

# TOLI Risk Management at Litigation Crossroads

E. Randolph Whitelaw and Liz Colosimo

## EXECUTIVE SUMMARY:

The Trust-Owned Life Insurance (TOLI) failing policy crisis exposes fiduciaries to breach of trust liability. The defensible standard of care appropriate for non-guaranteed TOLI policies is known. This commentary explains how fiduciaries can look at the right information in the right way.

## FACTS:

Unmanaged Trust-Owned Life Insurance (TOLI herein) risk, inherent in every insurance trust and trust-owned life insurance policy, remains prime fodder for litigation attorneys. As 'best practices' risk management replaces out-of-date custodial practices, those who fail to ramp-up to current standards assume unprecedented fiduciary liability.

Life insurance, a risk transfer mechanism, is a sophisticated financial asset ideally suited for trust ownership<sup>1</sup>, but it is not self-managing. The purpose of a prudent TOLI risk management process is to demonstrate and document fiduciary evaluation of the right trust and policy information in the right way.

## THE FOUR QUESTIONS:

Annual verification of the right information is generally comprised of four suitability criteria:

1. Does the policy remain suitable for the trust's purpose set out in the TOLI Investment Policy Statement?
2. Are scheduled premiums adequate to sustain the policy to contract maturity or insured life expectancy, as a minimum?
3. Has the underwriting carrier's third-party ratings deteriorated?
4. Are trust administration and asset management costs reasonable and appropriate?

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### About the Authors:

**E. Randolph Whitelaw** is Managing Director of **Trust Asset Consultants, LLC**, in St. Louis. He is a recognized trust owned life insurance placement and restructuring expert, specializing in evaluation of product suitability and premium adequacy, policy design, and underwriting. His email is [Randy@TrustAssetConsultants.com](mailto:Randy@TrustAssetConsultants.com).

**Liz Colosimo** is Co-Managing Director of **Life Settlement Partners, LLC** which provides life settlement consulting and brokerage services to individuals, businesses, charities, professional advisors, and professional fiduciaries. Liz focuses on placement of large death benefit policies that may be considered 'exceptions' under many provider guidelines. She is a licensed life settlement broker, registered nurse, and attorney. Her email is [LizColosimo@LifeSettlementPartners.com](mailto:LizColosimo@LifeSettlementPartners.com).

Randy and Liz teamed up to provide **LISI** members with an incredible overview of the liability faced by fiduciaries in trust owned life insurance situations – and guidelines for staying out of trouble and performing in the most professional manner possible.

For more information concerning **TOLI Risk Management Practices**, please visit [www.TrustAssetConsultants.com](http://www.TrustAssetConsultants.com)

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Adoption of these criteria will result in a TOLI risk management process that is legally defensible, academically justifiable, and cost efficient.

## **WHAT YOU'RE DOING MAY BE INSUFFICIENT!**

Yet, countless TOLI fiduciaries continue to provide custodial services for non-guaranteed policies. These services often amount to no more than preparing Crummey notices, paying premiums, and periodically requesting carrier illustrations.

As such, these services, even in combination, are insufficient to protect policies from lack of suitability and lapse<sup>2</sup>. Fiduciaries are thereby knowingly<sup>3</sup> exposed to an increase in the number of failing TOLI policies, corresponding allegations of breach of fiduciary duty, and potential TOLI litigation and liability.

## **FIDUCIARY'S BASIC DUTIES:**

The basic duty of a fiduciary is to maximize the probability of a favorable outcome to the trust estate. This article will review:

- How TOLI trustees can look at the right information (best available) in the right way.
- How legal and tax advisors can verify that a comprehensive and defensible risk management determination has been prudently made in the interest of safeguarding their insurance trust grantor and beneficiary clients.
- How trustees, legal and tax advisors can identify<sup>4</sup> low cost and/or limited service third-party TOLI vendors that expose TOLI fiduciaries to breach of duty allegations.
- How life insurance producers can play a vital problem-solving role in policy management decisions.

## **REVISITING THE TOLI POLICY CRISIS**

The TOLI crisis, the subject of cautionary articles for 15 years, is the result of primarily two risk related issues – unexpected policy lapse and unwarranted policy replacement.

Based on our experience, approximately 25% of in-force non-guaranteed TOLI policies are currently predicted to lapse during the insured's lifetime. This percentage will continue to increase<sup>5</sup> unless corrective action is taken. About-to-lapse policies tend to be 'minimum funded', large death benefit policies that require premium adequacy evaluation annually and scheduled premium adjustment periodically.

Failure to make these prudent determinations and to carefully document them has resulted in a proliferation of lapsed policies and corresponding allegations of breach of fiduciary duty.

At recent life insurance association meetings, sponsors of TOLI replacement programs reported success in 'cracking the lucrative TOLI market'<sup>6</sup>. Yet, insurance regulators and experts concur that policy replacement generally is not in the policy owner's best interests<sup>7</sup>.

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Trustees, knowing that carrier illustrations are neither credible nor appropriate for policy comparisons<sup>8</sup> and that agents of the underwriting carrier do not contractually represent the policy owner<sup>9</sup>, assume a heavy burden to justify a replacement recommendation.

## **POLICY LAPSE AND RESTRUCTURE (REPLACEMENT AND SALE)**

**Lapse:** Failing policies are those that are expected to lapse during the insured's lifetime due to under-performance and, in effect, imprudent TOLI risk management. Most irrevocable insurance trust agreements require an annual accounting to trust beneficiaries. An annual accounting is only useful for the prevention of lapse if it is comprehensive in scope and impartial in its analysis.

Grantors and beneficiaries, or their representatives, should request from the trustee a copy of the TOLI Investment Policy Statement (TIPS) and the most recent policy evaluation report.

Then they should submit in writing to the trustee a demand for adherence to the TIPS and immediate action to remedy any policy issues that are likely to result in policy lapse. Unexpected lapse can be avoided.

**Restructure:** Policy restructure should be considered for about-to-lapse, unsuitable and unwanted policies.

Unsuitable policies (inconsistent with trust objectives) necessitate policy replacement. The burden of proof rests solely with the trustee to justify a replacement recommendation. Replacement justification should:

- Be consistent with TIPS guidance,
- Summarize the Request for Proposal process,
- Affirm reasonable and appropriate costs (including broker compensation),
- Avoid factual omissions, and
- Confirm annual policy evaluation requirements going forward.

A non-commissionable replacement should be considered with the existing or an alternative carrier. This would avoid un-necessary costs, maximize the existing policy cash value available to purchase needed death benefit coverage, and minimize the cash flow commitment to pay future premiums.

Replacement with “no lapse guarantee” UL and VUL policies should only be considered when:

- Rider terms are fully understood,
- Policy accumulation value is no longer a TOLI management objective, and
- Annual policy administration can confirm that rider terms are annually satisfied.

Unwarranted replacement is the exchange of one policy for another without compelling need. This unfortunate situation does not benefit the owner but usually results in a windfall commission to the selling agent.

Such abuse can be avoided in much the same way as lapse can be avoided. Prudent ILIT management procedures for the administration and maintenance of life insurance policies held in trust must

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focus on defensible determinations for any substantive change to policy type and death benefit.

Legal and tax advisors should question any and all policy restructure changes suggested or implemented, and demand that a defensible policy evaluation procedure justify the replacement.

**Unwanted:** Unwanted policies warrant special handling<sup>10</sup>. The financial and non-financial benefits of maintaining the life insurance policy must be compared to those attributable to terminating the death benefit coverage. Policy sale in the secondary market (life settlement) should be considered if the policy's fair market value is more favorable than its cash surrender value. A properly administered Request for Proposal process should solicit offers from established institutional purchasers. The trustee's recommendation of a life settlement transaction must provide for full disclosure of all material facts including broker compensation.

## RED FLAGS FOR CRISIS MANAGEMENT

The average TOLI policy death benefit is \$1,710,923<sup>11</sup>, but the average death benefit for failing policies approximates \$3,350,000. Damage to the interest of beneficiaries in these cases is both knowable and significant. Litigation, therefore, may be anticipated.

Legal and tax advisors should request verification of a TOLI trustee's annual product suitability determination, and recognize the following situations as red flags warranting further scrutiny.

- An irrevocable life insurance trust without a TOLI Investment Policy Statement.
- A limited duty trustee arrangement when the trustee is the *only* party who has the power to act to protect the beneficiaries' interests.
- A trust agreement that does not permit delegation of periodic policy evaluation.
- A trustee that does not provide an annual report to the beneficiaries confirming that the policy is suitable for the trust purpose and that its performance achieves benchmark expectations.
- A personal or advisor trustee who lacks life insurance expertise and does not obtain credible third-party policy evaluation.
- Annual performance reports for non-guaranteed death benefit policies that are not actuarially certified.
- Annual performance reports for variable universal life policies that do not affirm the asset allocation strategy and related volatility-tested premium adequacy evaluation.
- Any policy replacement recommendation/notice.

## INSTITUTIONAL TRUSTEE LITIGATION CONSIDERATIONS

Trust litigators often describe TOLI litigation as 'low hanging fruit' because trust files are either empty or 'papered' with meaningless analysis that is likely to document imprudent decisions. Subsequent trustee depositions effectively identify the disconnect between well-intended management practices and out-of-date procedures.

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The most prevalent of the disconnects is trustee delegation of policy performance monitoring to low cost, limited service vendors that employ custodial practices. The reports generated by these vendors are not defensible for policies with non-guaranteed features<sup>12</sup> because illustrations of policy performance are neither credible nor appropriate for TOLI determinations.

Illustrations are not credible because they disclaim predictive value and are not based on impartial analysis of objective data. They are not appropriate for TOLI performance monitoring because they fail to evaluate premium adequacy.

## **BEWARE OF THESE SCHEMES:**

It should be noted that some low cost limited service vendors participate in TOLI replacement schemes that:

1. Use unexplainable policy suitability<sup>13</sup> ratings to justify policy replacement recommendations<sup>14</sup>,
2. Share confidential information with unauthorized third-parties, and
3. Generate commission-related compensation that may not be disclosed.

Such schemes expose the fiduciary to liability and are examples of looking at the wrong information in the wrong way. The duty to delegate sets out specific vendor screening and annual verification responsibilities that, if utilized, will identify these limited service vendors, problematic replacement schemes, and their unsupportable marketing representations.

## **KEY TOLI ISSUES:**

In 2006 leading industry experts, regulatory agencies, and special interest groups focused their attention on the following TOLI issues:

- Obsolete Insurance Trust Administration Practices - The American Bankers Association addressed the ‘pitfalls’<sup>15</sup> and set out the ‘necessary’ as well as ‘ideal’ approaches to TOLI management.
- Inadequate TOLI Risk Management Standards - The American College of Trust and Estate Counsel published a Four-Part comprehensive ‘best practices’ TOLI risk management article. The article eliminates TOLI myths and provides an excellent roadmap<sup>16</sup> for trust litigators.

Also, the Pension Protection Act of 2006 added a new section to the Internal Revenue Code that may impact institutional trustees who exclude fair market valuation of insurance trust policies from client statements.

## **GUIDANCE AVAILABLE FROM REGULATORY AGENCIES:**

Regulatory agencies (OCC, OTS, Federal Reserve, FDIC and State Officials) offer guidance concerning account and asset acceptance, administration, management, and restructure procedures. Their examiners are primarily risk-focused and rely upon the knowledge and expertise of an institution’s internal risk management staff to address and report all potential risk related items.

It is therefore imperative that the institution’s internal process<sup>17</sup> includes the tools to identify and

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measure TOLI related risks. While examiners may review an institution's TOLI risk management procedures, specific guidance is rarely provided until notice is given to the regulator by the institution that pending or threatened litigation may result in a charge against earnings, and thereby have a detrimental impact on capital.

Fiduciaries are well advised to heed the recommendations of these authorities as failure to incorporate them into trust management practices may reasonably result in indefensible accusations of conduct that falls below the known, best practices industry standards.

Institutional trustees are especially vulnerable to litigation for their questionable management of variable policies. Institutional trustees know that variable policies require a TOLI Investment Policy Statement, asset allocation strategy, investment subaccount performance monitoring, and active policy value management that includes volatility simulation<sup>18</sup> of the asset allocation strategy. Never-the-less, these requirements are often overlooked as evidenced by the number of variable policy replacement recommendations.

## **PERSONAL TRUSTEE, PROFESSIONAL ADVISOR TRUSTEE, AND CO-TRUSTEE ARRANGEMENTS**

The majority of in-force TOLI policies are managed by non-institutional trustees. The litigation considerations are generally the same for non-institutional trustees as for institutional trustees.

While Professional Advisor Trustee and Co-Trustee arrangements often clarify trust operation roles and responsibilities, they rarely provide for the delegation of life insurance product suitability determinations to a credible third-party. But, from a care and skill perspective, delegation to a credible third-party is necessary to secure the requisite trust operation, product suitability, and policy management expertise mandated under the Prudent Investor Rule<sup>19</sup>.

Trust objectives, family circumstances, tax legislation, gifting capacity, and life insurance products change over a 10 to 50 year time horizon. Therefore, a TOLI Investment Policy Statement must be available to offer guidance to accommodate these changes and maintain a reasoned investment strategy.

## **LOOKING AT THE RIGHT INFORMATION IN THE RIGHT WAY**

As previously noted, defensible TOLI determinations require annual verification of four suitability criteria to confirm that the fiduciary is evaluating the right information in the right way.

**1. Does the policy remain suitable for the trust's purpose set out in the TOLI Investment Policy Statement?** A TIPS serves as a practical guide for trustees who rely upon professional advisors and/or third-party experts for trust operation guidance because it clarifies roles, duties, and delegation expectations.

Generally prepared by the trustee, TIPS is a dynamic document that can provide guidance in the event that trust objectives or grantor funding capacity or tax laws change.

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A well designed and comprehensive trust investment policy statement will state a clear and reasoned overall investment strategy and:

- Enumerate procedures to systematically monitor trust asset performance and maximize the probability of a favorable outcome to the trust estate,
- Outline the trustee's policy selection and management process, including asset evaluation criteria,
- Affirm the grantor's objectives and expectations,
- Memorialize the guidance set out in the trust agreement and trust operation memo prepared by the attorney drafting the trust agreement.

Policy restructure should be considered for unsuitable and unwanted policies. Unsuitable policies necessitate policy exchange. Unwanted policies warrant special handling<sup>20</sup>.

The burden of proof rests solely with the trustee to justify policy exchange, replacement, and special handling such as surrender or sale in the secondary market. Such justification should be prepared consistent with TIPS guidance.

**2. Are scheduled premiums adequate to sustain the policy to contract maturity or insured life expectancy, as a minimum?** A trustee can demonstrate a defensible determination of premium adequacy if the trust owns a fixed premium guaranteed death benefit product or if the premium adequacy evaluation of a flexible premium non-guaranteed product is actuarially certified.

Actuarial evaluation is a credible risk identification and risk mitigation process. If an in-force TOLI policy is under-performing its acceptance benchmark values, actuarial evaluation can calculate the risk-appropriate premium and death benefit adjustment necessary. If under-performance poses a risk of lapse, actuarial evaluation can calculate the earliest possible lapse age and concentration of lapse ages for comparison to insured life expectancy so that policy management options can be properly assessed. If a policy warrants restructure, actuarial evaluation facilitates credible analysis of restructure options.

The TOLI policy crisis is concentrated in indeterminate premium non-guaranteed policy types that have become the TOLI policy-of-choice, especially for larger death benefit policies, issued in the past 25 years. A fiduciary is well advised to *annually* request third-party vendor confirmation that its report is actuarially certified and that premium adequacy evaluations are volatility tested.

**3. Have the underwriting carrier's ratings deteriorated?** Carrier size and third-party ratings are suitability considerations. A decline in ratings can result in reduced policy crediting rates and/or increased policy costs, requiring additional premium for these policies to achieve their acceptance benchmark values.

**4. Are trust administration and policy costs reasonable and appropriate?** Trust administration and policy costs should be differentiated and annually reviewed by *all* insurance trust parties. Our suggestion is to delineate trust administration costs in the TIPS and to provide for their payment using a simple 'cost-plus' accounting. For example, trust administration costs can include:

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- Crummey notices,
  - Grantor gift notice,
  - Premium payment notice,
  - Third-party ‘risk management’ policy evaluation<sup>21</sup>, and
  - Beneficiary reporting.

Distinct from trust administration costs, policy costs (i.e. cost of insurance, taxes, sales, administration, and transaction charges) for in-force policies should be measured against a policy standards database to calculate the favorable/unfavorable deviation percentage. If a policy is underperforming its benchmark values and premium adjustment is needed, a policy with an unfavorable trend requires a higher premium commitment than a policy with a favorable trend.

Policy acquisition and replacement/exchange costs should be quantified and disclosed.

Policy exchange costs can be managed by negotiating an internal exchange with the existing carrier that reduces or eliminates surrender penalties and new commissions.

An external exchange should include consideration of non-commissionable policies without surrender penalties. All carriers and all policies are not the same. Therefore, a credible comparison of carrier/policy options is essential to an informed trustee decision.

## **THE LIFE INSURANCE PRODUCER CHANGING ROLE**

Most TOLI fiduciaries blame the TOLI crisis on the life insurance producer and the life insurance industry’s questionable marketing practices<sup>22</sup>. Further, many fiduciaries are under the false assumption that the life insurance agent of record will monitor policy performance.

In fact, commission-motivated replacement schemes marketed to ‘crack the lucrative TOLI marketplace’ have justly tarnished the image of the once-trusted life insurance producer. Accordingly, skeptical TOLI fiduciaries place no reliance on the producer’s perceived self-serving practices.

For producers electing to assist their clients in focusing on the right information in the right way, the value of their participation is incalculable. This scrupulous producer should introduce the trustee to impartial third-party expertise, participate in the credible monitoring of policy performance, and assist grantor/beneficiary communication. The role of this producer, as determined by the parties, should be clearly delineated and documented in the TIPS.

## **CONCLUSION**

TOLI fiduciaries are at litigation crossroads, and should consider the ‘best practices’ risk management matrix used by trust litigators to assess procedural prudence or the lack thereof. Based on this matrix, TOLI fiduciaries must ensure engagement of an impartial third-party policy evaluation vendor that provides actuarially certified premium adequacy evaluation reports for non-guaranteed policies.

In short, un-necessary lapse and unwarranted replacement is avoidable. Policy lapse demonstrates

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negligence and quantifies damages. Unwarranted replacement documents an imprudent risk management process. The occurrence of either demonstrates mismanagement and exposes a TOLI fiduciary to breach of duty allegations and potential liability.

Antiquated custodial care practices must be abandoned. No different from fixed income and equity investments, TOLI can be appropriately managed if the right information is evaluated in the right way, using contemporary risk management tools and known 'best practices' fiduciary standards.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!**

**RANDY WHITELAW      LIZ COLOSIMO**

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### **FOOTNOTES:**

<sup>1</sup>A life insurance policy allows the trustee to purchase/accept a death benefit equal to the trust's expected return, and to choose between a (1) fixed premium guaranteed product that transfers policy value performance risk to the underwriting carrier, and a (2) flexible or fixed premium non-guaranteed product that retains performance risk and requires life insurance premium adequacy evaluation expertise. Using irrevocable life insurance trusts as an example, the annual accounting to trust beneficiaries or their representative should affirm that policy values and scheduled premiums are adequate to successfully sustain the policy to contract maturity or insured life expectancy, as a minimum.

<sup>2</sup>Cline and Flagg, "Fiduciary Pitfalls with Trust-Owned Life Insurance", ABA Telephone Briefing, August 2006. "The question of which type of insurance product to choose has not always been answered in a very satisfactory fashion, but rather has often been the product of economic whim. Until the late 70's and early 80's, most TOLI was whole life. However, when interest rates soared, many whole life policies were exchanged for universal life products, often with the promise from agents of higher policy crediting interest crediting rates. Of course, the premium illustrations at these higher rates were projected for 30 years or more, but typically guaranteed for only 30 days, and eventually those illustrations did not hold up. As a result of these unreasonable expectations and the considerable expense involved in making changing policies, many universal life policies purchased in the 1980s are in jeopardy of lapsing without value and without paying the expected death claim. The same troubling cycle repeated itself in the 90's when falling interest rates and rising stock prices led the insurance industry to promote exchanges of universal life policies to variable policies. Once again, premiums were computed (but not guaranteed) using unsustainable market conditions, with the result that these products, too, are in danger of lapsing without value and without paying the expected death claim."

<sup>3</sup>Custodial services do not include credible premium adequacy and policy performance risk management evaluation of non-guaranteed policies. A discussion of credible life insurance policy evaluation is beyond the scope of this article but available in Whitelaw and Weber, "Trust-Owned Life Insurance: Risk Management Guidance for Fiduciaries" Estate Planning (September 2005) and Whitelaw and Weber, "Trust-Owned Life Insurance: Risk Management Guidance for Professional Advisors," Steve Leimberg's Estate Planning E-Mail Newsletter, Leimberg Information Services, Inc., Archive Message #891 (11/16/15). Additionally, life insurance carriers, brokerage general agents, and producers should refer to Richard M. Weber, "When is a Premium Not a Premium", Journal of Financial Service Professionals (July 2005).

<sup>4</sup>Prudent Investor Rule § 171 Duty with Respect to Delegation, General comment a, Fiduciary Duty and Discretion. Most TOLI fiduciaries lack life insurance expertise and elect to outsource the policy management function to third-party TOLI vendors. With few exceptions, these vendors lack the capabilities to credibly evaluate premium adequacy risk. Some provide subjective policy performance ratings based on unexplainable methodology that contradicts known regulatory guidance and life insurance industry practices. These vendors generally disclose their limited service capabilities but are selected due to their low cost. Engagement of a low cost, limited service vendor demonstrates a trustee's inappropriate delegation decision, the disconnect between well-intended management practices and out-of-date procedures, and the reason that breach of trust allegations are settled, not litigated.

<sup>5</sup>Between 1982 and 2006, carrier non-guaranteed 'current' crediting rates for in-force universal life policies have declined from the 12% level to the 5% level. 2006 TOLI Portfolio Statistics are available at [www.TheTOLICenter.com](http://www.TheTOLICenter.com), Fiduciary Advisor Series 5, January 2007.

<sup>6</sup>Actively marketed TOLI replacement programs were launched with the "Cracking the Lucrative Trust-Owned Life Insurance

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Marketplace – A Turnkey Solution!” presentation by Bisys-Potomac at the 2005 Top of the Table Annual Meeting. This presentation was described to life insurance producers as follows: “Until now, you have not had a method to crack this huge marketplace. BISYS-Potomac, the affluent market specialists for the largest brokerage general agent in the United States, in conjunction with Advicon the premier TOLI administration and evaluation service, has developed a *turnkey TOLI risk assessment and remediation process* (emphasis added). To further enhance value to TOLI administrators, this process is combined with state-of-the-art administration services. This turnkey approach allows a producer to provide value-added services to any provider of TOLI services from the local attorney to the national bank. Targets for this service are limitless, and the potential is huge.” Advicon, a low cost limited service vendor, was sold prior to this presentation and the turnkey arrangement maintained by Investment Scorecard. In 2006, the Journal of Practical Estate Planning published “Trust-Owned Life: New Facts and Revelations” in which the co-authors, two Investment Scorecard representatives, discussed an internal study to rate policy risk from “A” (low) to “F” (highest) without regard to suitability for the trust purpose or comparison to other policies available in the market. The authors comment, “Using the A-F rating scale previously referenced, policies receiving an “A” rating were often performing equal to or better than projected and typically have significant cash values. This can represent an opportunity for the trustee to be a “hero” since it may be possible to leverage these policies to provide increased coverage or the same coverage at a lower cost.” Caveat Emptor. The burden of proof rests solely with the trustee to document defensible decisions. A policy replacement recommendation warrants a second opinion from an impartial third-party to verify that the recommendation is consistent with current trust objectives, guidance set out in the Investment Policy Statement and trustee’s risk management procedures, competitive options, and provides full disclosure/avoidance of factual omissions.

<sup>7</sup>Ratner, “Life Insurance Policy Replacements: Real Peanuts or Just a Shell Game?” Trusts & Estates, April 2000. This article is specific to TOLI and the product suitability decisions a trustee must consider. Further guidance is available from the Replacement Questionnaire (RQ) evaluation form published in 1997 by the American Society of CLU & ChFC (now Society of Financial Service Professionals) and NAIC’s Life Insurance and Annuities Replacement Model Regulation. In 2002, actuarially defensible policy evaluation was introduced to TOLI fiduciaries and should be used to document credible policy comparisons.

<sup>8</sup>Whitelaw and Weber, “Trust-Owned Life Insurance: Risk Management Guidance for Professional Advisors,” Steve Leimberg’s Estate Planning E-Mail Newsletter, Leimberg Informational Services, Inc., Archive Message #891 (11/16/15). From a ‘care and skill’ perspective, a TOLI trustee is expected to know that non-guaranteed carrier sales and in-force illustrations disclaim predictive value, do not assess premium adequacy, and are inappropriate for policy comparisons. Some limited service vendors use in-force illustrations as the basis for their ratings; however, in-force illustrations often are not available or are limited to a 20-year time period. Some carriers now request that the policy owner notify the carrier if the policy owner finds any errors in the in-force illustration.

<sup>9</sup>Rybka and Holler, “Disclosure in a Post-Spitzer World,” Journal of Practical Estate Planning, February-March 2006.

<sup>10</sup>Leimberg, Whitelaw, Weber and Colosimo, “Life Settlements: Risk Management Guidance for Advisors and Fiduciaries” Estate Planning, August and September, 2006.

<sup>11</sup>2006 TOLI Portfolio Statistics, The TOLI Center, Fiduciary Advisor Services, January 2007.

<sup>12</sup>Whitelaw and Weber, *supra* note 6. TOLI fiduciaries are well advised to read illustration disclaimers, starting with the front page often stamped with a notice requesting the policy owner to notify the carrier if the policy owner finds any errors in the illustration information.

<sup>13</sup>A TOLI fiduciary should not confuse a life insurance producer’s commission-motivated policy suitability recommendation using a tool such as a “Life Insurance Audit” with a trustee’s product suitability determination.

<sup>14</sup>NAIC’s website provides an overview of licensable “agent” acts and non-licensable “clerical” acts that may assist TOLI fiduciaries in better understanding the appropriate role of such vendors relative to the solicitation, negotiation, sale, and services of existing policyholders.

<sup>15</sup>“Fiduciary Pitfalls with Trust-Owned Life Insurance”, *supra* note 2. The ‘ideal’ approach explained in this material has been available to TOLI fiduciaries for 5 years.

<sup>16</sup>This four-part article reviews questionable trust administration practices and life insurance marketing schemes such as the use of ‘gamed illustrations’. Part 3 explains how actuarially defensible premium adequacy evaluation can calculate premium ‘mispricing risk’ and demonstrate credible and appropriate risk management decisions.

<sup>17</sup>Financial institutions understand the importance of impartial verifiable information. For a \$1,700,000 loan request, loan officers obtain audited financial statements or IRS tax returns. At the time of accepting a \$1,700,000 investment portfolio, trust investment officers formalize an Investment Policy Statement and undertake an asset allocation study using impartial analysis and objective data to establish a reasoned portfolio investment strategy for client affirmation. By contrast, a trustee accepts a \$1,700,000 variable universal life insurance policy without preparing an IPS, or undertaking any form of volatility simulation to test different asset allocations and their premium adequacy implications, or reviewing the performance of different investment subaccount options.

<sup>18</sup>On September 28, 2004, the Securities and Exchange Commission approved the NASD’s proposed new Interpretative Material to NASD Rule 2210(d)(2)(N) to allow the use of investment analysis tools that produce simulations and statistical analyses showing the probability that various investment outcomes may occur.

<sup>19</sup>Prudent Investor Rule § 229 comment a, Duty to Restructure Trust Portfolio: “With the trust’s objectives in mind, the trustee must review the original investments and, if and as necessary, formulate a plan for restructuring the portfolio to achieve a suitable level of risk and expected return with appropriate degrees of diversification and income productivity...The trustee must deter-

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mine whether the trust terms direct retention or disposition of any of the inception assets.”

<sup>20</sup>Leimberg, Whitelaw, Weber and Colosimo, supra note 9.

<sup>21</sup>Non-guaranteed policies warrant a tiered fee schedule based on the scope of service provided. For example, a universal life policy requires actuarially certified premium adequacy evaluation whereas a variable universal life policy requires carrier confirmation and performance review of the selected investment subaccounts, volatility simulation of the asset allocation strategy, and periodic rebalancing based on the changing needs and risk tolerance of the beneficiaries. A fixed premium policy warrants performance review of non-guaranteed features such as paid-up addition and term insurance riders or paid-up additions coverage of premium financing obligations.

<sup>22</sup>ACTEC, supra note 16. Life insurance carriers, brokerage general agents, and producers should heed the tone of this article and its “misrepresentation treasure hunt” comments. Further, when trust objectives have not changed, a producer’s replacement recommendation begs two obvious questions: (1) when will he/she get it right? and (2) how many times should the trust have to pay a commission to maintain the same death benefit? Defensible non-guaranteed TOLI policy determinations require an alternative ‘risk management’ policy service platform. Regardless of the reason, the producer is generally perceived as the problem, not the solution.