Bloomberg Tax

Daily Tax Report®

Reproduced with permission from Daily Tax Report, 173 DTR 8, 9/6/18. Copyright © 2018 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

Insurance

INSIGHT: Consequential Liabilities and Remedies to Mismanaged Individual and Trust Owned Life Insurance

BY HENRY MONTAG, CFP, AND ROBERT BARNETT, CPA, ESQ.

An increasing number of non-guaranteed life insurance policies are expiring prematurely, caused by sustained and reduced interest rates in conjunction with fiduciary inattention by unskilled/amateur trustees of irrevocable life insurance trusts (ILIT), or special needs trusts (SNT). The Wall Street Journal reported that this trend is the life insurance industry's "not so little dirty secret." (Leslie Scism, *Retirees Stung By "Universal Life" Cost*, Wall St. J., Aug. 9, 2015.) The reasons can be easily understood, and will be explored with the intention of providing a basic understanding of how the problem arose and how it is currently affecting clients, their attorneys, CPAs, agent/brokers, as well as the insurance companies providing the life insurance policies. Case law will be discussed citing specific rulings and examples of what needs to be done. Most importantly, we will discuss the various solutions to fix an existing problem as well as how to avoid a problem from occurring in the first place.

We will explore the options and provide the reasoning and guidance for the advisor working with the amateur/unskilled trustee to do what's necessary to prevent their life insurance policy from joining the increasing numbers of life insurance policies expiring years earlier than expected. Time will also be spent pointing out the steps necessary to achieve a successful outcome of the tax-free distribution of a death benefit for the next generation or to a business partner.

How can so many life insurance policies owned by so many trustees, many of whom are smart business owners and professionals, be expiring prematurely when one would have expected that they could have prevented this from happening? Many of these business owners and professionals are still unaware and confused about how this occurred, and what they as owners and trustees must do going forward to prevent the life insurance they're responsible for from continuing to expire earlier than anticipated.

There are several reasons for this confusion. (Based on research for a book published by the American Bar Association: Henry Montag and E. Randolph Whitelaw, *The Life Insurance Policy Crisis: The Advisors and Trustees Guide to Managing Risk & Avoiding a Client Crisis* (ABA)(2017).) Confusion that's causing approximately 23 to 25 percent of the 45 percent of existing in force non-guaranteed life insurance policies to expire prematurely.

THE WAY IT WAS

In the mid 1980's, when interest rates were in the 17 to 18 percent range, many people withdrew their cash value accumulations from their existing life insurance policies that were earning 3 to 4 percent and transferred them into banks and CDs to earn a substantially higher rate of return. In order to stop this tremendous outflow of money from the cash value accounts of life insurance policies to the banks, the insurance industry

came out with a new line of life insurance products called flexible premium life insurance. In 1982, E.F Hutton became the first major insurer to develop and market what would become one of the most common types of flexible premium life insurance policies, called universal life insurance. Because this type of a policy paid a higher interest rate than whole life, the cost to purchase an equivalent amount of universal life insurance was significantly less expensive.

As a result of its popularity, by 1986, 25 percent of the life insurance industry had a universal life policy available for sale. However, what wasn't discussed by many of the agents/brokers, nor encouraged to be pointed out by the insurance industry, was that this rate was not fixed, as it was tied into the current prevailing interest rate. So while most insureds were concentrating on the current interest rate, very few agents/brokers spoke about the fact that the policies were not guaranteed, and that the owner/trustee assumed 100 percent of the management responsibility as well as the performance risk of the life insurance policy. This meant that a higher premium would have to be paid to the insurer to make certain that the duration of the coverage would survive the insured if interest rates declined, as they did.

How Did Rates Affect the Performance of the Contracts?

Because interest rates were substantially higher when these contracts were first created and marketed in the mid 1980's to the early 1990's, many insureds and their trustees erroneously assumed based on a 'linear paper illustration'. This tool has often been criticized by industry experts that point out that this type of a tool often misled consumers and their advisors into believing that their policies would always continue to earn the same higher interest rates they initially earned for the next 30 to 40 years. However, when interest rates began declining, neither the insureds nor the owners of the life insurance policies, usually their eldest child, were aware that they should have increased the amount of premium they were paying to the insurance company. This often occurred because the original illustration indicated a premium payment based on an interest rate that wasn't achieved. They expected the insurance company to increase their premium payments if that was necessary. However, that wasn't the insurance company's responsibility nor decision to make. Instead it was the sole responsibility of the policy owner to do so. It's now obvious that the insurance industry could have done a better job communicating to the consumers to let them know the shortcomings of not increasing their premium payments. Similarly, a better job could have been done by the insureds/trustees, and their advisors, who didn't make sufficient inquiries as to the status of their existing life insurance policies.

So, after years of sustained reduced interest rates and neglect on the part of the owners and trustees, their policies' cash value began to diminish earlier than expected, causing their life insurance policy coverage to expire earlier than originally anticipated. The majority of the owners of these policies weren't aware that their life insurance portfolio should have been treated as a ''Buy and Manage'' asset just like any of their other stock and bond investment portfolios, rather than a ''Buy and Hold'' asset in which they placed their life insurance policy in the proverbial bottom left hand desk drawer and forgot about it.

Why Didn't the Insurance Company/Agent Monitor the Situation?

Many trustees, grantors, and their advisors were, and still are today, under the misimpression it was the agent/broker's or Insurer's role/responsibility to monitor the policy. However, the agent is contracted with and obligated to the insurance company, not to the insured. It's the agent/broker's job to market and distribute the insurance policy to its customers. It's the insurance company's job to provide the death benefit coverage and send the owner an annual statement. It's the insureds/trustees' job to manage the life insurance policy and make certain that there's enough premium being paid to keep the insurance in force until whatever age they want the coverage to last. Unlike the ''on again off again'' proposed Labor Department fiduciary rule, there was no requirement on the part of the insurance company, nor the agent/broker, to do what is in the insured's or trustee's best interest. The insurance company is only obligated to do what's in the company/shareholder's best interest. It is significant and important to keep in mind that when a life insurance policy expires before the insured dies, the insurance company receives a windfall profit, as the insurance company gets to keep all the previous years of paid premiums, and subsequently will never have to pay out a death claim.

To Make Matters Even Worse, the COI's Increased

As if it weren't bad enough that sustained reduced interest rates and neglect combined to make policies lapse years earlier than originally anticipated, now that the insurance industry had the consumer between their crosshairs they decided to accelerate the process by which life insurance policies could be made to expire even more quickly than before. In 2016 the insurance industry, for the first time ever, decided to increase the internal costs of life insurance (COI). In doing so, they created the ''perfect storm'' and further exacerbated an already deteriorating situation hastening the premature expiration of an increasing number of life policies at an even quicker pace than before.

Because the insurers were already contractually approved to make these increases at will, when they decided to exercise these options they were done at a moment's notice and even the regulators were caught off guard. Today, individual states are taking steps to protect their consumers against such action taken by the insurers, despite the fact that insurers already have the legal ability to pass these additional cost increases on to the consumers. Currently, the various state insurance departments are significantly slowing down the period of time before such increases can take effect by making certain that the insurers are complying with all of the administrative requirements. While on the topic of state regulations, it should be mentioned that the New York Department of Financial Services on July 19, 2018, is-

COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.

sued final regulations mandating that an agent/broker of an insurance company be required to act in the insureds' best interest. The 'Best Interest' ruling becomes effective Aug. 1, 2019, for annuities, and Feb. 1, 2020, for life insurance. Although this regulation was adopted for New York State it's expected to become the law of the land in many other states as well.

WHAT NEEDS TO BE DONE

The first thing that needs to be done is for the insured/owner/trustee to request a ''historic projection'' from the insurer indicating all premiums that were paid to date, as well as the interest rates credited since the policy went into effect. Once this information is received, an independent insurance consultant can prepare a policy performance evaluation to determine the current status of the life insurance policy and, based on the current premium, determine exactly how much longer the policy is expected to remain in force. Another calculation should then be made to determine how much additional premium is required to maintain the policy on a guaranteed basis to a specific desired age. These steps are necessary in a non-guaranteed universal life or variable universal life insurance policy because, unlike their more expensive whole life counterparts containing lifetime guarantees, these policies were not guaranteed to last for a lifetime. Instead, their performance was tied to an anticipated annual interest crediting rate or an anticipated stock index performance in a variable life policy. In either case, the anticipated returns were never achieved. Whole life policies are guaranteed if all premiums are paid in full and in a timely manner. However, many insureds use the dividend to reduce the premiums or buy term insurance. It therefore must be emphasized that since dividends are not guaranteed, and have recently been reduced by as much as 50 to 60 percent, even a whole life policy can be adversely impacted and should be reviewed periodically to assure its financial health.

While the introduction of this interest-sensitive product in the early 1980's solved the immediate outflow problem for the insurance industry, it has created other far more significant problems for policy owners and their families that purchased such a product over the last 15 to 25 plus years, and the matter is growing increasingly worse with the passage of time. These facts created the present situation that has caused a growing percentage of amateur trustees to discover that their portfolios require immediate corrective action.

If the policy is owned in an irrevocable life insurance trust (ILIT), the trustee has to be made aware that they have the sole duty, responsibility, and fiduciary liability to manage the trust asset. However, oftentimes these amateur trustees, serving as an accommodation to their parents, have no clue as to what needs to be done and they rely solely upon their advisors for all communication and instructions regarding required trust administration functions. It is estimated that 90 percent of in-force trust-owned life insurance (TOLI) policies are administered by family members or friends acting as unskilled amateur trustees, with only 10 percent being managed by corporate trustees. Why do attorneys often suggest that clients use trusts to hold a family's life insurance, and what are some specific things we should know about their use, and lack of use?

Why Do Attorneys Suggest the Use of Trusts?

Trusts are utilized for a variety of purposes and need to be carefully drafted in accordance with the settlor's intent. The most common reasons for utilizing a trust to hold life insurance are for asset protection and tax savings. The central feature of a trust is the separation of management from the beneficial enjoyment of property. (Restatement (3rd) of Trusts, Section 2. A trust is ''a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of. . . one or more persons.'') The trust is created by the settlor for the benefit of the beneficiary for whose benefit the property is held. The trustee has the legal authority and responsibility to manage and distribute trust assets in accordance with the settlor's intent and the terms of the trust. It is important to carefully memorialize the settlor's intent with respect to the selection and retention of trust assets. As described below, insurance trusts require special considerations.

Terms of the trust should include provisions describing the trustee's duties and obligations. Trustees have several duties and responsibilities, and although these are based upon state law, they can be generally summarized as follows:

- A duty to administer the trust in accordance with its terms.
- A duty of loyalty to administer the trust solely in the interest of the beneficiaries.
- A duty of care and prudence in the administration of the trust generally as a prudent person.
- A duty to keep beneficiaries reasonably informed about significant trust developments.
- A duty to diversify investments and to follow the prudent investor standards as adopted in the relevant jurisdiction.
- Acts according to UPIA rules to treat all assets equally.

A trustee who violates any of these duties may be held liable and surcharged in an amount required to restore value to the trust or to the beneficiary. The general trustee duties have a heightened and focused application in the context of life insurance trusts.

OVERVIEW OF LIFE INSURANCE TRUSTS

Although this article is not intended to be a detailed analysis of life insurance trusts, some general overview is essential. Life insurance trusts are unique in that their purpose is generally focused upon estate tax savings and, to a lesser degree, asset protection. In *Hatleberg v. Norwest Bank Wisconsin, n/k/a Wells Fargo Bank*, the bank, as trustee was held liable for a breach of duty to disclose information of which it had knowledge. Wells Fargo became aware that the trust document did not contain a *Crummey* provision allowing trust beneficiaries a present withdrawal interest in the trust. *Crummey* provisions provide trust beneficiaries a withdrawal right in order to create a present interest gift that will qualify for the annual gift exclusion. The failure of the trust to include such provision resulted in a tax detrimental to the settlor in that premium pay-

COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.

ments did not qualify as tax-exempt gifts but reduced the settlor's lifetime exemption. In its general discussion of trustee duties, the court in *Hatleberg* stressed that the trustee had a duty to be vigilant in guarding the trust assets and that such duties go beyond the trust agreement. The trustee failed to implement the settlor's intent of achieving estate tax savings by failing to warn the settlor that a withdrawal right was not included in the trust. The trustee's obligation arose after the trustee became aware of such defect.

Numerous tax considerations are relevant in properly drafted life insurance trusts. For example, it is important to utilize properly drafted *Crummey* withdrawal powers. In addition, the trust must often tread that careful line of qualifying as a grantor trust for income tax purposes, while not subjecting the settlor to potential adverse estate tax consequences. (*See, e.g.*, Revenue Ruling 2007-13, allowing a tax-free transfer of policies among grantor trusts thereby avoiding the tax code Section 101(a)(1) transfer for value trap.) The Internal Revenue Service has clarified that a settlor's power exercisable in a non-fiduciary capacity to substitute property of equivalent value will not cause the value of the policy to be included in the settlor's gross estate under tax code Section 2042. Such substitution power may not be utilized to shift benefits among trust beneficiaries and the property substituted must be of equivalent value. (Rev. Rul. 2011-28.) It is also imperative that incidents of ownership not be granted to the settlor because it would create estate tax inclusion. (Tax code Section 2042; Treasury Regulation Section 20.2042-1(c)(2).) Incidents of ownership include various powers with respect to the life insurance policy, including powers to borrow, control the economic disposition, alter, amend, or revoke the policy.

Trustees also have a careful duty to monitor the economic vitality and performance of the policy. In *Cimini v. Jaspen Schlesinger Hoffman LLP*, an action was commenced alleging fraud, breach of fiduciary duty, breach of contract, and tortious interference with contract. The dispute arose with respect to a life insurance policy that was held in trust for the benefit of the insured's spouse. The policy lapsed for failure to pay premiums, and the trustee failed to send any correspondence or notices to the insured or to the beneficiary. The trust included an exculpatory provision that stated that the trustee had no duty to notify the grantor when premiums became due and had no duty to maintain the policy. The U.S. District Court for the Eastern District of New York said that the trustee is nonetheless liable for breaches of trust, bad faith, and for intentional or reckless indifference to the interest of beneficiaries. The defendant's motion to dismiss claims on the basis of the exoneration provision was denied.

Fiduciary Duties and Responsibilities

A clear recital of trustee duties and exculpatory provisions should be included in every life insurance trust. For example, because life insurance trusts are often non-diversified, with the life insurance policy as the sole and central asset, diversification issues are paramount. The complexity and differences with respect to life insurance policies and the various issuing companies are extremely complex. Many policies have been adversely affected by the historically low interest and dividend rates. Trustees must watch policy performance in light of these longstanding factors. As previously mentioned, whole life Insurance policies often depend upon the performance of policy dividends, which are determined by the underlying insurance company's available earnings. Many insurance companies have reduced dividend rates in the last several years. Trustees must continually monitor policy performance in light of these trends. For example, cases have arisen regarding improper selection of the life insurance policy. An insured may have been provided financial projections requiring payment for a limited number of years, but due to economic conditions such predications were overly optimistic.

In *Noveletsky v. Metro. Life Ins. Co.*, the plaintiffs brought suit alleging many fiduciary breaches arising out of poor economic performance. The settlor expected to pay premiums for only 10 years and then have a paid-up policy. However, the trustee failed to advise the settlor that dividends were below projections, and at existing rates the policy was not expected to become self-funding until at least 17 premium payments had been made. To further highlight the legal risks inherent in life insurance trusts, a similar issue arose in the *Cochran v. KeyBank*. In this case, the bank was confronted with several variable universal life policies whose performance and viability was questionable due to economic downturn and recognized losses. At current performance, the policies may have lapsed within five years or significant additional premiums may have been required. After reviewing an independent report, the bank decided to replace the policies with a reduced death benefit policy guaranteed until age 100. The insured then died prematurely and unexpectedly at age 53. The beneficiaries tried unsuccessfully to hold the bank responsible for the reduced death benefit associated with the guaranteed policy. The court said the bank appropriately met its fiduciary obligation by instituting a professional evaluation but was nonetheless required to justify its actions and reliance thereon.

HOW IS THIS MATTER HANDLED IN YOUR OFFICE?

An 82-year-old client calls to tell you that their daughter, who is acting as a trustee for your client's family trust, just received a letter from the life insurance company stating that their $2.5 million dollar life insurance policy is about to expire unless their premium is increased from $54,000 to $90,000. They've already paid in over $700,000 in past premiums, and have loans of an unspecified amount. How would you advise your client to respond?

There is a large demand for independent credible professional assistance to respond to these questions as well as to create a prudent and reasoned process that maximizes the probability of a favorable outcome for the life insurance funding a client's trust estate. Unfortunately, in very few cases is the necessary advice sought, and in fewer cases is the advice forthcoming to provide the eldest son or daughter the assistance that they need to avoid becoming one of the growing statistics of people whose non-guaranteed life insurance policies are expiring prematurely. It is far easier to draft an exculpatory clause than it is to take the time to inform, educate, and provide guidance to an amateur trustee. However, doing so will be greatly appreciated by the trust beneficiaries and their amateur trustees.

COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.

The trust agreement must be reviewed to determine if it contains a trustee ''hold harmless'' provision, which basically protects the trustee from being sued for matters related to his/her judgments and resulting actions. Remember, the trustee has the sole responsibility for managing the trust asset. If the trust has a ''hold harmless'' provision and the trustee lacks life insurance product and policy evaluation expertise, how will the policy suitability issues be addressed and managed? The ''hold harmless'' issue must be addressed to make certain the family does not suffer at the expense of protecting the sibling, kind enough to act as the amateur trustee, from being sued by other sibling beneficiaries. It makes far more sense to educate the trustee rather than protect them against liabilities they should learn to deal with in order to better protect themselves and their beneficiaries.

Joseph La Ferlita, a partner at Farrell Fritz a law firm in New York City, who advises trustees and beneficiaries of trusts, responded as follows when asked about the need to provide guidance to the many siblings who act as accommodation amateur trustees for their parents' family trust. ''Trustees often fail to realize that a trust creates a fiduciary relationship between the trustee and the beneficiaries. A trustee owes a fiduciary duty to the beneficiaries to act prudently in light of the trust's purposes. Managing the trust's assets is a key trustee function. Many mistakenly don't view trust-owned life insurance as an asset. It is. Just as the prudent trustee periodically reviews the 'health' of (e.g.,) the trust's stock and bond portfolio, he should also periodically review the 'health' of the trust's life insurance policy to make sure it will perform as needed. Sadly, many think that box is checked merely by timely paying the insurance premiums. But that's not always enough. Insurance products are complex and sometimes fail to perform as expected—even when premiums are timely paid. Thus, the trustee should have a qualified insurance professional perform such periodic 'stress tests' on the trust's policy.''

A WORD ABOUT GUARANTEES

Are guarantees actually needed? Do they serve a useful purpose? Is the extra money being spent for these guarantees worth it? Are most policies issued today guaranteed?

Most of the problems faced by owners of prematurely expiring life insurance policies today stem from a time when these policies were first issued from the mid-1980s to 2002. In 2002 the life insurance companies first began offering guaranteed universal life insurance policies. Prior to that date a guaranteed universal policy simply didn't exist. One might question whether the extra cost of incorporating such a guarantee into a policy was worth the cost. Many individuals thought the additional cost was well worth the security it provided, knowing that it was a realistic premium that could help them achieve their goals while still costing far less than a whole life policy. Having a guarantee also allows one to individually quantify the three components of a life insurance policy: the death benefit; the premium; and most importantly, the duration of the coverage. For example, one can determine if it's more important for an individual trustee to maintain a smaller death benefit for a longer period of time, or a larger death benefit for a shorter period of time, knowing that the answer will stand the test of time on a guaranteed basis.

Having stated the obvious—that guarantees are worth the extra cost—it's disturbing that the majority of new products being offered in the consumer marketplace today, i.e., indexed universal products and variable products as well as equity indexed policies, all involve non-guaranteed policies. It seems as if we're going back to a time when the industry offered non-guaranteed solutions to offer the consumer a lower cost and seemingly more competitive product. Why are we going back to a trend that resulted in these non-guaranteed products causing so many consumer problems, disappointments, and complaints? It is anticipated the new ''Best Interest'' guidelines issued by New York Department of Financial Services will do a better job of having the agents/brokers fully disclose the good and the bad features of any product recommendation they make.

WHAT HAPPENS WHEN A LIFE INSURANCE POLICY IS NO LONGER NEEDED ?

An amateur trustee might have to determine if life insurance coverage may no longer be required, and identify the most advantageous manner to facilitate the removal of this coverage from a family's life insurance portfolio. For example, the 2017 tax act increased the estate tax exclusion for individuals to $11.1 million. (Section 2010(c)(3)(C), added by Pub. L. No. 115-97, Section 11061, effective for decedents dying and gifts made after Dec. 31, 2017, and before Jan. 1, 2026.) As a result, many families with estates between $10-20 million are now reconsidering whether they need to maintain the additional life insurance for estate taxes that may no longer be required. Removing the possibility as to whether the estate taxes may re-appear in 2026 when the current laws sunset, certain choices have to be made. Does the trustee merely stop paying the required premium? Does the trustee surrender the life insurance policy back to the insurance company in exchange for the cash value? Or does the trustee consider selling the policy on the secondary marketplace as a life settlement where the payout could be significantly larger. Proper guidance in this area is extremely important and should be discussed with an experienced independent life insurance settlement consultant.

In regard to corporate trustees, who make up only 10 percent of the professional trustees, the Office of the Controller of the Currency (OCC) offers excellent prudent process guidance, suggesting: ''Policy performance evaluation should examine the financial health of the issuing insurance company, and consider whether the policy is performing as illustrated. If the policy is underperforming, or if the policy can be improved upon, the fiduciary should consider replacement or remediation. If a trustee lacks the expertise to evaluate whether the current premium is sufficient to reach the beneficiary's objectives, the trustee has a duty to delegate and engage the necessary experts to make these determinations and assist in the suggested remediation steps.'' (Office of the Comptroller of the Currency, Unique and Hard-to-Value Assets, pp. 37–39 Revised (August 2012).) While that advice is specifically directed at corporate trustees, it is excellent advice for the other 90 percent of the unskilled accommodation trustees to follow as well.

COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.

WHAT IS A POLICY PERFORMANCE EVALUATION?

A historic projection will assist a trustee in determining the best way to prevent a current policy from lapsing. A policy performance evaluation, be it an adjustable life, universal life, variable universal life, or indexed universal life policy, should be independently conducted to determine, at a minimum:

- The financial health of the insurance company;
- Whether the current policy can be improved by making various changes;
- Whether it's prudent for client to keep current policy, or obtain a new one; and
- Whether the current amount of premium paid and resulting cash value is sufficient, as well as whether it should be reduced if the client is in poor health and not expected to live to normal life expectancy.

In the event it's determined that a policy requires some form of remediation, there are five options your clients should explore.

1. An individual can pay a higher life insurance premium in order to keep the same coverage in the existing policy in effect for a longer guaranteed period of time.
2. An individual can reduce the current death benefit in order to extend the duration of the existing policy to a longer period of time.
3. If the individual insured is sufficiently healthy he/she can apply for a new life policy that may be less expensive and contain more living benefits.
4. An individual may choose to surrender the policy for its cash value, but a better choice may be to sell the policy as a life settlement for a higher price.
5. A combination of the four choices mentioned above.

In either case care must be taken to not allow a life policy to expire prior to the death of the insured if there are any outstanding loans, as doing so will trigger an adverse tax liability on any gains.

IN SUMMARY: THE PROBLEMS AND SOME SOLUTIONS

The Problems

The insureds had no idea what terms such as ''flexible premium'' and universal life insurance meant, nor that the policies they purchased were not guaranteed.

The buyers had no knowledge that they retained all of their policy's performance risk, and management responsibility.

Clients and trustees alike often incorrectly assume that either the agent or the insurance company is responsible for making certain that their policies continue to remain in force. However it's actually in the insurance company's best financial interest if, after all those years of paying the premium, it becomes too costly for the insured/trustee to continue to pay for the policy and the death benefit is reduced or the policy is surrendered.

Donald Walters, General Counsel for the Insurance Marketplace Standards Association (IMSA), said in a 2014 speech to IMSA members, **''While insurers have not publicized the issue, there is a growing concern in the industry about lapsing universal life policies.'' Carriers and agents have no obligation to monitor policy performance relative to original performance expectations. Carriers are merely required to send a scheduled premium billing and an annual policy value statement. It is the sole responsibility of the policy owner to review the policy value statement and determine the needed premium adjustments to achieve originally illustrated policy values.**

Some Solutions

In August 2012, the Office of the Comptroller of the Currency (OCC) issued revised guidelines that directed financial institutions serving as trustee of an insurance trust to treat life insurance as they would any other asset. (Office of the Comptroller of the Currency, Unique and Hard-to-Value Assets, pp. 37-39 (Revised, Aug. 2012).) This means life insurance, just like stocks, bonds, and real estate, needs to be actively managed, ending the dangerous ''Buy and Hold'' attitude currently in place in which amateur trustees think they can merely ignore their life insurance policies.

An investment policy statement, an in-force policy evaluation, and a historic projection are fundamental steps that can help ensure the longer-term planning objectives of a policy owner as well as provide safeguards for the trustee. The tools enabling a trustee to evaluate and monitor the performance of a life insurance policy are currently available to the amateur trustee, they just have to be used. Perhaps one of the best and most effective new tools added to an amateur trustee's arsenal to help a trust beneficiary as well as an amateur trustee is a ''trust protector,'' an individual that knows the grantor and their family, and can view a situation that is causing harm or disarray to a trust beneficiary and attempt to make things better. Much depends on the limited or broad powers given to this individual by the trust grantor.

A thorough review is just as important for life insurance as it is for fixed income and equity investments. Trustees should ask themselves:

1. Are trust administration and policy costs reasonable and appropriate?
2. Have ILIT gifts, beneficiary *Crummey* notices, and premium payments been administered properly with trust documents and fiduciary law?
3. Is a current TOLI investment policy statement in place, and when was it last reviewed?
4. Is the current investment strategy appropriate for client's objectives today?
5. Is there an attorney/grantor memo providing guidance regarding policy use?
6. Has the CPA provided an adequate funding statement (AFS) indicating that a sufficient premium is being paid to maintain the death benefit to an agreed age?
7. What steps should be taken to remediate the policy if it becomes necessary?

An independent in-force policy evaluation encompassing the above points can help ensure the longer-term planning objectives of a policy owner/trustee and provide safeguards for their beneficiaries. Although this article primarily dealt with protecting a life insurance policy's death benefit, equal attention must be paid to the assumed accumulation of a policy's cash value if its intent is to be used to supplement a key employee's living/ retirement benefit as a supplemental executive

COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.

retirement plan (SERP), or a corporate deferred compensation plan. The same holds true for living benefits that allow an individual to withdraw funds on a tax free basis from the death benefit of a Hybrid/Combo/Linked policy to pay for long term care costs. .

While term insurance would not normally be expected to be found in an ILIT or special needs trust, due to its temporary nature, it often is. If a term policy is discovered before a guaranteed conversion period expires, it can be extremely helpful and useful to extend the coverage beyond the initial term coverage period as most term policies expire when an insured is in their early to mid-80s. This is especially meaningful if the grantor's health has diminished, preventing that individual from obtaining life insurance coverage at any cost. Each term policy, as every other life Insurance policy, must be reviewed for its unique conversion deadlines and limitations as to what type of products a term policy may be converted to. Once the current situation is assessed, it can then be compared to that which is currently available in the marketplace.

These and other strategies and remedies will work in stemming the significant loss of life insurance assets currently allocated to our client's next generation, but only if they're used. Unfortunately, we know that 23 to 25 percent of those assets won't get there because of the neglect on the part of a generation of amateur trustees that to date haven't yet been properly advised. Many clients express their dismay at not having received the guidance they say they were relying on from their advisors in the area of individually-owned and trust-owned life insurance. Many clients aren't even aware of the relevant questions to ask, so unless they're guided as to what specific questions need to be asked by their attorney, CPA, or investment advisor, they'll ignore the entire issue. While their life insurance advisor will certainly ask the necessary questions, many clients, due to their aversion to the subject, lack of understanding, and mistrust of the person delivering the information, will avoid contacting a broker or agent that could help them. Keep in mind an agent has many incentives to place business for the insurance company he/she represents, while a broker is independent, and is free to choose the company and product that best represents the client's best interest with no regard for compensation nor product incentives.

In light of today's specific problems taking place in your clients' life insurance portfolios, it would be very useful for the client's advisors to develop a relationship with an experienced, independent, fee-based insurance consultant that can act as a resource when it comes to answering questions and providing useful creative strategies regarding your clients' life insurance portfolios. There's an opportunity to distinguish yourself by not only asking the obvious question, ''how much life insurance do you currently own?'', but to be able to go deeper to ask the client ''when was this life insurance portfolio you're responsible for last reviewed,'' and ''how long do you believe your life insurance coverage will last?'' Your client's beneficiaries and trustees—your next generation clients—will be most grateful that you pointed out a potential problem that could prevent them from receiving the life insurance estate their parents allocated to them. Keep in mind the earlier a potential problem is found the more options are available to remedy the situation, and more often with a less expensive price tag, and a better outcome for your client

Henry Montag, CFP, has been in practice since 1976 with offices located on Long Island, NY. He is a principal of The TOLI Center East, which provides independent, consultative, fee-based individual and trust owned life insurance performance evaluations for high net worth clientele, their trustees, and advisors. He co-authored an ABA Flagship book in 2017, ***The Life Insurance Policy Crisis: The Advisors and Trustees Guide to Managing Risk & Avoiding a Client Crisis****.*

Robert S. Barnett is a founding partner of Capell Barnett Matalon & Schoenfeld LLP, Attorneys at Law, in New York. His practice is highly concentrated in the areas of taxation, trusts, estates, corporate and partnership law, and charitable planning. He has authored numerous articles and presented to the NYSBA, NYSSCPA on matters related to practical and creative solutions to estate, tax and business planning matters. He serves on many professional and charitable boards.

Henry Montag CFP, CLTC
thetolicentereast.com
516-695-4662

COPYRIGHT © 2018 BY THE BUREAU OF NATIONAL AFFAIRS, INC.