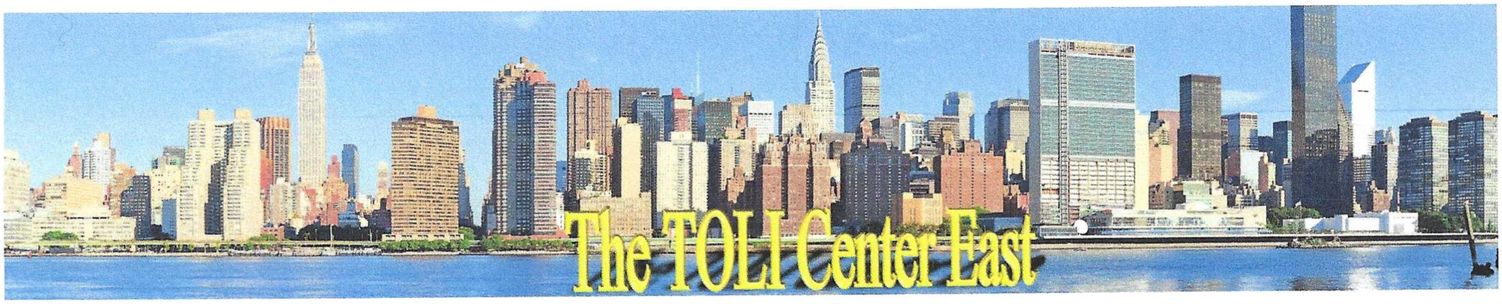

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Dear NYCLA Attendee

March 15, 2023.

I hope you found our session regarding 'Maintaining Life Ins coverage in ILIT's useful and of interest. Most clients are unfamiliar with most of the "Points to Keep in Mind". Consider asking a client about their life Insurance coverage, be it owned individually or in an ILIT, include several of the questions below. Urge them to get the answer if they're Not familiar with the answers.

I'd be delighted to share my 37 years' experience as an independent CFP, CLTC, & act as a resource for you, or a client in this ever-changing world of providing information regarding the right type of life Insurance and appropriate strategies that **most clients aren't familiar with.**

For example, should I consider the traditional guaranteed or non-guaranteed life Insurance with or without the ability to pay for any qualified long term care costs directly from the death benefit of the policy tax free, or should I consider a traditional LTCI Ins policy?
Should I surrender my policy for its cash value or is there a better alternative?

The points to keep in mind are as follows. ***Have client compare what they think they have to what they actually have. How long will their existing coverage last? Are they sure? When was the last time their personal or trust owned life Insurance was evaluated? Lack of management results in 40-45% of Non-Guaranteed Universal Life coverage expiring early. It's the Owners'/Trustees' sole responsibility to manage their policy & prevent a premature lapse.***

I've attached several relevant articles I thought you'd find of interest. Please feel free to call or email if I can answer any general or personal questions as I am a very good resource of info.

Best Regards,

Henry Montag CFP, CLTC

Bloomberg Tax

Tax Management Estates, Gifts and Trusts Journal™

What an Attorney and CPA Must Know About Maintaining the Life Insurance Coverage in an Irrevocable Trust (ILIT)

By Henry Montag CFP[*]
The TOLI Center East
Long Island, NY

The purpose of this article is to provide professional estate planning advisors with pertinent analysis and recommendations on life insurance developments in order to help them:

1. Protect their clients from any unexpected unpleasant surprises regarding their life insurance coverage funding their irrevocable life insurance trust (ILIT) expiring early.

2. Assist their clients in leaving as large a legacy as possible to their family via an ILIT.

The intent is to assist you in better understanding a life insurance portfolio from a personal, as well as a professional perspective. While the current federal estate tax exemption is approximately $11,500,000, it will sunset at the end of 2024 back to approximately $5,500,000. In addition, many states tax inheritances of more than $1,000,000. Life insurance plays a large part in settling the estate taxes which are due and payable within nine months of the date of death, with several exceptions, before any part of the estate can go to the family. Typically, your client's eldest son or daughter is asked to act as an unskilled/amateur trustee and is not aware that the life insurance for which they are responsible and, as a fiduciary liable, is possibly in danger of expiring prematurely. As a result of the passage of the Uniform Prudent Investor Act (UPIA), trustees are now held to a higher standard than under previous law. Trustees have been put on notice that they must treat life insurance as they would any other trust asset such as stocks, bonds, or real estate.

THE PROBLEM: UNIVERSAL LIFE INSURANCE MAY NOT LAST FOREVER

As a trusted adviser to your clients, you have an opportunity to educate them and their unskilled trustees concerning the fact that as many as 50–60% of universal life insurance contracts written over the last 25 years are not guaranteed and 35–40% of those policies (about a quarter of policies overall) are now in danger of expiring prematurely, as highlighted in *The Advisors' and Trustees' Guide. . .*, cited above (see press release). This has occurred as a result of significantly reduced interest rates coupled with neglect over the last two decades. It affects individually owned as well as trust-owned life insurance policies, as all non-guaranteed life insurance policies have been equally adversely impacted.

Prior to the mid-1980s there were two types of life insurance policies, both guaranteed.

- Term Life Insurance, in which a specific dollar amount of life insurance was guaranteed to remain in force for a specific period of time — one, five, 10, or 20 years — and at a specific guaranteed premium.

[*] Henry Montag, CFP, Managing Director of The TOLI Center East in practice since 1976 with offices in Long Island, NY, has authored articles and acted as a source for NYSBA; NYSSCPA; Bloomberg's Daily Tax Report and Estates, Gifts & Trusts Journal; Trusts & Estate Magazine; Accounting Today; and The Wall Street Journal. He has appeared as a guest on Wall Street Week, Fox Business News, and News 12. He co-authored an American Bar Association flagship publication, *The Life Insurance Policy Crisis: The Advisors' and Trustees' Guide to Managing Risks and Avoiding a Client Crisis*, released at the Heckerling Institute on Estate Planning in January 2017.

This article may be cited as Henry Montag, *What an Attorney and CPA Must Know About Maintaining the Life Insurance Coverage in an Irrevocable Trust (ILIT)*, 48 Tax Mgmt. Est., Gifts & Tr. J. No. 2 (Mar. 9, 2023).

- Whole Life Insurance/Permanent Coverage, which was guaranteed to remain in force for the insured's life as long as the stated premium was paid each and every year. Whole life policies contained a tax deferred accumulation account known as cash value which was credited 3% annually.

Creation of Universal Life

Prior to 1984, if a consumer wanted their life insurance coverage to last beyond age 80, when a term policy would expire, they had no choice other than to purchase a whole life policy whose cash value was growing annually at a guaranteed 3% while bank deposits or CDs had continuously increased the yield on their deposits which at the time were yielding 15–17% annually. As one can imagine, it wasn't long before the general public saw the economic sense in borrowing the cash value from their current whole life policy, or in some instances completely cashing out the accumulated cash value from their existing 3% life insurance policy and transferring it into a higher-yielding bank deposit.

Then E.F. Hutton, primarily known as an investment brokerage firm, realized that there was a competitive advantage to be first to market a welcomed new type of life insurance policy that was flexible and less costly to already dissatisfied consumers. The new E.F. Hutton life insurance company offered a competitive, flexible interest rate to purchasers of its newly created universal life insurance. This type of policy provided the insured an assumption that their policy would be credited with a more competitive interest rate than the 3% that was previously paid by a whole life insurance policy. A universal policy offered coverage beyond age 80, and an assumed yield of 12–14% for an assumed 20 or 30+ year period which, if rates matched expectations (which they didn't), could have resulted in a significantly lower premium than the traditional whole life insurance policy.

A new type of a life insurance product was born, and people were in a frenzy to set their own reduced premiums based on the non-guaranteed higher interest rate assumptions they or their agent used to calculate the anticipated premium. At the time there was no regulation and if someone wanted to assume a 12–13% anticipated rate of return they were free to do so.

By the late '80s, nearly every major life insurance company offered a universal life policy. Consumers and agents were more concerned with the assumed interest rates and lower premiums than with the fact that the assumed interest rate was not guaranteed.

However, if the assumed interest rate was not achieved consistently over the next 20 or 30+ years, the duration of the coverage would be shortened. Consumer and agents were not aware that the actual achievement of the assumed interest rate should have been recalculated every few years. For example, if the credited rates increased, they could have paid a lower premium — but if interest rates decreased, as they continuously did, then the premiums should have been increased to make up for the lower actual return. In other words, non-guaranteed life insurance should have been treated as a buy-and-manage asset rather than as a buy-and-hold asset.

Types of Trustees

Many accountants and attorneys have suggested that their high-net-worth clients use an institutional trustee for their trust-owned life insurance policies, while many others have chosen to serve as trustees of such trusts themselves. Since many institutional trustees charge a fee for their service, very few trust-owned life insurance (TOLI) policies — less than 10% — use a corporate/institutional trustee to professionally manage a client's irrevocable life insurance trust (ILIT). These trustees, unlike their unskilled counterparts, actively manage the policies entrusted to them as they are under the watchful eye of the Office of the Controller of the Currency (OCC), which monitors their activity on an annual basis. If their offices don't have the necessary expertise to evaluate the performance of a policy, they would of course retain the services of an expert who does.

The other 90% of TOLI policies are managed by the grantor's son or daughter who for the most part, acting as unskilled trustees, don't have the basic understanding that the policies for which they're responsible are not guaranteed and require active management just like their stock/bond or real estate portfolios, otherwise their coverage could expire prematurely — as increasing proportions of them already have. Most trustees are unaware that they've assumed 100% of the performance risk as well as the fiduciary responsibility and liability when they agreed to act as a trustee for a non-guaranteed universal life insurance policy. Since most unskilled trustees are not equipped to evaluate the risks, nor monitor the performance, of a non-guaranteed universal life insurance policy, they are unlikely to do what is necessary to remediate the underlying problems to prevent premature expiration.

While the majority of problem has come from flexible premium, non-guaranteed universal policies, the problem extends to variable and even whole life insurance contracts that are being paid for out of their cash value — when the owner or trustee fails to pay a premium, for instance.

The Source of the Problem

So how can the attorney/accountant, acting as trustee themselves or an adviser to the policy owner/

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trustee know if their or their client's universal life policy has problems? The original illustration is generally of no help since life insurance illustrations are simply computer printouts that show various aspects of the policy, i.e., premiums, cash values and the duration of the death benefits using assumed interest crediting rates often made 20+ years ago when assumed interest rates were significantly higher than they have been over the recent past. The insurance company is not required to meet these estimates, nor were they ever guaranteed. The only certainty about illustrated values is that the policy's actual performance will differ from the original proposals.

While the annual policy statement contains footnotes that can highlight a problem, it is usually missed in the 6–8-page report and is filed along with the policy without much attention being paid to the early warnings provided by the insurance company. The best way to understand how a policy is performing is to *order an in-force historic re-projection.* This evaluation is an illustration of the policy from the inception to the present and contains its current values which must now be projected into the future based on current guaranteed crediting rates and increasing mortality costs. A universal life policy is based upon an assumed crediting rate often set by the insurer's board of directors annually, while a variable universal life policy relies on the assumed sub-account stock or mutual fund returns. The difference between what was initially projected and what is currently needed determines whether the current premium is sufficient to carry the policy to maturity or if it should be increased.

In the case of a lapsing policy with a loan, the policy owner can be subject to income taxes, as a result of forgiveness of debt if the policy expires before the insured. Likewise, if a trustee or grantor forgets to pay the premium or assumes no premium is due when in fact it is, most insurance companies will automatically pay the premium from the cash value to keep the policy in force. Further, it will consider those premiums as a loan and charge a cumulative 5% interest rate on the loan each year. The trustee/owner is often unaware that this loan accrues interest compounding each year and draining the policy's cash value until it prematurely expires.

A Necessary Procedure

My 35+ years' experience as a practitioner has led me to believe me that a typical unskilled trustee has no procedure in place to properly manage a TOLI policy. Further exacerbating the problem is the fact that, contrary to popular belief, neither the insurance agent/broker nor the insurance company are obligated to make certain that your premium is sufficient to keep your policy in force. Nor is it in the insurer's interest that your coverage remains in force. The insurer after just eight years of an insured paying a premium, breaks even and after 20+ years stands to gain substantially if the policy lapses, because then it retains all the years of premiums paid without ever having to pay out a death benefit. Keep in mind that the insurance company is merely required to send out premium notices to the insured, provide one annual statement and pay the death benefit if the policy is in force at the time of the insured's death. The management of the policy to make certain the premium is sufficient to maintain the death benefit to a desired age is solely up to the owner/trustee.

Therefore, every grantor of a TOLI and every trustee should have in place an actively managed annual review process which includes a documented Trust Investment Policy Statement (TIPS), stating how the trust asset should be managed and what's important to the grantor under normal circumstances as well as in the event of certain future contingencies such as required premium increases. An Adequate Funding Statement (AFS) outlining the financial evaluation to assure the premium is adequate to maintain the coverage. In response to backlash and complaints, the insurance industry has begun to offer "No-Lapse Guarantee Riders" to new universal contracts to prevent their coverage from expiring prematurely. However, they do not apply to any of the non-guaranteed policies issued prior to the creation of these riders.

SOLUTIONS TO FIX A FAILING LIFE INSURANCE POLICY

An insured could start paying a higher premium to guarantee that a policy's coverage will not expire earlier than five years beyond their normal life expectancy. Or the death benefit could be reduced to a smaller amount without adjusting the premium. If the client is healthy and it makes economic sense, they could consider the purchase of a new policy available in the open marketplace today, based on lower mortality costs, and increased underwriting classifications. In addition, they could take advantage of new "Living Benefits" of Life Insurance as an "Asset Class," which was previously unavailable. This includes the ability to *pay for long-term care costs directly from the death benefit, tax free.* If it's determined that the necessary premium is more than the insured wishes to spend, or can afford, the trustee should retain the services of a *licensed life settlement broker to sell the policy as a life settlement* in the secondary market to an institutional investor rather than simply allowing the policy to expire worthlessly. It's been my personal experience as a practitioner that this strategy can re-

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turn upwards of 100% more than an insured would receive if they were to merely surrender the policy to the insurer for its cash value. With proper guidance and intrafamily communication, a trustee or individual owner can turn a bill into an asset. If intervention is needed, the logical go-to is a tax or legal advisor working in conjunction *with an experienced independent life insurance consultant familiar with these issues.*

The trustee should make certain that all beneficiaries are based on the insured's current wishes, rather than rely on what was put in place years ago when the coverage was first applied for. There is no better way to inure yourself to the next generation than to suggest a meeting to assist the son or daughter responsible for maintaining and managing a significant amount of life insurance allocated to financially assist the next generation by paying their estate taxes and maximizing the legacy left by their parents. The most important question in addition to inquiring how much life insurance is available, is to ask: *How long is your current life insurance coverage guaranteed to last? How do you know?*

Educate on Any Trustee Hold Harmless Clause

If a trust contains a hold harmless provision, make certain the grantor is aware of its existence and its meaning. Since the trustee has the sole responsibility for managing the trust asset, if he or she lacks life insurance evaluation expertise and the trust has a hold harmless provision, how will it affect the management and the ultimate duration of the life insurance coverage? Might it not make more sense to provide the amateur trustee with the guidance he/she will need, rather than allow the beneficiaries' inheritance to suffer because the grantor didn't want to ensure that the trustee could fulfill the responsibility entrusted to him/her?

Advocate for the Next Generation (of Clients)

Someone needs to advocate for the grantor's beneficiaries and coordinate all of the above to make certain that the next generation's future inheritance and well-being are not endangered as a result of outside economic conditions or neglect. There is perhaps no better way to meet and engage your next-generation clients than to initiate a conversation regarding the current state of their life insurance coverage and to let them know that it's important to determine exactly how long their existing coverage will last based on the current premiums they're paying and what can be done to preserve the inheritance left by your client, their parents. While it may be easier to draft an exculpatory clause in the trust, rather than provide guidance to an amateur trustee, the rewards of that guidance will be far greater and appreciated by your next-generation client. The estate planning attorney or the CPA is the professional advisor best positioned to arrange, invite, and manage such an initial meeting.

IN SUMMARY

In conclusion, you as a trusted advisor can choose to anticipate and avoid various family infighting and finger pointing as to who is to blame for a significant amount of life insurance coverage disappearing as a result of a lack of proper management. You can do this by setting up your own system taking all of the above into consideration. Or if you don't have the inclination or expertise, you can suggest that an unskilled trustee retain the services of an independent non-biased consultant who will evaluate, monitor, and review their life contracts and make suggestions based on additional ways to take advantage of various preventative measures or, if needed, provide some positive remediation strategies. Your clients will thank you.

The better approach for all parties is to require that the trustee treat a life insurance policy like any other trust asset, evaluating it and determines its appropriateness on a continuing basis — and getting paid for these services. Sometimes, penny wise really is pound foolish — for both the payor and the payee. It should be obvious that while relieving a trustee of various duties may lower the cost in trustee fees, it will also leave the trust without anyone to assure that the full value of the death benefit gets to the family.

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What Your Clients Wish You Told Them About Fixing & Preventing Mis-Managed Life Insurance From Affecting Their Estate Plan

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New York, NY

Attorneys establish trusts and business agreements for their clients for a variety of reasons. Perhaps an irrevocable life insurance trust (ILIT), to provide liquidity for estate taxes. A grantor trust for a parent or grandparent wanting to provide family income, professional management, or guidance for an inheritance earmarked for the next generation. A special needs trust (SNT) to provide for the welfare of a child after their parents are no longer here to take care of them. A buy sell agreement to assure the orderly transfer or disposition of their business interest for the benefit of their family and business partners. Since over 90% of the Fortune 500 corporate clients have a deferred compensation plan (DCP),[1] many of their small business owner clients have similarly requested to establish a deferred compensation plan to supplement their retirement income, or perhaps to allow a class of key employees the ability to defer a portion of their income as a perk at their place of employment.

Similarly, their CPA's will prepare their Crummy letters and make certain there's sufficient funds available to pay the ongoing necessary premiums to keep the coverage in force beyond their life expectancy.

THE ROLE OF A LIFE INSURANCE POLICY

What do all of these trusts, and agreements have in common? There's a life insurance policy used to fund each of the situations mentioned above. It's therefore important for the grantor as well as the amateur trustee, usually the eldest sibling, to become more knowledgeable regarding their responsibilities associated with managing the various types of life insurance policies funding their trusts and agreements. The purpose of this article is to familiarize the reader with information that can be used to better understand the opportunities that exist, and identify the proper strategy required, to provide guidance to your clients as well as their children acting as "amateur/accomodation trustees," that have received very little guidance regarding their responsibilities and the consequences of their actions and inactions when it comes to dealing with the current mismanagement and neglect of many of their existing life insurance policies in their portfolios. Life insurance has two purposes that can be used individually or combined to provide a traditional "Death Benefit" as well as a lesser known "Living Benefit."

Regardless of the use or purpose it's essential that a client understands that life insurance policies do not come with an automatic management function and that each of the policies funding their respective trusts

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This article may be cited as Henry Montag, *What Your Clients Wish You Told Them About Fixing & Prevent-ing Mis-Managed Life Insurance From Affecting Their Estate Plan*, 46 Tax Mgmt. Est. Gift & Tr. J. No. 5 (Sept. 9, 2021).

[1] Reg Ed Non Qualified Deferred Compensation Course, p. 7 (Mar. 2017).

and agreements require an ongoing review process because personal events and economic situations can and do change. How would you as an amateur trustee or an advisor to an amateur trustee of an ILIT react to receiving a notice from the insurer stating that the $1,700,000 life insurance policy in the trust is going to lapse in the next 12 months unless a significantly higher premium is paid? The insured is age 81, in good health and so far, has paid over $400,000 in premium. Your action is needed immediately. What would you advise? The point is if you, the advisor, or your amateur trustee client doesn't have the necessary skills, to properly evaluate the existing policy coverage it's your responsibility to retain the services of someone that does.

HOW DID THAT HAPPEN?

All too often a person, be it the client's advisor or eldest child will accept the title of trustee but won't fully understand the ramifications, the responsibility, nor the fiduciary liabilities that comes along with that title. One of the prime responsibilities of a trustee using any type of a life insurance policy is to make certain that the policy will be in force when the grantor dies. Let's look at a typical situation occurring today. In 1990-2000 if a client purchased a one million dollar life insurance policy it would have been suggested that the policy be owned by someone other than the insured outright, or if management and or creditor protection was desired, by a trustee of an ILIT, both to keep the death benefit out of the grantor's taxable estate. In 10% of the situations the grantor would have chosen to use an institutional or corporate trustee. However, in the other 90% it was usually the grantors' eldest child that was asked to serve as a trustee. A trustee that had the responsibility but not the necessary knowledge, experience, nor guidance to properly manage the life insurance policy to prevent it from expiring prematurely. Nor did the trustee realize that they assumed 100% of the performance risk for the life insurance policy that they didn't know was not guaranteed to last for the remainder of the insured's life.

WHAT HAPPENED?

The death benefit coverage of a life insurance policy could significantly be shortened as a result of 25-plus years of reduced sustained interest rates and neglect on the part of the amateur trustee, that wasn't aware that the life insurance premium he/she was paying should have been increased. The problem compounded itself over the years to the point where many 80-year old's today are currently discovering that their life insurance coverage is only going to last for just a few more years unless a significantly higher premium is paid to make up the insufficiency created over the last 25-plus years. How can that be asked of the client when they paid all of my premiums on time, in full and never borrowed any of the cash value. What they nor their amateur trustees, and advisors didn't understand is that 45% of the life insurance contracts they purchased over the last 25 years were non-guaranteed universal life insurance policies that were not guaranteed to last for the rest of an individual's life. The duration of the policy was based on an anticipated interest rate 10, 20, or 30 years ago that didn't materialize, and was never adjusted to coincide with the continuous reduced interest rate environment. This situation continued throughout the early 2000's when insurers began offering guaranteed universal life policies. The difference between a non-guaranteed universal and a guaranteed universal or a whole life policy is that the latter has a higher premium that's used to build up a sufficient amount of cash value designed to guarantee that the policy will last for the rest of an individual's life, or to a desired, specific age, in the case of a guaranteed universal policy.

However, with any non-guaranteed universal life policies purchased prior to the early 2000's, It was the owner/trustees' responsibility to evaluate the performance of the policy to make certain that any shortfalls, between the assumed interest rate when the policy was first taken out, and the actual interest rate that was credited to the policy in each of the last 20-30 years, be made up by increasing the premium paid to the insurer.

THE ROLE OF THE TRUSTEE

Unfortunately, neither the amateur trustees nor their advisers realized that a non-guaranteed life policy required this type of active management, and as a result 25-35% of these non-guaranteed universal life insurance policies are now expiring prematurely.[2] This situation has grown increasingly worse because just as people are living longer,[3] their non-guaranteed life policies are expiring earlier.

Most life insurance policies, even whole life policies, require some form of active management due to the fact that dividends which are often used to buy term insurance or reduce premiums are not guaranteed, and should be considered a "Buy and Manage" asset rather than the "Buy and Hold" asset they are often erroneously considered.

Once a problem is discovered trustees and beneficiaries alike often begin looking at who is at fault and

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[2] Randy Whitelaw and Henry Montag, *The Life Insurance Policy Crisis*, ABA (Jan. 2017).

[3] Society of Actuaries Report (Nov. 2014).

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who can be blamed for their problem. "Isn't it the agents' responsibility to make sure I'm billed properly?" or "Shouldn't the insurance company have billed me correctly?" or "Shouldn't my attorney that drafted the trust or my CPA who is involved in all my financial decisions have advised or informed me?" Despite the fact that 90% of the trustees that serve in the capacity as an amateur trustee have no skills and receive very little guidance when it comes to dealing with maintaining a non-guaranteed life insurance policy, the answer to the above questions is "No."

Neither the agent nor the company is responsible. It's the trustee that has 100% of the responsibility to manage the policy and only the owner/trustee can make a decision to increase or decrease the billed premium of the policy funding the trust.

JUDICIAL DECISIONS

In August 2012 the Office of the Comptroller of the Currency (OCC) issued guidelines[4] which directed financial institutions serving as corporate trustee of an insurance trust to treat life insurance as they would any other asset. Meaning that life insurance, like stocks, bonds, and real estate, requires active management.

Providing a policy performance evaluation and then monitoring it every two to three years, depending upon product would be a good idea for all amateur trustees. This is similar to the directive issued to corporate trustees under the Uniform Prudent Investor Act (UPIA), that also mandates that life insurance be treated as any other trust asset.

IMPACT OF COI

Why is all of this attention suddenly being paid to this topic? Very simply life insurance companies more so than many other financial organizations have been adversely affected by the sustained reduced interest rate environment and are currently seeking to do whatever they can to offset their losses.

Please inform your clients that the life insurance company has no obligation to the insured nor the beneficiaries. Clearly their obligation is to their stock or shareholders. When a life insurance policy lapses, it means the insurer gets to keep all of the premiums that were paid, and they will never have to pay out a death benefit. A very profitable situation for the insurers as all they're required to do is provide a policy stating the coverage, send out the premium notices and the annual summary statements, that most people don't read, and by virtue of inertia individual life policies are expiring years earlier than anticipated. To further enhance this process an increasing number of insurance companies are now exercising their contractual right to increase the internal cost of insurance (COI) for the 45% of the existing non-guaranteed universal life insurance policies. This action in addition to 25 years of reduced interest rates and neglect has caused a 'Perfect Storm' which is now further exacerbating an already deteriorating situation causing more life policies to expire even sooner. So, just as people are living longer their life insurance coverage is expiring sooner.

DO I STILL NEED THAT POLICY?

Considering the uncertainty of estate taxes, many of your clients are now pondering what to do with the life insurance they had previously purchased with the intent of using it to pay their federal and state estate taxes. While that topic is a subject to be discussed in a separate article, the question for many becomes "Should I continue to pay an increasing premium for insurance I may no longer need? Or should I give up my coverage? If I decide to give it up, exactly what should I do? Should I surrender the policy back to the insurer in exchange for the cash value? Should I merely reduce the death benefit and pay less premium?" Should I just stop paying the premium all together and keep the policy for as long as the coverage will last? Depending on an individual's health and age, a smarter but less well-known option is an alternate exit strategy known as a "Life Settlement." This is a process where the insured sells all or a portion of their existing life insurance portfolio, just like they would a car or a house. Such a sale is transacted on the secondary market in which a hedge fund/institutional investor acts as a purchaser, and the seller usually receives a significantly higher payout than if they would have surrendered the policy back to the insurer. Such a strategy can also be used to rescue a failing life insurance policy as a result of neglect or even unpaid loans against the cash value that could result in a significant tax bill, if the policy were to lapse, by turning an increasing premium bill into a liquid asset.

DO I NEED A GUARANTEE?

Going forward, today a client can obtain a guaranteed universal life insurance policy that can be designed to last for as long as they choose. Naturally the longer a person wishes to guarantee that their life policy will remain in force, the more it would cost and vice versa.

Guaranteed duration is especially important for a family setting up a special needs trust (SNT) when

[4] *See* Comptrollers Handbook, Asset Management (AM): Unique and Hard-to-Value Assets (Aug. 2012).

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they want to make 100% certain that the life insurance policy they purchase, remain in force for the duration of their lives to support their child after they're gone or to provide an inheritance as a legacy allocated for the next generation. The solution is a personal choice predicated on one's personal finances and thoughts regarding longevity. An ongoing evaluation of one's policy can also determine that an individual age 75 or 80 with a significant health issue and an expected shortened life span should not be paying premiums to keep a policy in force to age 95 if their prognosis determines that they may not live beyond age 85. Although guaranteed universal policies are now available, a guaranteed policy is more expensive than a non-guaranteed policy, so make certain as a consumer you're educated and know what you're buying.

TERM OR PERMANENT LIFE INSURANCE?

A buy-sell agreement between business partners can either be funded with a less expensive term life insurance policy, which is guaranteed to last anywhere from five to 30 years, or up to age 83, or it can be funded with a permanent life insurance policy that costs significantly more but lasts a lifetime because it builds up cash value. This cash value can later be used to supplement their retirement income. If a business is first starting out, or if cash flow is an issue, they should use a term policy to provide the maximum death benefit for the longest period of time, for the least amount of premium outlay. But if your client is involved in a well-established company where cash flow is plentiful, they may consider utilizing a permanent life insurance policy for its tax deferred accumulation benefits which, in addition to providing life insurance coverage, can later be used as an asset class to supplement their income at retirement. Keep in mind that some insurers only allow a term policy to be converted to a permanent product to age 65, or 70. This conversion privilege is extremely important to any individual that developed an illness, as it allows them to convert the policy's coverage to one that lasts a lifetime without any evidence of insurability. This opportunity is often missed and once it passes, is irreversible. point of information, association group term insurance is a great buy up until age 45, but with increases every five years at 50 it's terrible so shop around at age 49.

LIFE INSURANCE AS AN ASSET CLASS

Sometimes life insurance is not used for its death benefit and is instead used for its living benefit, as an asset class, i.e., providing a favorable tax deferred accumulation build up and tax-free distributions. Such would be the case if a client involved in a C-corp decided to use life insurance as an asset class for its living benefit via a deferred compensation plan (DCP). In this manner a key employee or the owner of the business itself, depending on certain restrictions, can reduce their current income and place the reduced amount of salary in a life insurance policy with just enough life insurance to not violate MEC rules, and still be able to utilize the life insurance policy's tax deferred accumulation status. Doing so would not only build up a tax deferred accumulation fund but can also years later, distribute the income from the cash value on a favorable income tax free basis to supplement their otherwise taxable retirement income.

Mechanically this can be done through the use of a series of withdrawals up to basis, and then loans that never have to be paid back as long as the death benefit survives the insured. A split dollar arrangement can also be used to make certain that the corporation gets back 100% of their initial outlay from the death benefit. A similar arrangement called a supplemental executive retirement plan (SERP), may be used in an S-corp or LLC for an employer, based on various percentage ownership rules, or an employee but only on an after-tax basis.

TO CLARIFY MATTERS

It's solely up to you, the clients trusted advisor who sees their client on an ongoing basis to protect your client's current life insurance portfolios. A useful tool I use in my practice to record all available options including the life insurance, is a Letter of Intent Statement (LOIS) where I have the grantor meet with the trustee on an informal basis to discuss in plain and simple language the grantor's intent and to assure the trustee's understanding of what needs to be done under various circumstances. I then turn this into an informal letter given to the trustee by the grantor. This letter along with an Adequate Funding Statement (AFS) obtained from a client's CPA or retained independent life insurance consultant, is used to ensure that the life insurance policy chosen is sufficiently funded to meet the grantor's objectives, and that they are periodically updated and reviewed to keep current with the grantor's wishes as to beneficiaries, duties, and allocated percentage distributions.

IN SUMMARY

Remember, your client may not be not familiar with their life insurance portfolio, may not know that it can expire years earlier than originally anticipated, is not comfortable talking about the subject, and does not understand how non-guaranteed life insurance and in-

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terest crediting rates work. In many cases the existing policy has not seen the light of day since it was purchased many years ago. Therefore, it becomes imperative that you, as their adviser, take a proactive role, and advocate for the next generation to assure that your client is aware that reduced sustained interest rates, neglect, and most recently the increased COI's has adversely affected the duration of their existing life insurance policies. There is perhaps no better way to meet and engage your next generation clients than to initiate a conversation with them regarding the consequences of the current mismanagement of their existing life insurance policies and to let them know that they need to locate, evaluate the performance, and actively manage their life insurance portfolio in order to preserve the life insurance inheritance left by your client, their parents, for them and their children.

While avoiding a policy lapse as a result of inadequate funding is the primary goal, it is important for the client to not waste assets and maximize the value of the life policies they currently have, as compared to what other policies may be available in the marketplace today. To assure that this is done, a client should be referred to an independent and experienced life insurance consultant to assist them in ordering a 'historic projection' to help determining whether they can take action today, which will prevent them from becoming a part of the increasing number of individuals whose life insurance policies have become compromised.

Doing so will allow a trustee to see how the policy might perform going forward based on the policy's current values, rather than on the originally illustrated projections that never materialized. A trustee may need to make some changes with or without additional costs based on the client's current objectives rather than on the original objectives made years ago that may no longer be relevant today. Trustees may find new features such as long-term care riders that pay for qualified long-term care expenses directly from the death benefit of a life insurance policy on a tax-free basis which were previously unavailable. Improved life expectancy as a result of modern pharmacology is now reflected in reduced pricing of new policies. Insurers are now offering guarantees which previously didn't exist.

In some cases, it may be less expensive for a trustee to purchase a new policy, even though the insured is older, through the use of an older policy's cash values transferred through a I.R.C. §1035 tax free exchange. This action should only be taken after weighing such considerations as changes in an insured's health, new surrender charges, and the beginning of a new contestability period. Other options may include reducing the current death benefit or increasing the premium. As previously mentioned, if the other options don't solve the problem a trustee should consider the sale of all or a part of a policy to turn an increasing premium into a cash asset as a result of a life settlement to a third-party institutional investor, or a combination of the above-mentioned strategies.

While it may be easier for an attorney to draft an exculpatory clause in a client's trust than to provide guidance to an amateur trustee, the rewards of that guidance will be far greater and appreciated by your next generation client. The estate planning attorney or the client's CPA is the logical choice as the professional advisors who are in the best positions to arrange, invite, and manage such an initial meeting with the assistance of an independent experienced life insurance professional.

The point is, the sooner the problem is brought to the attention of the client, insured, owner, amateur trustee, grantor, or beneficiary, the more options they will have available, and less costly it will be for them to resolve their problem.

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