Chapter 7

Life Insurance and Estate Planning

Chapter Objectives

On completion of this chapter you should have a basic knowledge on:

- The Many Uses of Life Insurance as a Estate Planning Tool
- The Advantages of the Nomination System
- Trust Policies and Its Benefits to High Net Worth Individuals
- Assignments of Insurance Policies
- Bankruptcy Principles and Its Effect on Estate Planning

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Introduction

The subject of Life Insurance has been mentioned in the earlier chapters of this module and in great detail in Module 2 of the RFP Programme. It is undoubtedly the most useful tool in the risk management of an individual with regards to managing "personal risks" such as death, permanent disability and major illnesses. What many people do not know or realise is that it is also a very important tool for estate planning purposes. This is because it is able to meet several fundamental objectives of estate planning and this must be clearly understood by a financial planner and emphasised to a client in very simple and clear terms. What are these important objectives?

The advantages of Life Insurance in Estate Planning

i) The very essence of life insurance is that it guarantees an immediate "**cash estate**" for the policyowner the moment he has effected an insurance policy on his life. This is a fundamental feature and benefit of life insurance and this "cash estate" can be acquired with a relatively small initial contribution or premiums, compared with other types of assets of significant value, such as the purchase of immoveable assets.

ii) The "**immediate cash available**" feature in a life insurance policy, upon the death of a policy owner, will be of great use to the estate and the beneficiaries. Outstanding debts and liabilities such as credit card bills may be settled. The usual loans an individual may have and not settled at the terms of his premature death, such as housing, hire-purchase (car loans) and personal loans can be paid off. Cash is also available to meet the medical expenses which may have been incurred by virtue of the last illness that caused the death of the policyowner. Funds will also be available to pay legal fees and related expenses for the estate administration process. Thus, the cash available from the death claim proceeds of life insurance policies will allow the estate to settle all outstanding payments without the need to incur unnecessary interest or penalties for late payments. Although the estate of the deceased may consists of other assets, these may be "frozen" until the Grant of Probate or Letters of Administration are obtained from the courts. This we have already learnt in the earlier chapters.

iii) The payment of life insurance proceeds, or a personal accident policy can be obtained from the insurance company in a "**prompt manner**" upon the death of the policy owner. If all the necessary documentation is correctly done in the policy, such as naming of nominees, proof of age, medical reports and other requirements to process the death claim are quickly forwarded to the insurance company, the proceeds of the policy can be quickly settled. Life insurance claims (and EPF Payments) upon the death of the insured policy owner are deemed "**non-probate**" estate and by virtue of the nomination system for settlement of death claims can be quickly received by the named nominees. We shall see further details of payment to nominees later in this chapter.

iv) The proceeds of life and personal accident policy moneys may also enjoy the benefit of a "**creditor-protection**" assets by virtue of a statutory provision in the Financial Services Act 2013 (the Insurance Act 1996 was incorporated into FSA).. This too, we will see in much detail, later in this chapter.

v) Death claim proceeds of life insurance polices are also greatly useful for **business organisations** and their owners, whether they be sole-proprietors, partners or shareholders in a company. This is the subject of chapter 8 and the details of the several advantages of life insurance for these organisations will be discussed there.

Payment to Nominees

We have noted that life insurance and personal accident moneys provide "immediate cash" upon the death of an insured policy owner. The term "immediate cash" is used here to highlight the fact that most of the other assets of the deceased's estate would be frozen and may not be quickly available to his beneficiaries on dependents. The practice and the system of insurance companies to pay death claims quickly is made possible because of the specific provisions of the Financial Services Act 2013 (the Insurance Act 1996 was incorporated into FSA) which repealed the legal principles that were in place earlier. Of particular relevance is **Paragraph 4 of Schedule 10 (Section 130)** of Financial Services Act 2013 which states as follows:

> *"Subject to subparagraph (2), where a policy owner dies having made a nomination, the licensed insurer shall pay the policy moneys according to the direction of the nomination upon receipt of the deceased policy owner according to the direction of the nomination upon receipt of a claim by the nominee together with proof of death of the policy owner."*

This provision effectively means that if the insurer is agreeable to pay out the death claim of the insured policy owner he must pay it to the named nominee(s). The nominees need not show proof of relationship with the insured. It is also not the insurer's responsibility whether the nominee is receiving the moneys beneficially, or in his capacity as an executor or even as a trustee. In short, the full proceeds of the policy must be paid to the nominees upon admission by the insurance company that the claim is payable.

Another provision in the Act also creates a system which encourages the insurer to pay out death claims quickly and this is found in **Paragraph 12 (1) of Schedule 10** of FSA 2013 which states as follows:

"(1) Where a claim or a part of a claim made under a life policy, or under a personal accident policy upon the death of the policy owner is not paid by the licensed insurer within sixty days of receipt of intimation of the claim, the licensed insurer shall pay a minimum compound interest of four per cent per annum or such other rate as may be prescribed on the amount of policy moneys upon expiry of the sixty days until the date of payment".

Thus, if a death claim of an insured policy owner is paid out after 60 days of the insurer being notified of the death, then interest on the proceeds must be paid as well. Irrespective of the reasons that caused the delay of payment, this interest must be paid. The current interest rate as specified by regulations is 4% per annum. It will be interesting to note that this rate is above the prevailing fixed deposit rates offered by most commercial banks. Thus, it is most likely that insurers would not, unnecessarily delay payments of such death claims!

We have thus far seen that proceeds of a insurance policies do have several advantages and the rules that compel insurance to pay out these moneys quickly further enhances life insurance as a powerful estate planning tool. These rules however, do place certain responsibilities on the nominees or claimants who receive the proceeds and we shall see the reason for these requirements below.

Trust Policies

On of the most important aspects of life insurance as an estate planning tool is that a statutory trust can be created out of the moneys payable upon death of a policy owner. This benefit is provided in **Paragraph 5 Subparagraph (1) and (2) of Schedule 10 of FSA 2013**.

Subparagraph (1) reads as follows:

Paragraph 5 Subparagraph (1) *A nomination by a policy owner, other than a Muslim policy owner, shall create a trust in favour of the nominee of the policy moneys payable upon the death of the policy owner, if*

(a) the nominee is his spouse or child; or

(b) where there is no spouse or child living at the time of nomination, the nominee is his parent,

Paragraph 5 Subparagraph (2) further states that "Notwithstanding any written law to the contrary, a payment under subparagraph (1) shall not form part of the estate of the deceased policy owner or be subject to his debts".

Let us further understand the key features of this trust,

i) These trusts may only be created by non-muslim policy owners

ii) The benefit of the trust is only created if the nominees are spouse, children and parents. However, if a parent is named, there must have been no spouse of children living at the time of nomination.

iii) The policy moneys payable under such trusts do not form part of the estate of the deceased or be subject to his debts.

It must be further noted, as provided in other provisions of the Act, that

a) this benefit is provided to both life and personal accident policies (Section 162).

b) the policy must be one which is provided by a policy owner upon his own life providing for payment of policy moneys upon his death (Section 162).

c) a nomination for such polices maybe made at the inception of the policy contract or at a later date (Section 163).

The trust that is created is thus, a very unique benefit given to policyowners by statutory law. Under the conditions as stated above, such policy moneys are the only asset of deceased policyowner which is not subject to the creditors of his estate. (A similar benefit is also seen in Section 23 of the Civil Law Act 1956 but insurers no longer issue policies under this provision). All the other assets that he would have had a beneficial interest in at the time of his death will be subject to creditors under the rules of the Bankruptcy Act 1967.

Nominees as Executors

Other than those individuals mentioned in **Paragraph 6 (1) of Schedule 10** of the Act all other nominees who receive death claim proceeds of an insured policy owner do so in the capacity of an executor. This applies to nominees of Muslim policy owners too, and is stated in **Paragraph 6 of Schedule 10 (Section 130) of Financial Services Act 2013**.

Paragraph 6 Subparagraph (1)
(1) A nominee, other than a nominee under subparagraph 5(1), shall receive the policy moneys payable on the death of the policy owner as an executor and not solely as a beneficiary and any payment to the nominee shall form part of the estate of the deceased policy owner and be subject to his debts and the licensed insurer shall be discharged from liability in respect of the policy moneys paid.

Paragraph 6 Subparagraph (2)
(2) The nominee referred to in subparagraph (1) shall distribute the policy moneys in due course of administration of the estate of the deceased policy owner in accordance with the will of that policy owner or the law relating to the distribution of the estate of deceased persons as applicable to that policy owner.

Paragraph 6 Subparagraph (3)
(3) Notwithstanding subparagraph (1), a nominee to whom policy moneys have been assigned under subparagraph 2 (4)(a) shall receive the policy moneys solely as a beneficiary and not as an executor.

These provisions were already explained in Chapter One of this module. It must however be further emphasised here that, in circumstances where these individuals are named as nominees, it is very important that policy owners do write a Will because it is important to identify the executor. The nominee who has the role of “executor” of the insurance policy moneys, need not be the executor named in the Will, but this is a matter which must be advised depending on the circumstance of the policyiowner. Of course, he should also further be advised to identify in the Will, the beneficiaries of these moneys. For muslims, this is nevertheless subject to the Islamic law principles which we have already seen earlier.

Assignments

An assignment of a life policy is a deed or document which is effective to transfer the ownership of the policy form the one person to another. The person who does the transfer in the assignment is called the **assignor**. The person who receives the benefit of the assignment is the **assignee**.

An assignment may be made to a person or corporations. It is a very common practice for policy owners to assign the benefits of the policy to banks or other financial institutions as a security for a loan granted to them. Upon completion of the loan, the bank will reassign the policy to the policy owner should he be still alive at the time. If he dies before the period of loan repayment the financial institution will receive the policy moneys (as assignees) from the insurance company. The amount of the loan which is outstanding at the time of death of the policy owner is retained by the institution and the balance is forwarded to his estate (Paragraph 7 (1) of Schedule 10 (Section 130) of Financial Services Act 2013 for details).

An assignment made for the purpose of transferring all of one’s ownership rights to another is called an *Absolute Assignment*. An assignment which is made for the purpose of transferring some ownership rights to another but on condition that these rights are reverted to the original owner upon certain conditions is called a *Conditional Assignment.*

In Paragraph 2 (4)(a) of Schedule 10 of FSA 2013 it is stated *“The licensed insurer shall prominently display in the nomination form that the policy owner has to assign the policy benefits to his nominee if his intention is for his nominee, other than his spouse, child or parent, to receive the policy benefits beneficially and not as an executor.”*

This provision is making reference to nominations made in life insurance policies other than those which create a trust. In such circumstances, the objective of an assignment is to give clear indication that the policy owner intends the named nominee to receive the policy moneys **beneficially.** If an assignment is not made in favour of such a nominee then it is deemed that he receives the policy moneys merely as an executor. Where a policy owner intends to assign the policy moneys to a particular nominee for these purposes, a conditional assignment may be most suitable.

Bankruptcy

Bankruptcy has been mentioned in various parts of this module and it is appropriate that a financial planner be aware of the main principles and practices involved. The term ***'bankruptcy'*** describes the procedure whereby the State takes over a person's (known as the debtor's) assets for the purpose of selling them in order to pay off the creditors of the debtor. The term ***'insolvency'*** refers to the situation whereby a person's liabilities exceed his assets, thus making him unable to pay off his debts. The two terms are different, as an insolvent person only becomes a bankrupt after the court has declared him to be so i.e. by making a court order to that effect. Therefore a bankrupt is insolvent but an insolvent person is not necessarily a bankrupt. The debtor can only be called a bankrupt after the court has made the order (known in legal terms as the adjudication order).

The objective of making a debtor bankrupt are:

(a) to secure a fair distribution of the debtor's assets among his creditors;

(b) to relieve the debtor from his debts and to enable him to make a fresh start as soon as he is discharged by the court;

The law of bankruptcy is stated in the Bankruptcy Act 1967 (hereinafter referred to as 'the Act in the section') and the law on procedure is found in the Bankruptcy Rules 1967.

Effects of Adjudication Order

Once an adjudication order is made, the bankrupt's assets **vests in the Director General of Insolvency (or DGI) (previously the Official Assignee)** who will decide on how to distribute the assets among the creditors. The DGI will take charge of the assets; he steps into the bankrupt's shoes and has full control over the bankrupt's assets. The DGI will also decide on whether certain earlier transactions entered into by the bankrupt are still valid or not. By this we mean transactions entered into by the bankrupt prior to him being declared a bankrupt. The relevant section on this is **Section 52(1) of the Act**. There are two circumstances provided for under this section and they are as follows:

1) *Any settlement of property done …………if the settlor becomes bankrupt within* ***two years*** *after the date of the settlement will be absolutely void against the DGI…..*

2) *.......and shall if, the settlor becomes bankrupt……… within five years……. of the settlement, be void against the DGI unless the parties claiming under the settlement can prove that the settlor was at the time of making the settlement, able to pay all his debts without the aid of that property…………..*

The meaning of the term 'settlement' is stated in section 52(3) as follows:

> ...... 'settlement' includes any conveyance or transfer of property, bill, bond, note, security for money or covenant for the payment of money and any gift of money.

As can be seen, the term 'settlement' is widely drafted and thus can include an insurance policy which has **been absolutely assigned** and also **a trust policy**.

For insurance policies which are statutory trusts however, the law is specifically provided for in **Paragraph 5 (6) of Schedule 10 of Financial Services Act 2013:** which states:

> *If it is proved that the policy was effected and the premiums paid with intent to defraud a creditor of the policy owner, the creditor shall be entitled to receive from the policy moneys payable under the policy a sum equal to the premium paid under that policy.*

This provision gives creditors the right to apply to the court for a declaration that the **interests of nominees are inapplicable because of fraud**. It is presumed that a creditor must prove that the premiums under the policy were paid to defraud the creditor. It is expected that this provision would be applied in a similar manner to the trust created by **Section 23(2) of the Civil Law Act 1956**.

Conclusion

We have seen in this chapter that life insurance can indeed be an effective estate planning tool. It provides cash when the client has passed away and the moneys available to the beneficiaries will undoubtedly be most useful for a wide range of purposes. Careful analysis must be done by the financial planner before recommending the various insurance polices available in the market. The appropriate sum assured, naming of nominees and creation of statutory or non-statutory trusts of life insurance polices must be analysed and advised to clients before the recommendations are made to them.