

## Dispute Defensible ILIT Administration and TOLI Policy Evaluation Checklist

State Uniform Prudent Investor Act (UPIA) provisions generally place fiduciary-level responsibilities on trustees - whether institutional or personal - yet nowhere has there been as much a “disconnect” between duties and activity as with Irrevocable Life Insurance Trust (ILIT) policies. Fiduciaries are expected to demonstrate a prudent and reasoned asset management process to maximize the probability of a favorable outcome to the trust estate, and yet it is estimated that 90% of Trust-Owned Life Insurance (TOLI) policies are administered by unskilled trustees who lack life insurance and policy management expertise, and have likely volunteered to the task out of friendship or family duty. No matter how well-intended, unskilled trustees provide minimal, if any, credible performance monitoring of these life insurance policies, and are in turn vulnerable to questionable unwarranted policy replacement proposals.<sup>1</sup>

An ILIT involves the interaction of a number of parties with different responsibilities and loyalties. As a ‘buy-and-manage’ financial asset, life insurance carriers and their contracted agents provide the ‘buy’ function, but not the management function. As a result, it is essential for ILIT beneficiaries or their representatives to understand the role and requisite expertise of each party. Further, since delegation of the life insurance product and policy evaluation expertise is to be expected, vendor “due diligence” at the time of selection and annually thereafter, is critical in demonstrating and documenting informed asset management determinations and a dispute defensible process.

The purpose of the following checklist is to summarize how an ILIT fiduciary - skilled or unskilled - can nonetheless document a prudent ILIT administrative process that can in turn facilitate dispute defensible policy evaluation determinations.

### Checklist

**Trust Agreement Administration:** Most attorneys provide the grantor and trustee with a memo that summarizes all administration activities and, often, the form they should take. Is this Memo available and does it set out criteria for the management of life insurance assets and annual accounting to trust beneficiaries?

**Trust File Documentation:** As a minimum, the ILIT file should contain:

1. A copy of the attorney memo.
2. A signed copy of the trust agreement.
3. The policy contract and a signed copy of the ‘as sold’ policy delivery illustration.
4. A current TOLI Investment Policy Statement.
5. Signed grantor letter guidance at the time of policy issue concerning the policy purpose and long-term performance expectations.

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<sup>1</sup> Most ILIT fiduciaries lack life insurance and credible policy evaluation expertise. As a result, they either do not monitor policy performance annually or delegate this responsibility to life insurance producers and third-party administrators, trusting that they offer the needed expertise. Unfortunately most employ policy analysis methodology known to be inappropriate for predictive value determinations per Society of Actuaries and FINRA guidance. The TOLI Center offers fact-based actuarially-certified policy evaluation.

6. Carrier and product suitability evaluation prepared and signed by the writing agent that summarizes:
  - (a) Carriers and products considered.
  - (b) Specific reasons for the selected carrier/product.
  - (c) Performance risks that require annual monitoring.
  - (d) Form of analysis appropriate for this monitoring.
  - (e) Compensation earned (including commission, override and office support).
7. Copy of annual performance monitoring reports, and
8. Copy of annual beneficiary communication.

**Hold Harmless Protection:** If the Trust Agreement or Trustee arrangement or state statutes provide for hold harmless protection, how are customary asset management decisions made, recognizing that the trustee has the sole responsibility for trust and asset management decisions? If the Trust Agreement has a successor trustee provision and the existing trustee is not providing any administrative services, successor trustee appointment should be considered.

**Investment Policy Statement:** If a TOLI Investment Policy Statement (TIPS) has not been prepared and currently maintained, it should be established and set out carrier and product suitability monitoring criteria. Further, if the ILIT owns a non-guaranteed death benefit policy, the TIPS needs to establish credible and dispute defensible policy evaluation criteria along with vendor screening and annual monitoring criteria. Finally, the TIPS should provide restructure guidance and criteria if the policy becomes un-needed or unaffordable.

**Policy Performance Monitoring Evaluation:** In 1992, the Society of Actuaries clarified that the purpose of an illustration was only to show how a policy works, not to provide predictive value and policy comparison determinations. In 2006, the 4-Part ACTEC article explained in detail the inappropriate use of current assumption illustrations as well as the appropriate use of benchmarks and policy standards in making informed fact-based risk management determinations: *“Just as the use of appropriate benchmarks levels the playing field between investment managers and facilitates accurate measurement of investment skills and risks so, also, benchmarks can put competing insurance products on a level playing field to generate meaningful risk/reward insights and comparisons.”*

**Policy Restructure:** A TOLI policy is usually purchased for a 10-50 year duration. Trust objectives, tax legislation, carrier financial strength and life insurance products continually change. Restructure should be expected especially if the policy is no longer suitable per current trust objectives, or affordable, or needed. The TIPS should set out the restructure process and criteria.

**Life Insurance Expertise:** If the trustee lacks life insurance carrier, product and policy performance monitoring expertise, this expertise should be delegated to a third-party. A request for proposal should be used for delegation of the policy evaluation function to affirm the credibility of the vendor’s reports. For example, policy evaluation should be fact-based using generally accepted actuarial principles and should not solely rely on in-force or sales illustrations.

**Red Flags to Monitor and Consider a Second Opinion:**

- An empty trust file.
- A file lacking an annually reviewed Investment Policy Statement.
- Non-existent or infrequent policy performance monitoring reports.
- Policy performance reports that employ subjective ratings such as competitive/non-competitive or “1-to-5” ratings based upon proprietary (aka unexplainable) methodology, or analysis known to be inappropriate for policy comparisons and predictive value determinations.
- An unsolicited policy replacement recommendation.
- No beneficiary communication.

## Initial Client Questions & Document Checklist

CPAs and Attorneys providing personal or business advice to their clients may want to add the following questions to periodic reviews of client assets.

1. Do you have life insurance on your and/or your spouse's life - including policies owned by you personally, by a business, by an insurance trust, by a retirement plan, or by a charity?
2. What is the death benefit of the policy(ies)?
3. Why did you purchase the policy(ies) and why that amount(s)?
4. Does the "why" still exist?
5. What kind of life insurance do you have on your life? There are lots of variations - whole life, universal life, guaranteed death benefit, variable, indexed and term.
6. How are you paying the premiums? Out of personal income? Out of an investment portfolio's resources? Gifts to insurance trusts? Or are you not currently paying premiums on any of these policies?
7. If there is a life insurance trust - who is the trustee?
8. When is the last time you had the policy(ies) independently reviewed, and what process was utilized for this review? Was the process dispute defensible?
9. How much estate tax do you want to pay?
10. Other than possibly funding estate taxes costs with life insurance, what are you doing to minimize the effect of loss of estate value at death?

If there are policies that should be reviewed, the following information will be very useful. Of course, this information can be independently obtained from the insurance company if not readily available from the client:

- Most recent annual statement for each policy
- Initial policy illustration
- Any "in-force" policy illustrations recently provided to you
- Copy of the policy

This checklist was developed by E. Randolph Whitelaw, Gary Flotron, Lawrence Brody, Richard M. Weber and Richard A. Schwartz as the handout for their program, *"The Uniform Prudent Investor Act (UPIA) and Trust-Owned Life Insurance (TOLI): The Impossible Dream or a Match Made in Heaven – UPIA compliance, Risk Management and the Evaluation of Permanent Life Insurance"*. This program and checklist are intended to assist unskilled ILIT trustees and their professional advisors in demonstrating and documenting a prudent and reasoned process that maximizes the probability of a favorable outcome to the trust estate.