

The Fiduciary Legislation Committee (“Committee”) of the Fiduciary Law Section of the State Bar of Georgia recommends that the Georgia insurable interest statute with respect to the purchase of life insurance, O.C.G.A. § 33-24-3, be amended as set forth below.

The purpose of insurable interest laws generally is to prevent the use of life insurance to wager on the lives of individuals by persons who otherwise would suffer no loss (financial or otherwise) by the individual’s death. The recommended amendments are *not* intended to *create or expand* insurable interest where none existed before, but are instead intended to codify certain persons’ insurable interests that, while presumed in the market place and, in some cases, recognized at common law, are not *expressly* stated in the insurable interest statute. The need to recognize expressly such insurable interests is highlighted by the recent case of *Chawla v. Transamerica Occidental Life Insurance Company*, 2005 WL 405405 (E.D. Va. Feb. 3, 2005), in which a federal district court in Virginia, construing the insurable interest statute of the state of Maryland, determined that a trust lacked an insurable interest in the life of the settlor of the trust, essentially because the Maryland insurable interest statute did not expressly state that a trust had any such insurable interest. The facts in *Chawla* were somewhat peculiar, and the court’s ruling on the insurable interest issue was not necessary to the resolution of the case and has been widely criticized. Nevertheless, given that the use of personal life insurance trust is one of the most common and time honored techniques of estate planning, the fact that any court could determine that such a trust lacks insurable interest is cause for concern.

The following proposed legislation includes footnote commentaries explaining the reasons for the recommended amendments.

A BILL TO BE ENTITLED  
AN ACT

To amend Section 3 of Chapter 24 of Title 33 of the Official Code of Georgia Annotated, relating to insurance, so as to clarify the circumstances under which an insurable interest exists with respect to personal insurance; to codify the common law with respect to certain insurable interests; to amend certain other provisions of Title 33 so that references therein to certain subsections of Section 3 of Chapter 24 of Title 33 will be consistent with the renumbering of the subsections as set forth herein; to repeal conflicting laws; and for other purposes.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF GEORGIA:

**SECTION 1.**

Code Section 33-24-3 of the Official Code of Georgia Annotated, relating to insurable interest with regard to personal insurance, is amended by striking subsections (a) through (f) and inserting in lieu thereof the following:

**O.C.G.A. § 33-24-3. Insurable interest; personal insurance**

(a) An insurable interest, with reference to personal insurance, is an interest based upon a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of another person and consequent loss by

reason of such person's death or disability or a substantial interest engendered by love and affection in the case of individuals closely related by blood or by law.<sup>1</sup>

(b) An individual has an unlimited insurable interest in his or her own life, health, and bodily safety and may lawfully take out a policy of insurance on his own life, health, or bodily safety and have the policy made payable to whomsoever such individual pleases, regardless of whether the beneficiary designated has an insurable interest.<sup>2</sup>

(c) The trustee of a trust established by an individual settlor has an insurable interest in the life of that individual settlor, and has the same insurable interest in the life of any other individual as does such individual settlor. The trustee of a trust has the same insurable interest in the life of any other individual as does any beneficiary of the trust with respect to proceeds of insurance on the life of such individual (or any portion of such proceeds) that are allocable to such beneficiary's interest in such trust. If multiple beneficiaries of a trust have an insurable interest in the life of the same individual, the trustee of such trust has the same aggregate insurable interest in such individual's life as such beneficiaries with respect to proceeds of insurance on the life of such individual (or any portion of such proceeds) that are allocable in the aggregate to such beneficiaries' interest in the trust;<sup>3</sup>

~~(e)~~ (d) A corporation, foreign or domestic, has an insurable interest in the life of any individual (i) holding at least ten percent of the issued and outstanding shares of such corporation or (ii) in whom the shareholders holding a majority of the issued and outstanding shares have an insurable interest, whether arising out of their status as shareholders of the corporation or otherwise, and in the life or physical or mental ability of any of its directors, officers, or employees or the directors, officers, or employees of any of its subsidiaries or any other person whose death or physical or mental disability might cause financial loss to the corporation; or, pursuant to any contractual arrangement with any shareholder

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<sup>1</sup> No amendments to subsection (a) are recommended, but it is included here for the purposes of context.

<sup>2</sup> No amendments to subsection (b) are recommended, but it is included here for the purposes of context.

<sup>3</sup> New subsection (c), which is based upon a similar provision of the Delaware insurable interest statute, expressly recognizes a trustee's insurable interest in the life of the settlor of a trust. The irrevocable life insurance trust (ILIT) is one of the most commonplace and time honored tools for estate planning in Georgia and throughout the rest of the United States. Consequently, even where a trustee's insurable interest is not expressly set forth in a statute, it has generally been presumed. In fact, even though the insurable interest of a trustee is not expressly set forth in the *insurance* provisions of the O.C.G.A., two provisions of the Georgia *Trust Act* acknowledge the propriety of the purchase of life insurance by trustees. O.C.G.A. § 53-12-22.1 establishes the circumstances under which an ILIT may be created by oral agreement and O.C.G.A. § 53-12-232, which sets forth the general fiduciary powers of trustees that may be incorporated by reference into trust agreements, provides in subsection (3) that a trustee may invest in "insurance contracts on the life of any beneficiary or of any person in whom a beneficiary has an insurable interest."

concerning the reacquisition of shares owned by him or her at the time of his or her death or disability, on the life or physical or mental ability of that shareholder for the purpose of carrying out such contractual arrangement; or, pursuant to any contract obligating the corporation as part of compensation arrangements or pursuant to a contract obligating the corporation as guarantor or surety, on the life of the principal obligor. The trustee of a trust established by a corporation for the sole benefit of the corporation has the same insurable interest in the life or physical or mental ability of any person as does the corporation. The trustee of a trust established by a corporation providing life, health, disability, retirement, or similar benefits to employees of the corporation or its affiliates and acting in a fiduciary capacity with respect to such employees, retired employees, or their dependents or beneficiaries has an insurable interest in the lives of employees for whom such benefits are to be provided. As used in this subsection, the term "employee" shall include any and all directors, officers, employees, or retired employees. The term "employee" shall include any former employee, but only for the purpose of replacing existing life insurance that will be surrendered in exchange for new life insurance in an amount not exceeding the insurance being surrendered.<sup>4</sup>

~~(e-1)~~ (e) The insurable interest of a corporation or trustee which has been established pursuant to subsection ~~(e)~~ (d) of this Code section shall be conveyed automatically to another corporation or to the trustee of a trust established by such other corporation for its sole benefit which has acquired by purchase, merger, or otherwise all or part of the first corporation's business. A corporation or the trustee of a trust established by such corporation for its sole benefit may exchange any policy of insurance issued to itself or to another corporation or the trustee of a trust established by such other corporation for its sole benefit from which the

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<sup>4</sup> The amendments to this subsection, previously designated subsection (c) and now re-designated subsection (d), expressly acknowledge that a corporation has an insurable interest in the lives of its shareholders, at least with respect to shareholders holding significant portions of the corporation's stock. Even prior to this amendment, subsection (c) recognized that *"The trustee of a trust established by a corporation for the sole benefit of the corporation has the same insurable interest in the life or physical or mental ability of any person as does the corporation."* In the same vein, a corporation created by one or more shareholders for their own benefit (as are all corporations) necessarily has an insurable interest in any individual in whom the shareholders of the corporation have an insurable interest, at least with respect to shareholders holding a substantial portion of the issued and outstanding shares. Even if a substantial shareholder is not actively involved in the management of the corporation, the smooth and harmonious operation of the corporation necessarily depends upon the shareholders having a reasonable working relationship with each other. Upon the death of a significant shareholder, the stock could pass to one or more persons that would be undesirable as significant shareholders, from the standpoint of the corporation or the other shareholders. Moreover, if the corporation is an "S" corporation, the death of a shareholder could result in the shares passing to some person or entity that is not a permissible S corporation shareholder. Therefore, even where the corporation and/or the other shareholders have not contractually *bound* themselves to purchase the stock of a deceased shareholder, they nevertheless have a profound interest in having the *ability* to purchase the shares of a deceased shareholder. Likewise in a corporation where the shareholders are also a source of additional capital when needed, the loss of such a shareholder is also the loss of a potential source of capital that can be replaced by insurance.

exchanging corporation has acquired by purchase, merger, or otherwise all or part of such other corporation's business for a new policy of insurance issued to itself without establishing a new insurable interest at the time of such exchange.<sup>5</sup>

(f) A shareholder in a corporation has an insurable interest in the life of any other shareholder pursuant to any contractual arrangement between or among such shareholders concerning the purchase by surviving shareholders of shares owned by a deceased or disabled shareholder, for the purpose of carrying out such contractual arrangement;<sup>6</sup>

(g) A partnership, limited liability company, business trust, or other business entity established under the laws of any state or of the United States shall have the same insurable interests as a corporation, as set forth in subsections (d) and (e) of this Code section, including, without limitation, insurable interests in such entity's partners, members, or holders of other equity ownership interests, and of its officers, directors, employees, and those of any subsidiaries of any such entity. The partners of a partnership, the owners of a limited liability company, and the owners of equity interests in any other form of business entity have the same insurable interest in the lives of the other partners, members or equity interest owners as to shareholders of corporations.<sup>7</sup>

~~(d)~~ (h) An insurable interest must exist at the time the contract of personal insurance becomes effective but need not exist at the time the loss occurs.<sup>8</sup>

~~(e)~~ (i) Any personal insurance contract procured or caused to be procured upon another individual is void unless the benefits under the contract are payable to the individual insured or such individual's personal representative or to a person having, at the time when the contract was made, an insurable interest in the individual insured. In the case of a void contract, the insurer shall not be liable on

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<sup>5</sup> This only changes to this subsection are to redesignate subsection (c.1) as subsection (e) and to change the reference to subsection (c) to redesignated subsection (d).

<sup>6</sup> New subsection (f) recognizes the insurable interest of the shareholders in the lives of the other shareholders. Subsection (d) (former subsection (c)) recognized the insurable interest of a *corporation* in the lives of its shareholders where there is a buy-sell agreement between them, but does not specifically address the purchase of shares by *other shareholders* that are parties to a "cross purchase" buy-sell agreement, which is as commonplace, if not more so, than agreements permitting the corporation to purchase shares at death.

<sup>7</sup> New subsection (g) recognizes expressly that all of the insurable interest provisions with respect to corporations and their shareholders apply equally to other types of business entities and their owners. This is especially important since, in the last several years, limited liability companies (LLCs) taxed as partnerships have become increasingly popular, particularly for closely held businesses, since they are "pass-through" entities for tax purposes, are simpler in structure than limited partnerships, and are not subject to all of the restrictions imposed upon S corporations.

<sup>8</sup> The only change to this subsection, previously designated subsection (d), is that it has been redesignated as subsection (h).

the contract but shall be liable to repay to the person or persons who have paid the premiums all premium payments without interest.<sup>9</sup>

~~(f)~~ (j) A charitable institution as defined under Sections 501(c)(3), 501(c)(6), 501(c)(8), and 501(c)(9) of the Internal Revenue Code of 1986 shall have an insurable interest in the life of any donor.<sup>10</sup>

(k) The insurable interests set forth in this Code Section are not exclusive, but are cumulative of, and not in lieu of, insurable interests existing in common law and not expressly set forth herein. No part of this Code Section specifically recognizing any insurable interest shall create any presumption or implication that such insurable interest did not exist prior to the enactment of such part. To the contrary, an insurable interest shall be presumed with respect to any life insurance policy issued, prior to the effective date of any part of this Code Section, to any person whose insurable interest is recognized in this Code Section.<sup>11</sup>

## SECTION 2.

Code Section 33-24-6.1 of the Official Code of Georgia Annotated, relating to prerequisites for replacement life insurance exceeding insurance being surrendered, is amended by striking the introductory paragraph and subsection (1) and inserting in lieu thereof the following:<sup>12</sup>

Notwithstanding the provisions of subsection ~~(e)~~ (d) of Code Section 33-24-3, subsection (d) of Code Section 33-24-6, or paragraph (11) of Code Section 33-27-3 which relate to the replacement of existing life insurance, any new life insurance may exceed the insurance being surrendered:

(1) When an entity has a proper interest pursuant to ~~subsection (e) or (e.1)~~ subsections (d) or (e) of Code Section 33-24-3 and the authority to effectuate life insurance pursuant to the provisions of paragraph (4), (5), or (6) of subsection (a) of Code Section 33-24-6; and

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<sup>9</sup> The only change to this subsection, previously designated subsection (e), is that it has been redesignated as subsection (i).

<sup>10</sup> The only change to this subsection, previously designated subsection (f), is that it has been redesignated as subsection (j).

<sup>11</sup> New subsection (k) is intended to avoid the misconception that these amendments create new insurable interests that did not already exist at common law, such that the enactment of these amendments *at this time* should not give rise to any presumption that such insurable interests did not exist previously. Therefore, this provision makes clear that that the insurable interests recognized in these amendments applies not only to new policies, but to policies issued prior to the effective date of these amendments.

<sup>12</sup> The amendments to Section 33-24-6.1 are to recognize the changed subsection designations of Section 33-24-3.

### SECTION 3.

Code Section 33-27-1 of the Official Code of Georgia Annotated, relating to group requirements generally, is amended by striking subsection (9) and inserting in lieu thereof the following:

(9) Special employee groups. ~~A corporation~~ An entity or a trustee of a trust established by ~~a corporation~~ an entity which has an insurable interest in employees pursuant to subsection ~~(e)~~ (d) of Code Section 33-24-3 and authority to effectuate insurance on employees pursuant to paragraph (4) or (5) of subsection (a) of Code Section 33-24-6 may establish an employee group to effectuate group life insurance policies on employees when such corporation or trustee of a trust is providing life, health, disability, retirement, or similar benefits to employees, provided that the premium for such group policies is wholly paid by the corporation or trustee of the trust and the proceeds of such policies are used to provide supplemental funding for such employee benefit plans.<sup>13</sup>

### SECTION 4.

Code Section 33-27-3 of the Official Code of Georgia Annotated, relating to group requirements generally, is amended by striking subsection (11) and inserting in lieu thereof the following:

(11) ~~A corporation~~ An entity or trustee of a trust having an insurable interest pursuant to subsection ~~(e)~~ (d) of Code Section 33-24-3 and effectuation authority pursuant to paragraph (4) or (5) of subsection (a) of Code Section 33-24-6, providing life, health, disability, retirement, or similar benefits to employees may designate the beneficiary of a group life insurance policy, providing that the corporation or trustee of a trust uses the insurance proceeds to provide life, health, disability, retirement, or similar benefits to such employees. As used in this paragraph, the term "employees" shall include directors, officers, employees, retired employees, or the dependents of such persons. The term "employee" shall include any former employee, but only for the purpose of replacing existing life insurance that will be surrendered in exchange for new life insurance in an amount not exceeding the insurance being surrendered.<sup>14</sup>

### SECTION 5.

This Act shall become effective upon its approval by the Governor or upon its becoming law without such approval.

### SECTION 6.

All laws and parts of laws in conflict with this Act are repealed.

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<sup>13</sup> **The amendments to Section 33-27-1 are to recognize the changed subsection designations and the fact that Section 33-24-3 applies to all business entities, not just corporations.**

<sup>14</sup> **The amendments to Section 33-27-3 are to recognize the changed subsection designations and the fact that Section 33-24-3 applies to all business entities, not just corporations.**