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# Trust Owned Life Insurance

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# Introduction

- Talking today about **Trust Owned Life Insurance**, or TOLI, and the crisis of failing TOLI policies and what that means to us as advisors
  - **What is TOLI:** “A Life Insurance policy purchased by a Trustee to serve the interests of the trust grantor and the trust beneficiaries”
    - Life Insurance is simply the financial vehicle used to achieve the specific objectives of the trust grantor
  - **Problem:** Unlike other financial assets which are more actively managed, Life Insurance can often be overlooked and not as actively managed, which could have disastrous results for our clients and their beneficiaries

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# Introduction

## ■ Agenda Today:

- Review TOLI Basics
- Review Fiduciary Duties of Trustees (*and Advisors???*)
- Discuss the Crisis of Failing TOLI Policies with an Eye Toward How to Better Protect Ourselves as Advisors and Better Serve Our Clients
- Analyze What Problems to Watch Out For in TOLI Policy Reviews
- Consider Opportunities for Business Development

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# Background

- It is estimated that over \$1 Trillion in Life Insurance is held in Irrevocable Trusts (ILITs, IDITs, etc.), and this number only stands to increase as life insurance continues to play an increasingly large role in estate and financial planning
- Only approximately 30% of these Trusts are managed by corporate or bank fiduciary departments

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# Background

- One author, citing a 2004 Survey, indicated that among trustees who administered trusts containing TOLI:
  - Among professional trustees, 83.5% did not have procedures for handling and managing TOLI policies
  - For non-professional trustees, 71.2% indicated they hadn't reviewed their TOLI policies in less than 5 years
  - 95% of trustees had no guidelines for handling Variable Insurance and required asset allocations
  - **Two other surveys indicated between 70-95% of all TOLI policies do not have a life insurance agent servicing the contracts**

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# TOLI Crisis

- There is a burgeoning crisis of failing TOLI policies
- Trustees **MUST** monitor and review the TOLI life insurance assets owned in trusts under their care
- Fiduciaries, Regulators, Grantors and their professional advisors – **including life insurance producers** – are focusing on this growing problem, recognizing the need for TOLI risk identification and mitigation practices to **avoid problems and accompanying allegations of imprudent practices**

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# Fiduciary Duties

- **Fiduciary Duties:** Trustees are required to act at all times in the best interests of their trust beneficiaries
- These duties include preserving and protecting trust assets – including Life Insurance
- Can be Held **personally liable** for breach of a fiduciary duty – will be compared to a prudent, reasonable trustee standard
- **Where Life Insurance is owned by a trust, special skills are required, and can pose significant risks to trustees**

# Fiduciary Duties

- **Failure to Review a Life Insurance Policy will put a Trustee at Risk.**
- **Uniform Prudent Investor Act: 20 PaCS § 7201**
  - **General Rule:** Must exercise reasonable skill—what you would do if you owned the policy
  - **Life Ins. Exception: Section 7208**
    - Trustee can acquire insurance policy on settlor's life without liability for loss for failure to:
      - Determine whether contract remains a proper investment;
      - Investigate financial strength of the life ins. Company
      - Exercise nonforfeiture provisions available under the contract; or
      - Diversify the contract
  - ***Is Lapse Covered?...***

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# TOLI Crisis Solution

- **Paradigm Shift for Advisors:**

- In analyzing the failing TOLI crisis, Steve Leimberg calls for a paradigm shift from inadequate policy management to a service based fiduciary model where there is **more attentive oversight by legal, tax and insurance advisors**
  - Third-Party TOLI review specialists are appearing as a highly specialized practice area

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# Paradigm Shift

- “While insurance companies are failing and restructuring, Litigation is escalating over policy lapses, questionable policy replacements, irresponsible premium financings, SOLI schemes, etc.”
- “We must manage and maintain policies better, recognizing policy owners expect their policies to be serviced over a very long time horizon”

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# Paradigm Shift

## Problem:

- Carriers continued to introduce generations of non-guaranteed, hybrid and related life products requiring **attentive and ongoing risk management**
  
- **Leimberg Conclusion:**
  - Traditional transaction-based commissionable policy sales model disregards client expectations for ongoing policy service and does not allow for ongoing risk assessment and management
  
  - **Advisors must provide clients and their trustees with prudent life insurance management from the outset and, just as importantly, *on a going forward basis***

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# Paradigm Shift

- **What should we do as legal, tax and insurance advisors to safeguard our clients' life insurance plans and fulfill our fiduciary duties?**
  - Implement mandatory TOLI policy reviews for existing clients
  - Consider expanding practice management to include life insurance consulting or oversight
  - If serving as a Trustee or Co-Trustee of an ILIT, this should be automatic

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# Life Insurance Complexities

- **Critical TOLI Risk Management Considerations:**
  - Carrier Suitability (AIG???)
  - Product Suitability
  - Credible In-Force Policy Performance Evaluation and Management (just like fixed income and equity investments)
    - Premium Adequacy
    - Death Benefit Performance Risks
  - Trust Grantor Estate Planning Intentions Still Being Satisfied?

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# Life Insurance Complexities

- High Crediting Rates: e.x. VLs with 10-12% expected returns, and underperforming
- Inadequate funding – costs higher and gifting capacity limited, one spouse passes away, etc.
- Step-Policies – higher premium at future anniversary date – due to underperformance, will be higher costs than expected
- Death benefit requirements change

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# Life Insurance Complexities

- Trustees should Order In-Force ledgers frequently
- Do policy pricing reviews to see if policy pricing can make a difference to client
- Verify Annually, especially in Non-Guaranteed and Flexible Premium Arrangements, that:
  - Scheduled premiums are adequate to sustain the policy to insured's life expectancy, and preferably to age 100 or contract maturity
  - Policy is performing consistent with acceptable benchmark values and trust objectives
  - Carrier's third party financial ratings are unchanged or improved

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# Benefits:

- **Lesson: Prudent Trust Management:** Suitability and Policy Performance Reviews should be mandatory and performed at least on an annual basis
- A recent study of TOLI policies done by a cross section of bank trust departments found:
  - 75% chance that death benefits could be increased by 40% or more with no increase in funding; and/or
  - Funding could be reduced by at least 10% with no decrease in death benefit
- If 70 to 95% of TOLI policies are not serviced on an ongoing basis by an insurance representative, is there an opportunity there?

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# Trust Owned Life Insurance

**The End.**

*Thank you for attending!*