phraseology customarily employed, what is a personal unfunded life insurance trust? During the recent rise of this type of trust, many perplexing questions have been asked about its legal incidents. The

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difficulty of these questions springs inevitably from the unique nature of life insurance. Throughout the evolution of the law of insurance, difficulties have been encountered in attempting to fit the law of this field, which is distinctly *sui generis*, into the general pattern of jurisprudence. The familiar labels crowd for application, but in using them the courts have sometimes permitted them to becloud the realities. It is important, therefore, that the progress of life insurance trusts be attended with a close study by all lawyers of the actual relations of the parties.

Let us take a typical case of an unfunded arrangement where the policies are not assigned. In the first place, an instrument is executed by the bank and the insured by which the bank promises to collect and administer the proceeds of such policies of insurance on the life of the insured as he shall make payable to the bank as trustee. The instrument also sets forth in detail the manner in which the funds shall be administered and to whom the income and principal shall be paid. The trust company as trustee is then designated as beneficiary under the policies, and they are delivered to the bank for safekeeping. For its services in administering the funds realized from the policies, the bank will be entitled to the compensation fixed by the agreement. During his lifetime the insured retains all privileges with respect to the policies; for example, he may withdraw one or more of the policies, he may borrow on them, receive dividends and surrender values, and change the beneficiary named in the policies without the consent of the trust company. He also pays the premiums, or, if he choose, may allow one or all of the policies to lapse. If the policies are repossessed by the insured before his death, the bank will be entitled to a nominal sum for the storage of the policies up to the time of withdrawal, such fee not infrequently being fixed in the instrument.

It will thus be seen that on the death of the insured the trust company will collect only such amounts as are then payable on policies kept in force by the insured. Moreover, until the death of the insured the only duty of the bank is to guard such policies as the insured permits to remain in its custody. As one writer has stated, "There is really nothing for the trustee to do until the insurance is payable."[1]

It is to be noted that in the above hypothetical case the policies are not assigned to the bank. The legal title remains in the insured. This gives rise to important legal considerations. When the policies become payable and funds for the first time reach the hands of the

[1]Collateral Agreements for the Use of Life Insurance Proceeds (1928) 55. Published by the Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin.

trust company, it is probably true that such funds are impressed with a trust character for all purposes.[2] The fact, however, that the legal title in the policies does not pass to the bank during the lifetime of the insured means that there is no trust of the policies during that period.[3] Upon the insured's death, the bank as the beneficiary named in the policies takes legal title to the proceeds and for the first time becomes a trustee. Prior to his death the bank is a bailee of the policies, the ownership being in the insured and the possession in the bank.[4]

Various legal catchwords have been applied from time to time to the typical unfunded arrangement, described above, in an attempt to bring it under some familiar category. The theory has sometimes been advanced, for example, that the unfunded arrangement amounts to an executory trust during the lifetime of the insured and becomes an executed trust upon his death.[5] This conception, however, involves a misuse of terms. An executory trust, properly so called, is one in which the limitations are imperfectly declared, the intention of the

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[2]Hirsh v. Auer, 146 N. Y. 13, 40 N. E. 397 (1895); Ditmars v. Smith, 3 App. Div. 57, 38 N. Y. Supp. 1036 (4th Dept. 1896); Lauterbach v. New York Inv. Co., 62 Misc. 561, 117 N. Y. Supp. 152 (Sup. Ct. 1909), *aff'd*, 137 App. Div. 919, 122 N. Y. Supp. 1137 (1st Dept. 1910).

[3]Chicago M. & St. P. Ry. v. Des Moines Ry., 254 U. S. 196, 208, 41 Sup. Ct. 81, 86 (1920); Brown v. Spohr, 180 N. Y. 201, 73 N. E. 14 (1904); Central Trust Co. v. Gaffney, 157 App. Div. 501, 142 N. Y. Supp. 902 (1st Dept. 1913), *aff'd*, 215 N. Y. 740, 109 N. E. 1069 (1915); Title Guarantee & Trust Co. v. Haven, 214 N. Y. 468, 108 N. E. 819 (1915); Farjeon v. Fulton Securities Co., 225 App. Div. 541, 233 N. Y. Supp. 577 (1st Dept. 1929); *cf.* Butler v. State Mut. Life Assur. Co., 55 Hun 296, 8 N. Y. Supp. 411 (1890), *aff'd*, 125 N. Y. 769, 27 N. E. 409 (1891).

At least one author, however, ventures the opinion that a present trust is created. He believes that the beneficial interest of the bank, although subject to defeasance by the lapse or withdrawal of the policies, is a sufficient *res* to support the trust. DANIEL S. REMSEN, THE PREPARATION OF WILLS AND TRUSTS, (2nd ed. 1930) 321. (The chapter on life insurance trusts in this work, it is stated in the preface, was prepared by Gerard T. Remsen).

[4]It has been claimed that where the bank is named as trustee-beneficiary without reservation in the insured of the right to change the beneficiary, a true trust comes into being immediately, although the policies are not assigned to the bank. (PRENTICE-HALL TRUST SERVICE [1928–1930] 2001). It is difficult to assent to this proposition because the insured has not sought to divest himself of legal title to the policies. The case is not different from the ordinary situation of a beneficiary named in a policy under which the insured has no right to change the beneficiary: the beneficiary does not have title to the policy whatever other rights he may possess.

[5]Part 2, PRENTICE-HALL TRAINING SERVICE FOR TRUST OFFICERS, LIFE INSURANCE TRUSTS (1929) 25. Published by Prentice-Hall, Inc., New York.

settlor being stated in such general terms that something not fully declared is required to be done in order to perfect the trust.[6]

Nor is it a "contingent" trust, *i. e.*, an express trust which depends for its operation upon a future event.[7] Since the legal title to the policies remains in the insured, no express trust with the bank as trustee is initially created; moreover, the insured does not become an express trustee to the ultimate beneficiaries since he does not intend to become trustee; nor does he become a constructive trustee for them.[8]

Nor is it a contract to establish a trust *in futuro*. The insured does not engage to keep the policies in force for any period of time. If all the policies were allowed to lapse, no person could complain. There is an absence of mutuality of obligation. Moreover, it is not a promise to give property in trust. The insured makes no statement or representation that he will keep the policies alive.

Finally, it is not a trust merely because the instrument designates the bank a "trustee" and the insured a "settlor", or because paragraphs are included referring to the reservation by the insured of the right to revoke the "trust", or referring to the "trust hereby created". It is elementary that the words "trust" and "trustee" do not always show a trust.[9]

Although a contract, other than the bailment of the policies, does not arise at the time they are delivered to the bank, something more than a mere bailment takes place. In effect, the bank, in addition to the subsidiary agreement of bailment, promises that it will receive, hold, and pay out the proceeds of the policies according to the terms of the instrument, if and after the policies become payable. In other words, the bank makes a written offer to the insured to act as a trustee after his death. This offer requires an acceptance by the insured before the transaction is raised to the dignity of a contract. But the insured suffers no detriment and makes no promise. The lapse of all the policies will not work a breach of contract.

The insured, in effect, says to the bank that he may continue the policies in force and that if he does maintain them and does not change the beneficiary away from the bank, the bank may act as

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[6]Wood v. Burnham, 6 Paige 513 (N. Y. 1837), *aff'd*, 26 Wend. 9 (N. Y. 1841). PERRY, TRUSTS AND TRUSTEES (7th ed. 1929) c. 12.

[7]39 CYC. 33.

[8]See EXPLANATORY NOTES ON TRUSTS (Tentative Draft No. 1, The American Law Institute) 6.

[9]Hathaway v. Hathaway, 37 Hun 265 (N. Y. 1885); *In re* Hawley, 104 N. Y. 250, 10 N. E. 352 (1887). RESTATEMENT OF THE LAW OF TRUSTS (Tentative Draft No. 1, The American Law Institute) § 36.

trustee after his death. To put it in another way, the bank makes an offer of a promise for an act, the act to be the maintenance of the policies in force until the death of the insured. If the insured, induced by the offer, performs the act and the bank's offer has not been withdrawn, a binding contract is perfected on the death of the insured.[10] The bank must then collect the avails of the policies and administer the same as trustee according to the contract.

(*b*) *Unfunded trust where policies are assigned.*

In the foregoing section, it was assumed that the bank was named in the policy as trustee-beneficiary while the legal title to the policies remained in the insured. Let us next consider the situation where the insured assigns the policies to the bank as trustee. In such case a trust is immediately created, because the legal title in the policies passes to the bank.[11] In this arrangement the beneficiaries under the trust are named in the instrument, but, of course, do not receive any income during the life of the insured. This fact, however, does not in any way invalidate the trust, which takes effect immediately. The enjoyment is postponed until after death, but the rights of the beneficiaries accrue before.[12]

In many instances the settlor reserves the power to revoke the entire trust and require the reassignment of the policies to himself, thereby terminating the interests of all parties. Such power of revocation, however, does not impair the trust *qua* trust;[13] and, moreover, does not render it a testamentary disposition.[14] The trust is

[10]In referring to the duty of the trustee in such a case, the court in Kerr v. Crane, 212 Mass. 224, 229, 98 N. E. 783, 785 (1912) made the following statement: "His prospective obligation becomes binding only when his contingent interest has become absolute."

[11]A policy of life insurance is held to constitute a contract to pay a certain sum to the payee on the death of the insured, and is a chose in action with all the usual incidents pertaining thereto. [Steinback v. Diepenbrock, 158 N. Y. 24, 52 N. E. 662 (1899)]. As a chose in action the policy is property capable of being held in trust by the bank as assignee. [Johnston v. Scott, 76 Misc. 641, 137 N. Y. Supp. 243 (Sup. Ct. 1912)].

[12]Gilman v. McArdle, 99 N. Y. 451, 459, 2 N. E. 464, 468 (1885); Van Cott v. Prentice, 104 N. Y. 45, 10 N. E. 257 (1887); Grafing v. Heilmann, 1 App. Div. 260, 37 N. Y. Supp. 253 (2d Dept. 1896), *aff'd*, 153 N. Y. 673, 48 N. E. 1104 (1897); Robb v. Washington & Jefferson College, 185 N. Y. 485, 78 N. E. 359 (1906); Johnston v. Scott, *supra* note 11.

[13]Van Cott v. Prentice, *supra* note 12; Brown v. Spohr, *supra* note 3; Schreyer v. Schreyer, 101 App. Div. 456, 91 N. Y. Supp. 1065 (1st Dept. 1905), *aff'd*, 182 N. Y. 555, 75 N. E. 1134 (1905).

[14]Matter of Diez, 50 N. Y. 88 (1872); Gilman v. McArdle; Robb v. Washington & Jefferson College, both *supra* note 12; Lauterbach v. New York Inv. Co., *supra* note 2; Johnston v. Scott, *supra* note 11.

good and effectual as if irrevocable until the power is exercised.[15] Nor does a reservation of the power to modify the terms of the trust, even to the extent of substituting new beneficiaries to receive the income after the settlor's death, render the trust invalid or the transfer a testamentary disposition. *Major continet in se minus*, and if an entire trust may be revoked by the settlor, a provision reserving the power of modification may be included.[16] Of course, if the power to revoke or modify is not reserved, it is lost when the policies are assigned, and no changes may thereafter be made by the settlor except with the consent of all those beneficially interested under the instrument.[17]

(*c*) *Funded trust.*

In a funded insurance trust, income-producing property is transferred to the bank, the income to be used during the lifetime of the insured to pay the premiums on the policies, which are also delivered to the bank. The trust agreement provides for the disposition of the proceeds of the insurance and also of the original income-producing trust property. There is no doubt that as to the latter a trust is created at the date of the transfer of the property to the bank. The settlor parts with the legal title and all elements of an ordinary express trust are present. Furthermore, as has been stated in the foregoing section, a trust of the policies immediately comes into being provided they are assigned. On the other hand, if the policies are not assigned but the bank is merely named as trustee-beneficiary, no trust as to the policies is created during the lifetime of the insured.

Prior to the year 1927 there was grave doubt in New York as to the legality of a funded life insurance trust on the ground that it

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[15]Van Cott v. Prentice, *supra* note 12; Von Hesse v. MacKaye, 136 N. Y. 114, 32 N. E. 615 (1892). PERRY, *op. cit. supra* note 6, § 104.

[16]Perry, *op. cit. supra* note 6, 497. Brown v. Spohr, *supra* note 3; Schreyer v. Schreyer, *supra* note 13.

[17]Title Guarantee & Trust Co. v. Haven, *supra* note 3, at 483, 108 N. E. at 824; Dorman v. Balestier, 175 N. Y. Supp. 677 (Sup. Ct. 1919); Gage v. Irving Bank & Trust Co., 222 App. Div. 92, 225 N. Y. Supp. 476 (2d Dept. 1927), *aff'd*, 248 N. Y. 554, 162 N. E. 522 (1928); N. Y. CONS. LAWS, c. 41 (PERSONAL PROPERTY LAW) § 23.

The provision in the policy that the insured has the right to change the beneficiary thereunder does not empower the insured, after an assignment pursuant to an irrevocable trust, to defeat the trust by an attempted exercise of such right (Johnston v. Scott, *supra* note 11). The assignment and not the policy controls. Of course, an insurance company having no notice of the assignment would be protected in paying the proceeds to whatever beneficiary was named on the face of the policy. See article by Francis J. Wright, *Designation of a Trustee as Beneficiary*, Best's Insurance News, August 1, 1930, pp. 282-287.

involved an unlawful accumulation of income.[18] This situation was partially remedied in that year by an amendment to Section 16 of the Personal Property Law.[19] This amendment, however, according to its terms saves the funded trust only where the policies are included in the trust and constitute a *res*. Therefore, in order to gain the protection of the amendment, the policies must be assigned tò the bank so as to vest title in it as trustee. If they are not assigned, but the bank is merely named as trustee-beneficiary, there is no "trust in property consisting of or including a policy or policies" of life insurance, and the statute would have no application. Such a trust in its entirety would perhaps be subject to successful attack as violating the rule against accumulations.

The rule against accumulations may be violated in still other ways unless care is taken. The amendment above mentioned relates only to the income used for the payment of premiums. Therefore, provision should be made with respect to the surplus income from the securities deposited with the bank. Such surplus, over and above the amounts required to pay the premiums, must be paid by the bank to someone and may not be held until the death of the insured.

In the next place, the trust instrument should provide for some lawful disposition of any proceeds realized on the policies prior to the death of the insured. For example, if a policy lapses and the bank receives the cash surrender value, the same may not be held and accumulated until the death of the insured to be then added to the avails of the other policies.

Many funded trust agreements provide that on the death of the insured the proceeds of the policies shall be added to the trust fund already held by the bank to meet premiums, and that thereafter the income from the consolidated fund shall be paid to certain life ben-

[18]See Bogert, *Funded Insurance Trusts and the Rule against Accumulations*, (1924) 9 CORNELL LAW QUARTERLY 113-137. However, in the case of *In re* Hartmann's Estate, 126 Misc. 862, 215 N. Y. Supp. 802 (Surr. Ct. 1926) where a testator created a trust directing his executors to set aside an annuity sufficient to pay the premiums on a policy insuring the life of his son-in-law, it was held that this did not constitute an accumulation. The reasoning in this case has been seriously challenged. See Hanna, *Some Legal Aspects of Life Insurance Trusts* (1930) 78 U. OF PA. L. REV. 346, 368-370.

[19]The amendment reads as follows: "Provided that a deed or other instrument which creates or declares a trust in property consisting of or including a policy or policies of life, health, accident or disability insurance and directs that the income of such trust shall be applied in whole or in part to the payment of premiums upon such policy or policies shall not be considered as effecting an accumulation either of the income so used for the payment of premiums or of the dividends on such policy or policies."

eficiaries until the termination of the trust. Such a provision may easily violate the rule against perpetuities where the trust as to the income-producing property is irrevocable. The latter fund should be treated separately because the absolute ownership thereof may already have been suspended for one life when the insured dies. The proceeds of the policies, on the contrary, may be trusteed for two lives after the settlor's death, provided the trust as to the policies is made revocable during the life of the insured, or provided certain circumstances exist as pointed out in the following paragraphs.

II. "Two Lives in Being"

The New York statute provides that the absolute ownership of personal property shall not be suspended by any limitation or condition for longer than two lives in being at the date of the instrument containing such limitation or condition, or, if such instrument is a will, for longer than two lives in being at the death of the testator, except that a contingent gift in remainder may be made on a prior gift in remainder, to take effect in the event that the persons to whom the first remainder is limited die under the age of twenty-one years, or on any other contingency by which the interest of such persons may be determined before they attain full age.[20]

As has been pointed out, if the policies are assigned, either in an unfunded or a funded agreement, a trust is thereby presently created. If, further, a power of revocation is reserved to the settlor in the trust deed, the absolute ownership of the policies and other property is not suspended at all during his life.[21] On the other hand, if the trust, either funded or unfunded, is irrevocable, the question arises as to the application of the statute on the suspension of ownership.

The statute has no application in an unfunded arrangement where the policies are not assigned, because in that case, it is submitted, there is no trust until the death of the insured.[22] The insured has the legal title to the policies throughout his life and consequently there is no suspension. If, however, the policies are assigned in an unfunded irrevocable trust, may it be said that the absolute ownership thereof is suspended during the life of the insured? Of course, the question is academic unless the settlor desires to trustee the proceeds of the policies for two lives after his death; this, however, is often the case.

[20]N. Y. Cons. Laws, c. 41 (Personal Property Law) § 11, as amended by N. Y. Laws 1929, c. 229, § 18.

[21]Equitable Trust Co. of New York v. Pratt, 117 Misc. 708, 193 N. Y. Supp. 152 (Sup. Ct. 1922), *aff'd*, 206 App. Div. 689, 199 N. Y. Supp. 921 (1st Dept. 1923).

[22]See first section of this article.

The question does not admit of a categorical answer, because the terms of instruments differ. If all the parties beneficially interested in the trust, whether as life beneficiaries or remaindermen, are adults, the absolute ownership is not suspended during the life of the insured. This is because by statute such persons could consent in writing to the revocation of the trust by the settlor.[23] Thus there are persons in being who could convey an absolute title in possession.

The absolute ownership would not be suspended during the life of the insured for still another reason, provided all life beneficiaries and remaindermen are of full age. Since a trust in which the *res* consists of life insurance policies is not a trust to receive the income of personal property and to apply it to the use of any person, the interests of the beneficiaries may be assigned, and they in conjunction with the remaindermen and trustee could convey to a third person.[24] In fact, if the life tenants and remaindermen joined in an assignment, the trustee would be obliged to transfer the policies to the assignee.[25]

The above reasoning, both as to revocation by consent and assignability of interests, also applies in the ease of an irrevocable funded life insurance trust, so far as the policies are concerned. Likewise, as to the income-producing fund, the above reasoning with respect to revocation by consent applies. If all persons beneficially interested in the income-producing fund are of full age, there is no suspension during the life of the settlor because by statute they may consent to the revocation of the trust by the settlor.[26] In such a special case, the trust instrument may provide that the income-producing fund be held in trust for two lives after the death of the insured.

The reasoning, however, with respect to the possibility of the alienation of the interests of the beneficiaries is inapplicable to the income-producing fund, beeause this is a trust to receive the income of personal property and to apply it to the use of some person. If a person other than the settlor is entitled to the surplus of the income-

[23]N. Y. CONS. LAWS, c. 41 (PERSONAL PROPERTY LAW) § 23. Williams v. Sage, 180 App. Div. 1, 167 N. Y. Supp. 179 (2d Dept. 1917); Cazzani v. Title G. & T. Co., 175 App. Div. 369, 161 N. Y. Supp. 884 (1st. Dept. 1916), *aff'd*, 220 N. Y. 683, 116 N. E. 1040 (1917); Whittemore v. Equitable Trust Co., 250 N. Y. 298, 165 N. E. 454 (1929).

[24]N. Y. CONS. LAWS, c. 41 (PERSONAL PROPERTY LAW) § 15. Wells v. Squires, 117 App. Div. 508, 102 N. Y. Supp. 597 (1st Dept. 1907), *aff'd*, 191 N. Y. 529, 84 N. E. 1122 (1908); Hammerstein v. Equitable Trust Co., 156 App. Div. 644, 141 N. Y. Supp. 1065 (1st Dept. 1912), *aff'd*, 209 N. Y. 429, 103 N. E. 706 (1913).

[25]Wells v. Squires, *supra* note 24. CHAPLIN, SUSPENSION OF THE POWER OF ALIENATION AND POSTPONEMENT OF VESTING UNDER THE LAWS OF NEW YORK (3rd ed. 1928) § 490.

[26]N. Y. CONS. LAWS, c. 41 (PERSONAL PROPERTY LAW) § 23.

producing fund over and above the amount of the premiums, or if the said fund is to continue to be held in trust after the death of the settlor, or if a person other than the settlor would be directly obligated to pay the premiums if it were not for the trust fund and such person consequently receives the direct benefit of the income from such fund, the interests of the beneficiaries are inalienable under the statute.[27]

Returning to our original question as to the suspension during the life of the insured of the absolute ownership of the policies in an irrevocable funded or unfunded trust, the answer would appear to be that the ownership is suspended except in the case where all those beneficially interested in the trust are of full age.

The practical effect of such suspension is important. It means that where policies are assigned irrevocably, except in the special case described, one measuring life is exhausted when the insured dies. Hence the proceeds of the policies in an irrevocable trust, either funded or unfunded, where the policies are assigned, except in the special case noted above, may be held in trust for only one life after the death of the insured.

III. Unborn Life Beneficiaries

A very interesting and practical question arises when the insured, in an ordinary unfunded arrangement where the bank is named trustee-beneficiary and the title to the policies remains in the insured, directs that the proceeds of the policies shall be divided into as many separate trusts as the insured leaves children him surviving, whether in being at the time the instrument is executed or born thereafter.

The statute, enacted long before the recent growth of life insurance trusts, provides that, "The absolute ownership of personal property shall not be suspended by any limitation or condition, for a longer period than during the continuance and until the termination of not more than two lives in being at the date of the instrument containing such limitation or condition, or, if such instrument be a last will and testament, for not more than two lives in being at the death of the testator . . ."[28] As has been said above, there is no suspension and no trust during the life of the insured where he retains title to the policies; when he dies, however, the insurance proceeds become trust funds and the period of suspension begins. Is it necessary that every life beneficiary who is now to receive income have been in being on the day the instrument was executed?

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[27]N. Y. Cons, Laws, c. 41 (Personal Property Law) § 15. *In re* United States Mortgage & Trust Co., 130 Misc. 635, 224 N. Y. Supp. 599 (Surr. Ct. 1927).

[28]N. Y. Cons. Laws, c. 41 (Personal Property Law) § 11.

The statute is primarily directed to testamentary and living trusts, and relates to the respective times such trusts are created. A will speaks as of the date of death; the statute, therefore, only requires that the beneficiaries of a testamentary trust be in existence at the death of the testator, when the trust period begins. A living trust speaks from the date of its creation, which ordinarily is the date on which the written trust instrument is executed by the settlor; the statute, therefore, requires that the beneficiaries shall be in being at the date of the instrument, which presumably means the date of its execution, which in turn usually coincides with the creation of the trust.

In a life insurance trust where the policies are assigned to the trustee, the transaction results in a living trust. The duties of the trustee, to be sure, are not numerous, unless the trust is funded, but they are, nevertheless, present and quite real. The bank is to hold title to the policies and is not a mere custodian thereof; the bank must protect the policies with all the zeal of a trustee and not merely with the care of a bailee. The bank will also be charged with the duties and responsibilities of a trustee in the collection of the proceeds of the policies, whereas in the case where the bank does not hold title to the policies, it will collect the proceeds by virtue of its obligation as a party bound by a contract and will become a trustee only after it receives the money from the insurance company.[29] Since the assignment of the policies results in a living trust, there can be little doubt that the requirement as to lives in being at the date of the execution of the trust agreement will be imposed by the courts. Less justification, however, appears for such a holding where the policies are not assigned and no trust is created until after the death of the insured. Here the insured is looking forward primarily to the time subsequent to his death when the proceeds become available to the trustee. In such a case, since the title does not pass, the absolute ownership is not suspended under any circumstances during the life of the insured. Hence no social purpose appears for a statute directed against this situation. Furthermore, the statutory rule against suspension of ownership must be and has been strictly construed because it is a derogation from the common law.[30] It would seem that a court should struggle to hold the statute inapplicable in the field of unfunded insurance "trusts".

The statute does not define the words "date of the instrument", which phrase may conceivably mean either the date of the execution of the instrument or the effective date of the instrument. The

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[29]See first section of this article.

[30]Perin v. Carey, 24 How. 465 (U. S. 1860); Cochrane v. Schell, 140 N. Y. 516, 532, 35 N. E. 971, 976 (1894).

question as to the interpretation of this phrase does not appear to have been expressly adjudicated with respect to life insurance trusts. The effective date of an unfunded life insurance "trust" instrument where the policies are not assigned, is not the date when the instrument is signed but the date of the death of the insured. There is no trust and no contract, beyond the bailment of the policies, so long as the insured lives; there is merely a continuing offer on the part of the bank to act as trustee of whatever insurance moneys it is enabled to collect by virtue of the continued maintenance of the policies by the insured.

The argument here presented as to the interpretation of the phrase "date of the instrument" may be thought too refined. At least one writer on the subject of life insurance trusts assumes that the words mean the date of the execution of the instrument and he warns against attempting to provide for after-born children.[31]

In whatever way the courts may construe the phrase in question, it would seem to admit of no argument that it is socially desirable that a man be allowed to direct the disposition of the proceeds of his insurance so as to include trusts for all children that may be born to him. Otherwise, the birth of every new child necessitates a new or amended instrument. It is quite possible that the father may postpone until too late the revision of the instrument, or he may have become mentally incompetent. At any rate, the after-born child may find himself destitute while his brothers and sisters are well taken care of, all without any fault on the part of his father. To remove all ambiguity in the statute, the legislature should amend it in the light of the recent tremendous growth of life insurance trusts.

IV. The Manner of Executing the Instrument

The question is sometimes raised as to the testamentary character of the unfunded "trust" where the policies are not assigned. If such a transaction is a testamentary disposition, the instrument must be executed with the formalities required in the case of a will and must be probated after the death of the insured. It is argued that since no present interest passes to the bank during the lifetime of the insured, especially where the right to change the beneficiary is reserved, and since the instrument only takes effect at his death, such document is a will. This theory, however, loses sight of certain facts.

It is true that the rights of the trustee-beneficiary, like those of any beneficiary,[32] where the right to change the beneficiary is reserved,

[31]Hanna, *op. cit. supra* note 18, at 359. See also, Shattuck, The Living Insurance Trust (1928) 40–41.

[32]With the possible exception of the case where the wife of the insured is the beneficiary. Wagner v. Thieriot, 203 App. Div. 757, 197 N. Y. Supp. 560 (1st

are entirely contingent, uncertain, and revocable during the life of the insured.[33] It is also true that no property interest in the policies passes to the bank during the life of the insured. Likewise it is true that outside of the bailment of the policies, which feature may be separately regarded,[34] the instrument does not take effect until the death of the insured. If these were the only considerations, the instrument might perhaps be required to be executed as a will.[35]

The distinguishing point, however, is that a policy of life insurance is not deemed an asset of the estate of the insured unless payable to the insured, his executors or administrators.[36] The mere fact that the insured has title to a policy and may change the beneficiary does not make the policy or its proceeds part of his estate; the money goes directly to the named beneficiary. The rule is not otherwise where the beneficiary is a trustee; the proceeds do not form part of the estate of the insured, whether or not the insured has reserved the right to change the beneficiary.[37]

Inasmuch as neither the policies nor their proceeds constitute part of the estate of the insured at his death, it becomes immaterial in what particular manner some instrument may have been executed by which the beneficiary under the policy is to hold or distribute the proceeds. After the death of the insured the instrument is merely evidence of a contract rendered binding at his death, under which contract the bank must collect the insurance and hold it in trust.

It has already been expressly held in a case where the policies were assigned and a trust was established during the life of the insured, that the plan was not testamentary in character.[38] In the *Voorhees'* case[38a] the Court said:

Dept. 1923), *aff'd*, 236 N. Y. 588, 142 N. E. 295 (1923); *cf.* earlier case of McGowin v. Menken, 223 N. Y. 509, 513, 119 N. E. 877 (1918).

[33]McGowin v. Menken, *supra* note 32; Schoenholz v. N. Y. Life Ins. Co., 234 N. Y. 24, 136 N. E. 227 (1922); Eltonhead v. Travelers' Ins. Co., 177 App. Div. 170, 163 N. Y. Supp. 838 (1st Dept. 1917); Strianese v. Metropolitan Life Ins. Co., 221 App. Div. 81, 223 N. Y. Supp. 16 (1st Dept. 1927).

[34]The presence of the bailment feature does not serve to prove that the instrument in other respects is not a will. The same instrument may be a will and also contain a contract. See 40 Cyc. 1088–1089.

[35]Matter of Diez, *supra* note 14; Butler v. Sherwood, 196 App. Div. 603, 188 N. Y. Supp. 242 (3d Dept. 1921), *aff'd*, 233 N. Y. 655, 135 N. E. 957 (1922).

[36]Matter of Van Dermoor, 42 Hun 326 (N. Y. 1886); *In re* Fay's Estate, 25 Misc. 468, 55 N. Y. Supp. 749 (Surr. Ct. 1898); Wagner v. Thieriot, *supra* note 32; Matter of Knoedler, 140 N. Y. 377, 35 N. E. 601 (1893).

[37]Matter of Van Dermoor, *supra* note 36; *In re* Voorhees' Estate, 200 App. Div. 259, 193 N. Y. Supp. 168 (3d Dept. 1922).

[38]*In re* Voorhees' Estate, *supra* note 37; Johnston v. Scott, *supra* note 11. See also, In re Haedrich's Estate, 134 Misc. 741, 236 N. Y. Supp. 395 (Surr. Ct. 1929).

[38a]*Supra* note 37, at 264, 193 N. Y. Supp. at 172.

> "He has indeed by his trust deeds directed how the proceeds of these policies shall be distributed after death, and named the conditions under which the beneficiaries should take. But this is the effect in principle of every life policy payable at death to another than the assured or his estate."

The same reasoning would apply where the policies are not assigned but the bank is named in the policies as trustee-beneficiary under an ordinary unfunded arrangement.[39]

V. The Insurance Company as Trustee

For the most part insurance companies do not attempt to act as trustees under life insurance trust agreements. Every effort is usually made to co-operate rather than compete with trust companies. On the other hand, some insurance corporations have accepted appointment as trustee under life insurance trust agreements, and it therefore becomes important to note the legal incidents arising in such cases.

It would seem that no insurance corporation, domestic or foreign, may exercise in New York the power to receive deposits of money, securities, or other personal property in trust; nor may any insurance corporation, domestic or foreign, exercise in New York the power to take, accept, or execute any trust or power of whatever nature or description, whether involving real or personal property, committed or entrusted to it by any person by grant, assignment, transfer, devise, bequest or otherwise.[40]

Despite the inclusive language of the statute, it would nevertheless seem clear that a foreign insurance corporation, lawfully acting as trustee in the state of its creation, could send the income from the trust to New York beneficiaries. This could hardly be construed as the "execution" of a trust in New York; a contrary holding would, of course, lead to absurd results.

It is most doubtful that any insurance corporation, domestic or foreign, may ever act as trustee under a life insurance trust, unless such power is expressly granted by statute or is lawfully included in the charter of the company. The situation is unlike that in which an insurance corporation pursuant to an option settlement pays definite sums of money at fixed times to the beneficiaries. Such payments are made according to a rigid contract with the insured, and are made

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[39]Such holding was in fact made more than twenty years ago. This was the case of Lauterbach v. New York Inv. Co., *supra* note 2. However, it might be argued under the facts of that case that the insured had transferred title in the policies to the trustee. Such is the view of that case apparently taken by Frank Irvine in his article on "Trusts" in 39 Cyc. at pp. 76–77.

[40]N. Y. Cons. Laws, c. 2 (Banking Law) § 223.

from the general funds of the company. There is no particular trust *res*, and no discretionary power in the corporation.[41]

It is true the ancient rule that a corporation aggregate could never act as trustee has long been exploded;[42] but a modern corporation may act as trustee only under certain conditions. In the first place, the corporation must have the legal capacity to take real or personal property for corporate purposes.[43] This capacity is sometimes conferred on all corporations by general act.[44] An insurance corporation, however, may be strictly limited as to the extent of real property holdings,[45] and its capacity to take and hold real property in a funded insurance trust, or to purchase real property for a trust, would be highly questionable.

In the second place, a corporation, insurance or otherwise, cannot take and hold property in trust for a purpose in which the corporation has no interest or which is foreign or repugnant to the objects for which the corporation was created.[46] This does not mean that a trust must be strictly within the scope of the direct purposes of the institution of the corporation, but the trust must certainly be at least collateral to such purposes.[47] Whether a trust formed from the proceeds of life insurance, the income from which is payable to private individuals with no relation to the insurance company, is sufficiently germane to the direct purposes of a corporation created to write life insurance, is an open question. It may perhaps be doubted that the administration of such a trust is necessary or proper for the exercise of the powers conferred upon a life insurance corporation.[48]

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[41]M. A. Linton, *Life Insurance Trusts from the Life Underwriter's Point of View*, BEST'S INSURANCE NEWS, July 1, 1930, at 199–203.

[42]Vidal v. Girard's Executors, 2 How. 127 (U. S. 1844). [43]*Ibid.*

[44]*E. g.*, in N. Y. CONS. LAWS, c. 22 (GENERAL CORPORATION LAW) § 14 (3).

[45]N. Y. CONS. LAWS, c. 27 (INSURANCE LAW) § 20.

[46]Vidal v. Girard's Executors, *supra* note 42; Jackson v. Hartwell, 8 Johns. 422 (N.Y. 1811); Matter of Howe, 1 Paige 214 (N. Y. 1828); Currin v. Fanning, 13 Hun 458 (N. Y. 1878); Sheldon v. Chappell, 47 Hun 59 (N. Y. 1888); 14a C. J. 514–515. [47]Vidal v. Girard's Executors, *supra* note 42.

[48]An insurance corporation has no implied power to engage in banking. Thus an insurance company may not issue notes or bills of exchange [Utica Ins. Co. v. Cadwell, 3 Wend. 296 (N. Y. 1829)]; nor engage in the business of discounting [New York Firemen Ins. Co. v. Sturges, 2 Cow. 664 (N. Y. 1824)]; nor issue negotiable bonds, not under seal, payable to the order of one of its clerks and endorsed in blank, in the form of ordinary post notes of banking institutions [Att'y Gen. v. Life and Fire Ins. Co., 9 Paige 470 (N. Y. 1842)]. An act of the legislature incorporating a fire insurance corporation was strictly construed in the case of The People v. Utica Ins. Co., 15 Johns. 358 (N. Y. 1818). The company was doing certain business of a banking nature with the result that *quo*

In the third place, an insurance company when it seeks to act as trustee under a life insurance trust may find itself in a position where its interests as a corporation conflict with its duties as a trustee. If one or more of the trust policies was written by the trustee, the company as trustee might be embarrassed if there were some defense to the payment of the policy. The company cannot sue itself.[49]

In conclusion, however, it is not to be forgotten that the mere appointment of an insurance corporation as trustee does not invalidate a life insurance trust. If the original trustee is incapable of acting as such, a new trustee will be substituted by the proper court, possessing equity jurisdiction, to enforce and administer the trust.[50]

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warranto proceedings were brought. In rendering judgment of ouster the court said (at 383): "It becomes my duty, however, to notice, a little more particularly, the several parts of the act which have been relied upon as conferring such powers. The preamble is said to contain some such intimation, because it declares, that this company ought to be *liberally encouraged.* This is certainly a pretty forced extension of that expression, and not warranted by anything contained in the recital, which states, that incorporating an *insurance company* which had been formed in *Utica*, would tend to mitigate the calamities of fire, give security to manufacturers, and confidence to those who adventure their property on our vast navigable waters; that those are laudable objects, and that a company promoting them ought to be liberally encouraged. But it is far fetched, indeed, to suppose that the right of carrying on banking operations was intended or intimated by this liberal encouragement. The second section, which professes to enumerate and define the powers of the company, does not contain an intimation that the right of banking is among such powers; and it cannot grow out of the general clause which authorizes them to transact all the business generally performed by *insurance companies*, excepting certain specified kinds of business therein particularly mentioned. It was, however, contended on the argument, that the right of carrying on banking operations was necessarily incident to the corporation, because not expressly prohibited, if they had surplus funds which they could spare for that purpose. But I cannot assent to this rule of construing a charter of incorporation for a *specific object.* Such an incorporated company have no rights except such as are specially granted, and those that are necessary to carry into effect the powers so granted. Many powers and capacities are tacitly annexed to a corporation duly created; but they are such only as are necessary to carry into effect the purposes for which it was established. The specification of certain powers operates as a restraint to such objects only, and is an implied prohibition of the exercise of other and distinct powers. A contrary doctrine would be productive of mischievous consequences, especially with us, where charter privileges have been so alarmingly multiplied."

[49]This difficulty arose in the case of New York Life Insurance Co. v. O'Brien, 27 F. (2d) 773 (W. D. Mich. 1927), appeal dismissed on stipulation of counsel, 22 F. (2d) 1016, 1017 (C. C. A. 6th 1927). In that case the New York Life Insurance Company was removed as trustee in favor of the Grand Rapids Trust Company.

[50]Vidal v. Girard's Executors, *supra* note 42. See also, RESTATEMENT OF THE LAW OF TRUSTS, (Tentative Draft No. 1, The American Law Institute) § 97.