VALMARK FINANCIAL GROUP

WHY ARE TRUST-OWNED POLICIES FALLING SHORT OF EXPECTATIONS?

Executive Summary

Many trust-owned life insurance policies are not on track to deliver on their promises. This is largely due to the overutilization of ill-equipped trustees and the lack of regulatory clarity on how to properly manage life insurance contracts.

A Series of Unfortunate Trends

Irrevocable Life Insurance Trusts (ILITs) are a cornerstone to a diverse array of financial strategies. However, a disturbing trend has emerged in recent years that should concern grantors and beneficiaries. Industry data has been pointing toward a looming policy suitability and lapsing crisis, often referred to as the Trust Owned Life Insurance (TOLI) ticking time bomb. Unfortunately, some policies may have been improperly sold and subsequently imprudently managed, and as a result many TOLI

90% of in-force TOLI policies are managed by unskilled trustees.[2]

82% of life insurance policies that are voluntarily terminated lapse without value.[4]

policies have a high risk of not delivering on their intended promises. Compounding the problem in more recent years is the negative impact the falling interest rate environment has had on carriers and life insurance products. Dividend and interest crediting rates have dropped considerably, which will lead to many policies inevitably falling well short of client expectations.

1 in 8 guaranteed policies have compromised guarantees[4]

Many prominent carriers have also exited the individual life insurance business, unable to cope with the financial demands associated with extremely low interest rates. In addition, studies published in Trusts and Estates indicate 84% of trustees had no guidelines and procedures for monitoring and reviewing Trust Owned Life Insurance (TOLI)[1]. It is estimated that 90% of in-force TOLI policies are managed by unskilled trustees, typically family members, friends, and advisors of the ILIT grantor[2]. While friends and family may be closest to understanding beneficiary needs, they do not possess the requisite expertise to prudently manage life insurance contracts.

40% of flexible premium policies illustrated to lapse within the insured's lifetime[5]

The life insurance industry and corresponding regulatory environment have done a less-than-optimal job of putting the right practices and policies in place to protect beneficiary interests. As a result, many TOLI policies have a high risk of not delivering on their intended promises. If ILIT beneficiaries want to maximize the probability of a favorable outcome for the trust estate, they must take the initiative to assure their trust-owned life insurance policies are actively managed by professionals.

5 Questions to Ask About Your Trust-Owned Policy

Grantors should ask pertinent questions when evaluating trustee candidates. Better questions will yield better answers and improved outcomes for beneficiaries. Trustees should seek delegation of some of their fiduciary obligations if they cannot provide satisfactory answers to the following questions:

1. How is policy performance measured?

Every ILIT should have a written Investment Policy Statement specific to a beneficiary's objectives and risk profile. There should be thoughtful consideration in determining the appropriate methods to analyze contract performance over time and in deciding what benchmarks to measure them against. Trustees have the obligation to consider alternatives if an asset they manage is consistently underperforming.

2. What infrastructure is in place to properly track premium payments and timing?

Evaluating the sufficiency of premiums is one of the best ways to safeguard against detrimental effects on policy performance and death benefit guarantees. Life insurance policies can be highly sensitive to modifications of premium or premium payment timing. Slight alterations can be enough to adversely affect policy performance, terminate guarantees, or even lapse a policy.

3. How is carrier financial strength and stability evaluated?

The financial stability of the different life insurance carriers on the market is constantly evolving. Events such as acquisitions, changes in core business competencies, and new regulations can significantly affect the risk profile of a given carrier. Analysis using third-party rating systems should be performed annually.

4. How are new products or riders assessed that may offer better features or cost efficiencies?

The life insurance market in an ever-changing industry with new products, riders and features. Given the long-term nature of these vehicles, restructure should be expected if a new offering provides cost improvements or enhanced benefits.

Over 56% of policies without active management are underperforming.[6]

5. How are future design changes monitored and administered?

Along the timeline of a policy there are often scheduled changes or events, sometimes many years in the future. These things include withdrawals, loans, death benefit option changes, or utilizing rider benefits. If some of these changes are not executed in a timely manner it can have detrimental effects on the policy.

Fiduciary Responsibility Loopholes

The Uniform Prudent Investors Act (UPIA) provides a framework of standards describing general trustee fiduciary responsibilities. However, there is little detailed language spelling out specifically how trustees should manage life insurance policies. This inevitably opens the door to subjective interpretation and confusion on how to appropriately monitor such a long-term, complicated financial instrument. To make matters worse, many states have enacted statutes exculpating trustees from any life insurance-related losses. Attorneys can even draft provisions that afford similar protections to the trustee.

Expectations of Trust-Owned Life Insurance Policies

1. **Death benefit paid in full to beneficiaries**
2. **Fulfill estate planning objectives**
3. **Cash value accumulation**
4. **Well-designed and competitive product**
5. **Highly rated carrier**

Although trustees do have legal obligations, the reality is that state laws, trust language, and even personal relationships may effectively shield the trustee from responsibility for a terminated or underperforming policy. In addition, they may not be qualified to manage the very asset they are tasked with monitoring. If things fall apart, it can be extremely costly for beneficiaries and potentially result in years in court for an uncertain and possibly unlikely outcome of recovery.

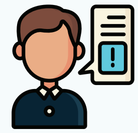
– UPIA Section 9, (a) "A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances." –

The good news is that Section 9 of the UPIA outlines parameters that allow trustees to delegate certain fiduciary responsibilities. In keeping with the best interest of beneficiaries, trustees have a duty to outsource certain responsibilities if outside of their realm of expertise. Friends and family are typically not equipped to assume the obligations associated with monitoring life insurance policies. Even skilled trustees that have substantial capability in managing more traditional asset varieties are finding they lack the technical prowess and infrastructure needed to suitably manage life insurance policies. Grantors and beneficiaries need to work with professionals that have a proven track record and specialized expertise in monitoring life insurance contracts.

– "Even skilled trustees that have substantial capability in managing more traditional asset varieties are finding they lack the technical prowess and infrastructure needed to suitably manage life policies." –

Conclusion

The statistics with TOLI policies are unsettling and many policies are falling short of their commitments. Life insurance contracts are strange and sophisticated financial tools often spanning 25-50 years that even skilled trustees can find themselves in over their head when managing. There are many skilled trustees who still need to employ assistance when dealing with the complexity of insurance contract performance management. Grantors do not want to find themselves on the wrong side of an ugly industry statistic, so they owe it to their beneficiaries to seek qualified professionals that have specialized expertise in policy evaluation capabilities.



90% of seniors who have let a policy lapse would have considered selling it if they had known that life settlement was an option.[7]

Valmark's Policy Management Company (PMC) partners with financial professionals to track key elements of life insurance policies designed to help detect deviation from original intentions. Through a dedicated team of experts experienced in sophisticated policy analysis, the PMC offers a detailed life insurance policy review process using objective analysis to determine policy performance and identify solutions to make improvements as needed.

Their demonstrated active policy management process has resulted in a 64% improvement over policies that do not have ongoing monitoring. Nobody wants to end up on the wrong side of an ugly statistic, and the life insurance industry data clearly indicates that it is better to have a bad product managed well than a good product managed poorly.

Citation

1. Harris and Prince, "The Problem with Trusts Owning Life Insurance," Trusts and Estates (May 2003):62.
2. Reliable data concerning life insurance policies owned in ILITs is unavailable. Since 1993, TOLI risk management articles have suggested that unskilled trustees administer up to 90 percent of in-force policies (How to Relieve the Plight of Unskilled Irrevocable Life Insurance Trust Trustees Unfamiliar with Their Duties

   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. While the prudent process tools for credible evaluation are readily available, such as FSP's Historic Volatility Calculator, they just are not used.
3. Whitelaw and Montag, "The Life Insurance Policy Crisis," (6/2017)
4. Whitelaw and Montag, "The Life Insurance Policy Crisis," (6/2017)
5. Whitelaw and Montag, "The Life Insurance Policy Crisis," (6/2017)
6. Policy Management Company review results from 5/2016-10/2017
7. Citing Whitelaw and Montag, "The Life Insurance Policy Crisis," (6/2017)