Abstract [optional/106 words]: Irrevocable Life Insurance Trusts (ILITs) have been the cornerstone of sophisticated estate liquidity and wealth management planning for over 40 years. There is a lapsing life insurance policy crisis for well-known reasons that could have been easily-avoided. While most skilled institutional ILIT trustees employ prudent and creditable policy risk management practices, unskilled accommodation ILIT trustees frequently are unaware of their trust administration and asset management duties, and lack the expertise to perform these duties, if known. Rescue is needed. This article explains the needed intervention and dispute defensible form it should take to maximize the probability of a favorable outcome to the trust estate.

Introduction – The Lapsing Life Insurance Policy Crisis - A Call to Action

Who do Irrevocable Life Insurance Trust (ILIT) Accommodation Trustees 'accommodate' if the Trust-Owned Life Insurance (TOLI) policy lapses without value ?

ILIT Accommodation Trustees usually are unskilled trustees such as the grantor's family members, friends or legal/tax advisors. It seems timely for Accommodation ILIT Trustees, ILIT beneficiaries, and the Grantor's Legal and Tax advisors to review how the trust administration and TOLI risk management duties of the trustee are being performed, and to assess whether or not they maximize the probability of a favorable outcome to the trust estate. Is each TOLI policy performing as originally expected and, if not, what corrective action is needed and how should it be obtained? If a TOLI Investment Policy Statement (TIPS) was not prepared at the time of trust implementation to establish prudent carrier and product suitability criteria along with policy performance monitoring and risk management objectives, it should be drafted immediately to maximize the probability of a favorable outcome.

Why? There is a well-known lapsing policy crisis, related allegations of misleading and deceptive sales practices, and escalating litigation. Inattention to very basic fiduciary and asset management practices hardly demonstrate a prudent process, and policy lapse due to inattention is a nightmare the 'accommodation' trustee and all trust parties want to avoid. This current-day scenario should be a red flag to any ILIT trustee and beneficiary that creditable dispute defensible policy evaluation intervention should be considered to safe-guard the interests of all parties.

This 'call to action' should come as no surprise to legal[1], tax, investment and life insurance advisors. The need for attentive policy performance monitoring and risk management has been the subject of many 'caveat emptor' warnings since the early 1980s when life insurance

[1]Authors' Comment: Martin M. Shenkman's article, *Individual (Accommodation) Trustees: The Trust Ticking Time Bomb*, included in our book, *The Life Insurance Policy Crisis*, provides an excellent discussion of good, bad and ugly Accommodation Trustee practices, and should be considered 'must' reading.

issuers introduced flexible premium non-guaranteed death benefit products in response to Customizable lower premiums and sophisticated purchaser planning needs. However, recognizing that life insurance sales agents and issuing carriers do not provide post-sales product-appropriate risk management services, delegation was needed to third-party policy administration providers offering creditable (dispute defensible) risk management services. And, as the investment options in these products became more sophisticated, the need for credible risk management attention also escalated.

As a practical matter, the selection of an Accommodation ILIT Trustee who has no familiarity with life insurance products nor capabilities to provide attentive and dispute defensible policy risk management services MAKES NO SENSE unless grantor risk tolerance is formalized in a Grantor Guidance Letter, a TOLI Investment Policy Statement adopted and the requisite policy administration and performance risk management delegated to a creditable third-party provider. Such a delegation services model already exists and is a dispute defensible rescue option. That said, Accommodation ILIT Trustees reading this article who are of the opinion they have no ILIT administration duties or beneficiary responsibilities should either resign or pursue the delegation option immediately.

Case Study – Typical Unskilled ILIT "Accommodation" Trustee Scenario

A female age 55 establishes an Irrevocable Life Insurance Trust, appoints her son as trustee, and relies upon the family attorney who drafted the ILIT to coordinate all trust administration and beneficiary communication requirements. The trustee, her son, takes delivery of a $1,000,000 flexible premium non-guaranteed death benefit variable-universal life policy per the guidance of his mother, an experienced investor. Based upon the policy illustration that accompanied the policy contract delivered to the trustee, payment of a $15,475 annual premium sustains policy coverage to insured age 100 contract maturity. The illustration assumed a 10% policy crediting rate of return in all years. The cash accumulation account was asset allocated 100% equities and zero% fixed income. Scheduled premiums were paid timely and, not surprising, the equity market experienced volatility. The trustee received anniversary statements from the issuing carrier that he forwarded to the attorney who placed them in the trust file. The sales agent met with the trustee and insured every few years to inquire if additional policies were needed (not to assist the credible performance evaluation and management of the existing trust-owned policy).

11 years later, the family attorney retires from active practice. His successor learns that the insured's estate has significantly appreciated in value and that the son ('accommodation' trustee) has no idea how the policy is performing relative to expectations at the time of policy purchase, much less appreciated estate values and liquidity needs. Further, the trusted sales agent has retired and, upon contacting the issuing carrier, the attorney learns the policy is

described as an 'orphan' without any agent attention. As a result, the attorney recommends and the family agrees to engagement of a fee-based life insurance consultant to review policy performance.

The consultant met with the family and attorney to clarify the trust's current objectives, confirm the trustee's risk tolerance criteria and life insurance expertise, and draft a TOLI Investment Policy Statement. Subsequently, the consultant obtained current policy values and inforce re-illustrations and, mindful that carrier illustrations for flexible premium products are inappropriate for predictive value determinations, prepared an actuarially-certified policy evaluation of different management options using Monte Carlo Simulation and Actuarially Certified Benchmark Policy Standards.

While the inforce re-illustration calculated policy lapse at insured age 74, 8 years from her current age, actuarial evaluation calculated zero probability the policy would sustain to insured life expectancy (age 85), much less contract maturity. The earliest predicted lapse was insured age 71 and the concentration of predicted lapses were between ages 72 and 76. Policy costs were 33% higher than the policy standards benchmark for variable-universal life policies. The correcting premium to sustain this policy to insured life expectancy was calculated at $29,507 and to contract maturity it was calculated at $36,856[2]. Additionally, the issuing carrier's third-party ratings had declined over the 11 year period and its COMDEX[3] score was now 78 as compared to 92 at the time of policy purchase.

The Consultant met with the family members and attorney to review this analysis and discuss different options. Given the insured's excellent health and the family's risk avoidance preference, the decision was made to pursue replacement with a 'guaranteed universal life' product purchased from a carrier ranked in the top 50 based upon admitted assets, the top 25 based upon premium renewal income from individual products, and having a Comdex score of 90 or higher. A specialty underwriter was engaged to gather medical records and screen qualifying carriers offering competitive GUL products to obtain expressions of interest. The more favorable expression of interest was pursued, an application submitted, medical exam taken, and an offer made consistent with the expression of interest. Also, a lapse expectancy was obtained using the insured's medical records. The premium payment schedule was designed to sustain coverage to the insured's life expectancy plus five years.

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[2]Since the VUL policy was asset allocated 100% equities, the consultant also considered the premium implications of asset re-allocation to 80% equities-20% fixed income and 60% equities-40% fixed income. Considering the insured's life expectancy, the reduced equity volatility of the 60%-40% reallocation calculated the more favorable premium outlay option.

[3] *"The Comdex is not a rating itself, but a composite of all the ratings that a company has received. The Comdex ranks the companies, on a scale of 1 to 100, in relation to other companies that have been rated by the services. The Comdex is an effort to reduce the confusion over ratings, which is caused by each rating service using a different scale"* (VitalSigns). The Comdex is typically considered in combination with the carrier's asset size/comparative ranking and its first year and annual renewal premium amounts from individual life insurance products.

The take-away from this Case Study is the need for attentive and creditable policy performance monitoring and risk management to avoid unintended consequences. Further, it introduces the need for intervention and the form it should take to maximize the probability of a favorable outcome to the trust estate. For example, Monte Carlo Simulation and Actuarially Certified Benchmark Standards creditably evaluate different risk tolerance, premium outlay and policy management options. A request for proposal 'reverse engineers' the policy application process for seniors with health issues. Life expectancy reports provide for meaningful policy duration planning decisions. Intervention and Delegation are critical to avoiding lapse and litigation, and demonstrating a prudent and reasoned process.

TOLI Risk Management Considerations for Accommodation Trustees

- A Grantor guidance letter should be requested that clarifies the grantor's risk tolerance, why the specific policy was selected, and the services to be rendered by the sales agent in addition to the issuing carrier. Assuming the policy will be delivered to the trustee by the sales agent, the trustee should request a suitability letter from the sales agent that sets out the risks that require annual review and the form such review should take. If the suitability letter does not comport with the grantor guidance letter, policy acceptance should be delayed until the differences are resolved.
- Carrier illustrations should not be used for predictive value purpose. The policy illustration, policy contract, FINRA guidance, Society of Actuaries guidance, and most life insurance agent associations clarify that carrier illustrations do not serve a predictive value purpose.
- Should sales agents represent illustrations as having predictive value? No. Such sales representations can be described as deceptive and misleading.
- Sales agents generally do not have carrier-imposed post-sales policy risk management duties. However, the agent should be expected to refer the policy owner to third-party vendors that offer creditable post-sales policy administration and risk management services. The trustee should use a Request for Proposal to clarify the scope of services requested and affirm the scope of services available from each provider.
- What is the estimated cost of intervention and delegation? To implement a dispute defensible process using an experienced fee-based TOLI consultant, a one-time cost of $2,000 to $3,000 should be expected. Thereafter, a $250 to $500 performance monitoring fee, depending on policy type, should be expected for a fact-based policy performance review. Putting the annual trust investment monitoring fee in perspective, assume the trust investment is $1,000,000 death benefit policy and the performance report cost is $500 – the annual cost is less than one basis point of the investment amount. By comparison to a $1,000,000 equities investment, the annual fee would approximate $5,000 to $10,000.

Conclusion

Unskilled Accommodation Trustees typically agree to serve in this role without understanding their duties and how to obtain creditable policy risk management that safeguards the interests of all ILIT parties. Due to the lapsing TOLI policy crisis, intervention is needed. As summarized in this article, expertise and policy evaluation 'tools' are readily available to provide needed intervention and creditable policy risk management and trust administration thereafter – they just need to be used.

The authors' recently released book, Oct 2016, The Life Insurance Policy Crisis – The Advisors' and Trustees' Guide to Managing Risks and Avoiding a Client Crisis*, published by the American Bar Association, discusses the lapse and litigation crisis in detail and sets out a prudent practices intervention guide that meets a dispute defensible standard. Further, the book is accompanied by the co-authors' OFFER TO PROVIDE CLE & CE continuing education programs, designed for bar associations, society of CPA's and estate planning councils.*

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