

THE TOLI LIABILITY

TRUST OWNED LIFE INSURANCE
(TOLI)



Agenda

- ◆ **Role of Trustee**
- ◆ **Present Dilemma**
- ◆ **Solutions**

Why The Bank Was Named Trustee

- ◆ Perpetual existence
- ◆ Impartiality and absence of conflict
- ◆ Business sophistication
- ◆ Accounting and tax planning expertise
- ◆ Record keeping and reporting ability
- ◆ Financial security
- ◆ Investment sophistication

Role of Trustee

- ◆ Majority of ILIT Trustees Only
 - ◆ Pay annual premium
 - ◆ Send out Crummey letters

Role of Trustee – Fiduciary Duty

◆ Prudent Investor Rule

Restatement (Third) of Trusts, Section 227(a):

The fiduciary must identify risk and return objectives for all of its specific investments in the context of an overall investment strategy.

Uniform Prudent Investor Act

- ◆ Prudent Trustee Rule redefined in the Uniform Prudent Investor Act (UPIA), requiring trustees to
 - ◆ Investigate
 - ◆ Monitor
 - ◆ Manage
- ◆ All trust assets, including life policies

- A 2004 survey by Trusts & Estates magazine revealed that 84% of trustees did not have stated guidelines or procedures for handling life insurance.
- A national accounting firm found that 85% of TOLI policies could be restructured to provide more value, at least 40% more death benefit for the same premium outlay or the same death benefit for a 40% lower premium.

Continued

- Due to changes in the Federal Estate Tax many grantors have estates that will no longer be liable for the tax, or for which the anticipated tax will be far lower. In these cases the conversion of a policy to investable assets would be a prudent action by the fiduciary.

Improvements in Life Insurance

- ◆ Lower cost of insurance per thousand
- ◆ Improved underwriting classifications
- ◆ Feature enhancements

Outside Forces Impacting Life Insurance Performance

- ◆ **Modified Endowment Contract (MEC) rules**
- ◆ **Insured's improved health or non-smoker status**
- ◆ **Death of first person on a second-to-die policy**

Alarming Statistic

- ◆ **20% of TOLI policies have lapsed or are close to lapsing**

Size of Problem

- ◆ \$1 Trillion of life insurance currently owned by trusts
- ◆ Survey indicated 20% of policies have lapsed or near lapse = \$200 Billion
- ◆ Average TOLI policy death benefit is \$1.5 M.

Dilemma: Who's Responsible?

- ◆ Trustee?
- ◆ Life Insurance Professional?

Alarming Statistic

- ◆ **79% of TOLI policies no longer have an insurance professional monitoring the policy.**

Recent Survey of Professional Trustees

- ◆ 84% had no guidelines or procedures for handling TOLI.
- ◆ Flexible premium policies now approximate 40% of TOLI policies as compared to less than 1% 25 years ago.
- ◆ 71% had not reviewed trust's life insurance policies in last 5 years.

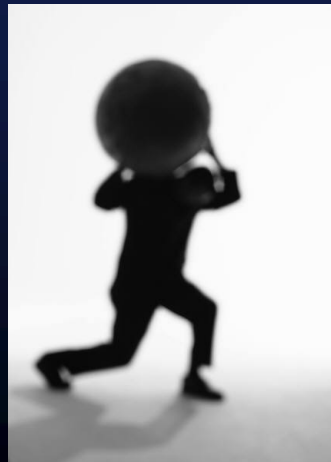
**Who is safeguarding
the interests of the
ILIT beneficiaries?**

Trustee liable if....

- ◆ Trustee has actual knowledge
policy
 - ◆ not suitable
 - ◆ not competitive
- ◆ Failed to exercise reasonable
diligence to monitor trust asset

Trustee May Elect to “Do Nothing”

- ◆ Rely on “hold harmless” language
- ◆ But...the Trustee is the **ONLY** one who has the power to act.



Policy Rescue Fiduciary Review

- ◆ 85% of policies can be restructured to provide more value
 - ◆ More death benefit for premium
 - ◆ Same death benefit for less premium

What Is The Solution?

- ◆ Work with skilled and experienced Professional to accomplish a fiduciary review of TOLI under Trustee's care
- ◆ Develop a “Best Practices” risk management process

“Best Practices” TOLI Risk Management Process

- ◆ Carrier’s size and ratings
- ◆ Product suitability
- ◆ Policy premium and performance
- ◆ Grantor’s ability and/or willingness to increase gifts to Trust
- ◆ Grantor’s insurability

Life Settlements

- ◆ This term refers to the sale of a life insurance policy in the secondary market.
- ◆ Previously, a policy would be returned to the issuing carrier for its “cash surrender value.”
- ◆ The purchase of life insurance policies in the secondary marketplace can often provide settlements 30% to 40% greater than cash surrender values.

Life Settlements

- ◆ Increase in Estate Tax Applicable Credit Amount has eliminated tax liability in the estate.
- ◆ Grantor no longer wishes to make gifts of additional premiums each year.
- ◆ Failing policy requires too substantial and increase in annual premiums.

Proceeds of Settlements

- ◆ Proceeds can be used as lump sum contributions to a replacement life insurance policy, reducing future premium outlays.
- ◆ Funds can be invested by the Trustee. These assets under management will appreciate and provide for any remaining Estate Tax liability or for the needs of the beneficiaries.

Benefits to Fiduciary

- ◆ Eliminate potential future liability to beneficiaries for loss due to failure of under performing policies to provide death benefits.
- ◆ Restructure trust holdings from non-revenue producing ILITs to substantial assets under financial management.



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