<u>CHOOSING CHILDREN AS BENEFICIARIES</u>

What are the rules regarding naming juvenile children as beneficiaries of a life insurance policy, in Ontario.

Answer: There are a number of advantages to naming a child or children to receive insurance proceeds. First, the insurance proceeds will not pass through the parent's estate on death and as a result, will be protected from the insurer's creditors.

In addition, if the policy has any cash value prior to the death of insured, then so long as the trustee designation remains in place, creditors cannot lay claim to the policy during his or her lifetime.

Finally, the proceeds will not form part of the value of the estate for the purpose of computing court fees on an application for letters of probate or letters of administration.

Here are some disadvantages to naming a juvenile child or children to receive insurance proceeds. In the context of estate planning, a parent will frequently specify in his or her will, that a child should not receive a share of the estate before a specified age. Or perhaps that payment of the inheritance be staged over time, such as one-third at age 21, one-third at age 25, and the balance at age 30.

Such a scheme gives the parent some comfort that the child will be mature enough to handle his or her inheritance when it is received. (*A staged distribution gives the child more than one chance to "blow the whole thing."*)

Because insurance proceeds designated payable to a child will not form part of the estate, the child will be entitled to receive the proceeds immediately on turning 18, irrespective of the provisions in the parent's Will. Where the insurance proceeds are substantial, this may seriously undermine the parent's estate planning objectives.

In order to be entitled to receive insurance proceeds on behalf of the child, a person must first be appointed guardian or trustee of the child's property. (In Ontario, the applicable statue is the Children's Law Reform Act.) This appointment should not be confused with an appointment as the custodian of the child. A trustee is typically named on your life insurance declaration.

In the absence of a proper trust setup, there is an inexpensive procedure under the Ontario Insurance Act. For a nominal fee, the insurer can pay the insurance proceeds (net of that fee) to the court. The insurance proceeds will be payable to the child when he or she turns 18. In the meantime, the proceeds will be invested at a prescribed rate of interest (adjusted quarterly).

Once the proceeds are paid to court, the person having legal custody of the child must make written requests to the official guardian in order to have payments made out of court for the child's expenses.

When a trustee is named as protected under the Insurance Act, the trustee is subject to the terms set out in the trust declaration, the Trustee Act of Ontario and to the general law applicable to trusts. To the extent that the document setting up the trust specifies the duties and authority of the trustee, this document will govern and override any inconsistent provisions contained in the Trustee Act.

Accordingly, the trustee must begin by reviewing the trust declaration under which they have been appointed and must advise whether he or she is holding the proceeds for a single beneficiary or more than one beneficiary. If the latter, the trustee must also specify if those proceeds are being held in separate equal shares for each beneficiary or in some other manner.

When the beneficiary for whom the insurer is holding the insurance proceeds reaches the age of majority (assuming the beneficiary is not otherwise incapacitated and there is no other competing interest involved) the trustee will turn the balance of the proceeds over to the beneficiary.

Initial duties of trustee

Upon being appointed, a trustee is required to do the following:

(a) determine the location of the proceeds;
(b) ensure the proceeds are safe custody; and
(c) ensure the proceeds are properly invested as permitted by the trust declaration or the Trustee Act.

Standard of care

The standard of care required of a non-professional trustee in administering a trust is that which a person of ordinary prudence would use a managing his or her affairs. Accordingly, as long as the trustee preserves the proceeds and invests them in authorized investments with ordinary prudence, the trustee will meet this standard care.

In making investments the trustee may be held liable for the loss of the trust proceeds if he or she makes an investment that is not authorized and the investments fails. The trustee would also be liable if he or she used the trust proceeds for his or her own benefit or the benefit of someone other than the beneficiary for whom he or she is holding the proceeds.

A trustee is required to make all decisions respecting the trust and cannot delegate his or her duties to someone else, once the trust proceeds and the obligations that go with them have been accepted.

Investment of trust funds

A trustee is under a duty to invest trust funds in investments that are authorized under the declaration of trust or are authorized by the Trustee Act. The particular investments chosen are at the discretion and judgement of the trustee. Generally the governing principle regarding investment is prudence and conservatism and risky or speculative investments should be avoided.

Advancing trust proceeds early
Most standard trust declarations give authority to the trustee to “use the proceeds for the maintenance and education of the beneficiary.” Accordingly, to the extent that the insurance money is required to provide for the maintenance or education of the beneficiary, the trustee may use part or all of the proceeds for such purpose.

There may also be other situations where the trustee wishes to provide some of the proceeds to the minor beneficiary prior to the beneficiary reaching the age of majority. However, unless such advances are for purposes permitted in the trust declaration or the Trustee Act, the trustees should be advised to apply to the Ontario Court (General Division) for permission to do so. By making such application the trustee would be protected should the minor beneficiary later dispute the property of the use to which the money was put.

Duty to account and provide information
A trustee is required to keep proper records indicating how the proceeds were handled. The beneficiary has the right to inspect the records upon request and to receive information on the state of the trust on a regular basis.

Compensation
A trustee may be entitled to compensation for managing trust funds. If the trust declaration does not set out the basis of such compensation in order to receive such compensation, the trustee must apply to the Ontario Court (General Division). The court will look into the care, pains, trouble and time expended concerning the trust in assessing appropriate compensation. In many cases, particularly when the trustee is a family member or friend, no compensation is sought or desired.

Appointment of new trustee in the event of death
A trustee may in his or her Will appoint one or more trustees to manage the trust in the event the trustee dies prior to the beneficiary reaching the age of majority.

Summary

The authority and duties of a trustee will vary depending on the trust declaration. However, in the usual situation where a trustee accepts a trust on behalf of a beneficiary under most standard trustee declarations, the applicable law (being the Trustee Act, the Trust Declaration and the Common Law) requires the trustee to hold the insurance proceeds payable to that beneficiary and to invest that money prudently in appropriate and authorized investments. The trustee may, in his or her discretion, use any of a beneficiary's funds for the maintenance or education of that beneficiary and when the child reaches the age of majority, the trustee will turn the balance over to the beneficiary and the trustees job will be finished.

Caution

Need further clarification or help, give us a call at 613-475-5109,
Toll-free 1-866-475-5109, ext #1; Fax 475-1581,
E-mail: DaveS@lighthousewealth.ca;
Be sure to visit our website at www.lighthousewealth.ca