

## Strategies to Maintain the Individually Owned or Trust-Owned Life Insurance Policy

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Over the years, many have called attention to the problem of prematurely expiring life insurance and what CPAs and attorneys need to know in order to advise and assist their clients' trustees (usually an eldest son or daughter) regarding the performance and monitoring of the life insurance policy for which they are responsible. This is an issue regardless of whether the life insurance policy is owned individually by the son or daughter or whether they sign as a trustee if a trust exists. In either case, the mechanics are the same.

An increasing number of non-guaranteed universal policies are expiring prematurely due to the reduced sustained low interest rate environment, as well as trustees and advisers who did not know they should have increased their premiums in order to prevent the duration of their life policies from expiring prematurely. This—coupled with a lack of notice from the agent or insurer of the consequences of not increasing premiums—has caused an even greater number of policies to expire years earlier than initially planned.

Non-guaranteed life insurance policies, which account for approximately 52% of existing coverage, have not achieved their intended goals because unskilled trustees did not have the knowledge or qualifications necessary to actively manage the complexities of their life insurance policies. Nor were they advised to delegate that responsibility, just as they would the responsibilities to properly manage their investments or real estate portfolio.

These amateur trustees usually were also not aware that they assumed 100% responsibility for the performance and sustainability of the life insurance policies with which they were entrusted. Even fewer were aware that as a trustee, they had assumed a fiduciary responsibility to manage the life insurance portfolios to ensure that the policy's death benefits would get to those family members who were originally intended as beneficiaries by their parents. In order to accomplish these tasks, the trustees or individual owners are often entirely dependent on their parent's CPA or attorney for assistance and guidance.

Unfortunately, that advice is usually neither sought nor provided. Often, an individual with a six-figure stock or bond portfolio would contact his or her investment adviser once or twice a day, a week, a month, or quarter. Yet that same individual with a seven-figure life insurance portfolio may not have looked at nor reviewed his or her life insurance policy's performance in years.

Most individuals are unaware that their current life insurance policies are not guaranteed to last for the rest of their lives—and that those policies need to be actively managed just like a stock, bond, or real estate portfolio. The old thinking of "buy and hold" must be replaced by a "buy and manage" philosophy to ensure that policies are adequately funded to keep their coverage in force to at least their normal life expectancy.

Whether you are an attorney or a CPA servicing a client or managing a family office, it's imperative that you realize the responsibility of maintaining your clients' life insurance coverage rests with the trustee—and not with the agent or broker that may have initially sold them their policy. Through several webinar polls and surveys, it was discovered that one of the more difficult concepts for many advisers to understand is the reason the insurance agent or

company does not take more responsibility to make certain that a policy stays in force. Doesn't the insurer make money when premiums are paid by an insured?

It may be of interest to note, however, that neither the insurance company nor agent has any obligation to manage the policy—that's the responsibility of the trustee. (See *Thompson v. UBS Financial Services*.) As a matter of fact, it's in the life insurance company's best interest when the policy lapses or is surrendered after a number of years—it means the insurer has no obligation to ever pay out a death claim, and all of the premiums they've collected (less expenses) falls to the bottom line as a profit.

People also have difficulty understanding how they could have paid a life insurance premium they were billed for by the insurer on time and for many years—and have those payments be insufficient to keep the policy in force for the rest of their lives. The point is that it was not sufficient to pay the originally billed premium when interest rates were significantly higher. What they should have done was adjust the premium each year based on the current interest rate. In the case of a variable life insurance policy, the performance results of their underlying investments should have been evaluated quarterly or annually. And if there was a shortfall of the anticipated investment results, they should have paid more premium dollars into the life policy.

The successful or unsuccessful transfer of assets earmarked for the next generation will also directly affect the type of relationship you will have—or not have—as the adviser for the next generation of your current clients. It's far better to go to your client with a word of advice suggesting that they proactively review their life insurance portfolio rather than have them come to you after the policy expired to inquire as to why you didn't warn them beforehand.

The attorney played a vital role in encouraging and assisting your clients to initiate or update their will or trust. He or she may have provided your client and their trustee with an exculpatory clause so that your clients' son or daughter, acting as an amateur trustee, will steer clear of any liability for the loss of their beneficiary's monies. A well-thought letter of instruction advising the trustee as to exactly how the grantor would have liked certain matters to be handled can also be a very useful tool after the grantor is gone.

As an accountant, you have an ongoing relationship with your client—one in which you likely set up their Crummey letters, concurred that they required the coverage, and determined that they had adequate cash flow to pay for the premium. But unless you also provided the amateur trustee with an ongoing monitoring system and performance evaluation services, you have not helped them avoid the ultimate erosion of their beneficiary's portfolio. Rather than relying on exculpatory clauses, perhaps the best thing you can do is provide your clients' children with instructions as to how they can obtain the information and guidance they'll need to avoid any type of preventable loss of their life insurance proceeds. Your client values your opinion and trusts your advice—if they didn't, that client would not pay your fees.

Your clients look to you to protect them from anything financial, so how might you explain the loss of an anticipated significant death benefit of an individually owned or trust-owned life insurance policy as a result of miscommunication or neglect by a client's family member? Life insurance can do much for estates of any size, but it does not come with an automatic self-manage function. That piece must be built into every non-guaranteed life insurance policy purchased between the early 1980s and 2003—at which point universal life policies began being offered with a guarantee. This also holds true for the non-guaranteed variety of life products still being offered today—for example, Indexed Universal Life policies (IUL).

Your client's son or daughter is probably not familiar with how their parents' life insurance policy works—nor are they comfortable talking about the subject. It's important that you, as their adviser, take a proactive role and advocate for the next generation by ensuring that your client is aware that reduced sustained interest rates and neglect are not the only causes of a policy expiring prematurely. Today, we must also be concerned with what I call the life insurance industry's "perfect storm," in which many insurance companies have begun to raise the internal cost of insurance (COI) for the first time, thus further exacerbating an already deteriorating situation that adversely affects the duration of the grantor's life insurance coverage. Keep in mind that a performance evaluation report provides a trustee with much needed information. And the sooner the problem is brought to the attention of the client, insured, owner, trustee, grantor, or beneficiary, the more options they will have available and the less costly it will be for them to resolve their life insurance coverage issues.

There are several simple choices one has in order to extend one's life insurance coverage: reduce the death benefit, increase the premium, or—if one is relatively healthy—shop the market for a similar policy at a better price and perhaps with more benefits. The decision to look in that direction is often the stumbling block. In 2012, as a result of a previously enacted Pension Protection Act, a new type of policy came into existence called a combo, hybrid, or linked plan. These new policies permitted an individual to withdraw dollars from the *death benefit*—not the cash value—on a tax-free basis to pay for qualified long-term care expenses. That's an excellent opportunity to use leverage and tax-free benefits to possibly pay for one's long-term care expenses. Similarly, clients need to be made aware that they should never surrender or intentionally lapse or reduce their life insurance policy death benefit without first exploring the potential benefits of a life settlement or refinance option.

U.S. Supreme Court Justice Oliver Wendell Holmes wrote, “[L]ife insurance has become in our days one of the best recognized forms of investment and . . . saving.” [This opinion](#) placed the ownership rights in a life insurance policy on the same legal footing as more traditional investment property, such as stocks and bonds. As a result, clients need to be aware that an individual has the ability and right to sell a life insurance policy that they no longer need or find too expensive—just like they would a home, a car, or any other personal property. Unfortunately, that's not the case with many clients, as estimates from 2015 indicate that \$143 billion of life insurance coverage has lapsed annually by insured's age 65 and older. Further, 90% of those that lapsed a policy said they would have considered a life settlement had they known of its existence. While advisers are aware of the benefits of receiving a higher payout with a life settlement than what would have been received from surrendering the policy for its cash value, very few advisers are familiar with the proprietary concepts that allow an individual to benefit by taking advantage of alternative exit or refinance strategies from their traditional life insurance policies.

Because a life settlement transaction keeps a life insurance policy in force rather than allowing it to be surrendered or lapsed, many life insurance companies have forbidden their life agents at career shops to discuss this concept because it takes away a percentage of their built-in profits when a policy does lapse. I understand the number to be as high as 7 to 9%. One such “gag order” preventing an agent from advising the client to consider a life settlement has resulted in a class action lawsuit that is now winding its way through the courts. (See [Larry Grill v. Lincoln National Life Ins.](#))

In today's toxic life insurance environment, where 11% of even guaranteed policies have already lost their guarantees due to noncompliance with existing rules—for example, paying a premium even a day late can void the existing guarantee provisions. If you don't have the necessary skills and expertise, you have two choices: You can either delegate your trustee responsibilities or resign as trustee. Anything else, and you're opening yourself up to one of the many lawsuits that clients' advisers are now bringing against amateur trustees, in spite of the various exculpatory clauses being written into ILITs. Rulings such as [Rafert v. Meyer](#), a Nebraska case, mean that fiduciary responsibility and liability cannot be drafted away—a trustee has a non-waivable duty to beneficiaries. This can explain why nationwide, the trusts and estates practice area has the fourth highest number of legal malpractice claims against attorneys. What's interesting to note is that the percentage of claims against attorneys in trust and estate matters has increased by over 50% in the last 25 years.

Not only have trusts and estates claims against attorneys increased nationally, but New York—a state that once prided itself on its very strict privity rules—has recently eroded those requirements and increased the potential for legal malpractice claims against the New York State trusts and estates practitioner. (See [Estate of Schneider v. Finmann](#) and [Iapiro v. Bachman](#).) While New York has gone so far as to give standing to the personal representative of an estate to bring a legal malpractice action against the decedent's attorney, it has not given the right to beneficiaries of an estate to bring an action against a decedent's attorney, as some other states have. The expansion of the class of potential plaintiffs against a trust and estate attorney, however, may not be that far off in the future.

Currently, 33% of legal malpractice claims against trusts and estates professionals come from errors in client communication. So it follows that the best way to guard against an avoidable malpractice lawsuit in today's environment is to suggest to clients that they conduct a thorough investigation and discovery process, which is best accomplished through a written performance evaluation of their life insurance portfolio.

Lastly, don't make the mistake of allowing your clients to get rid of their life insurance if and when the current administration succeeds in getting rid of the federal estate tax. While it's possible the federal estate tax will be gone, there is always the strong possibility that it will come back in four or eight years—at which point your client will be

older and may not medically qualify for an amount of life insurance necessary to satisfy their estate tax needs.

The client's CPA is truly in a position to advocate for the next generation and help the trustee delegate and obtain the necessary expert guidance they'll require to not only prevent a life insurance policy they're responsible for from expiring prematurely, but also to evaluate the ongoing transaction through the same transparent lens they use to evaluate their investment and or real estate portfolio. The tools to evaluate performance and fees and plot them against other comparative index grids are already in place. It's up to you—the client's most trusted adviser, the one they see on an annual basis, and the one that can truly advocate for and protect the life insurance assets allocated for the next generation so they can arrive as initially anticipated. Keep in mind that if you don't advocate by guiding, delegating, and assisting your client's children to do their job, there's a very good chance that no one else will.

**Henry Montag, CFP**, has been in practice since 1976 with offices in Long Island and New York. He is a principle of The TOLI Center East, which provides independent consultative fee-based life Insurance performance evaluations for trustees, their adviser's, and high net worth individuals regarding the protection of individual or trust-owned life Insurance. He has authored articles for the New York State Bar Association (NYSBA), the TaxStringer, Tax Facts, Trusts & Estate magazine, NcCPA & the Women's Bar Assoc. He has lectured extensively on the proper utilization of financial products to the NYSBA, NYSSCPA, AICPA, the National Conference of CPA Practitioners, and Financial Service Professionals. He has been a source for The Wall Street Journal, Investor's Business Daily, Investment News, Long Island Business News, Newsday and was featured in Financial Planning. He also appeared on Fox Business News, News 12, & Wall Street Week. He most recently co-authored a book for the American Bar Association in November 2016, "The Advisors' and Trustees' Guide to Managing Risk and Avoiding a Client Crisis."



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