

**The Uniform Prudent Investor Act
and Trust-Owned Life Insurance:
The Impossible Dream or a Match
Made In Heaven**

**Gary L. Flotron, MBA, CLU[®], ChFC[®], AEP[®]
University of Missouri – St. Louis
G. L. Flotron & Associates
St. Louis, Missouri**

**Spokane Estate Planning Council
Spokane, Washington
May 12, 2015**

IMPORTANT DISCLAIMERS AND NOTICES

These materials are intended for educational purposes only. They are designed to provide accurate and authoritative information in regard to the subject matter covered. However, Gary L. Flotron is not offering any type of legal, accounting, insurance, investment or other professional advice in these materials. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

These materials are provided solely for educational purposes. These materials cannot be sold, copied, reproduced or distributed in any form or manner whatsoever without the express written consent of the authors.

IRS Circular 230 Disclosure:

To ensure compliance with requirements imposed by the U. S. Internal Revenue Service, we inform you that any tax advice contained in this document (including any attachments) was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (1) avoiding tax-related penalties under the U. S. Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Copyright © 2015 Gary L. Flotron, MBA, CLU®, ChFC®, AEP®
All rights reserved. Reproduction in whole or in part without written permission of Gary L. Flotron is prohibited.

Table of Contents

Gary L. Flotron, MBA, CLU®, ChFC®, AEP® Bio

Presentation Abstract

Presentation PowerPoint Slides Handout

Excerpt from The Office of the Controller of the Currency Handbook

Sample TOLI Investment Policy Statement – E. Randolph Whitelaw, AEP® (Distinguished)

Monte Carlo Simulation and Actuarially Certified Policy Standards Analysis – Gary L. Flotron, MBA, CLU®, ChFC®, AEP®

Dispute Defensible ILIT Administration and TOLI Policy Evaluation Checklist – Lawrence Brody, JD, LLM, AEP® (Distinguished); Gary L. Flotron, MBA, CLU®, ChFC®, AEP®; Richard A. Schwartz, FSA, MAAA, CLU®; Richard M. Weber, MBA, CLU®, AEP® (Distinguished); E. Randolph Whitelaw, AEP® (Distinguished)

Suggested Readings with Comments – Gary L. Flotron, MBA, CLU®, ChFC®, AEP®

Gary L. Flotron, MBA, CLU®, ChFC®, AEP®

Gary L. Flotron is principal of G. L. Flotron & Associates, and specializes in estate and business planning, and executive and employee benefit plans. He is also the Associate Director Financial Planning and Counseling Programs and an Adjunct Faculty member at the College of Business Administration, University of Missouri - St. Louis, where he teaches courses in estate and trust planning, planning for business owners and professionals, employee benefits and life insurance. In addition, he is an Adjunct Professor with The American College of Bryn Mawr, Pennsylvania. An author and frequent national speaker, Gary has spoken to numerous professional associations and groups, including the Heckerling Institute On Estate Planning, the NAEPC Annual Conference, The Federal Tax Institute of New England, and, the FSP Video Training Conference.

Mr. Flotron has been an active member in various professional associations. He is Chair Emeritus and a Member of the Executive Committee for the Synergy Summit, an organization and think tank composed of representatives from ten major national legal and financial services professional organizations involved in estate planning. Previously he has served on the Executive Committee and is a Past Chair of the Professional Education and Development Committee for the Synergy Summit. He is a Past President of the National Association of Estate Planners & Councils (NAEPC) and The NAEPC Education Foundation, as well as past Chair of The NAEPC Education Foundation Committee and past Chair of the Accredited Estate Planner® (AEP®) Designation Committee for NAEPC. A past Member of the National Board of Directors of the Society of Financial Service Professionals (FSP), Mr. Flotron, in addition to having served on numerous National Committees and Task Forces, is the current Editor of the Estate Planning Section Newsletter for FSP. He is also a member of the University of Missouri – St. Louis Planned Giving Advisory Committee.

A past President of the FSP Greater St. Louis Chapter, Gary is also a past President of the Estate Planning Council of St. Louis, and past President of the National Association of Insurance and Financial Advisors St. Louis Chapter. He is a past Member of the Board of Directors of the Foundation for Financial Service Professionals and a past Regional Chair for the National Council of The American College. Mr. Flotron has also served as a Member of the Chartered Financial Consultant (ChFC®) Curriculum Advisory Board for The American College.

An MBA graduate of the Washington University John M. Olin Graduate School of Business Administration, where he was inducted into Beta Gamma Sigma, the National Business Honors Fraternity; Flotron completed his undergraduate work in engineering management with a concentration in electrical engineering (B.S.E.Mgt.) at the University of Missouri at Rolla (now Missouri University of Science and Technology). He received the Chartered Life Underwriter (CLU®) designation in 1984 and the Chartered Financial Consultant (ChFC®) designation in 1985, both granted by The American College. In 1995 he was awarded the Accredited Estate Planner® (AEP®) designation by NAEPC. Gary is the 1996 recipient of the Stan Towerman Excellence in Professional Education Award from the FSP Greater St. Louis Chapter, and a 1994 recipient of the Paul F. Mills Scholarship from the Foundation for Financial Service Professionals. He was inducted into the National Association of Insurance and Financial Advisors St. Louis Chapter Hall of Fame in 2003. The University of Missouri – St. Louis named Mr. Flotron as the recipient of the 2014-2015 Chancellor's Excellence Award for a Part-time Faculty Member.

In addition to his professional activities, Flotron is involved in other civic and social organizations. Some of the organizations and activities that he has been involved with include: The St. Louis Zoo; St. Louis Zoo Safari Club; Retired Greyhounds As Pets (REGAP); Rescued Racers; Wild Canid Survival and Research Center (Wolf Sanctuary); The World Affairs Council of St. Louis, host for foreign dignitaries and international visitors; World Trade Club of St. Louis; Missouri Athletic Club; and various political campaigns, including being the Campaign Committee Chair for (Franc) Flotron for Congress 2000. He is also a past President of the Frontenac Forest Subdivision.

Gary has two sons, Paul and John, a daughter in law Anna who is married to John, and one grandson, Luke, and one granddaughter, Liliana. Flotron's hobbies include reading and learning, traveling, exercising, hiking, modern era architecture, photography, and walking/running his greyhound Jackson (at least in spirit and until he gets another greyhound). Gary's response when asked "what is something about you that is unique and most folks are unaware of?" is "that he had a dinner party in his home for a man that subsequently led a *coup d'état* and is now the President/Dictator of an African country.

The Uniform Prudent Investor Act and Trust-Owned Life Insurance: The Impossible Dream or a Match Made In Heaven

Gary L. Flotron, MBA, CLU[®], ChFC[®], AEP[®]

Abstract

The Uniform Prudent Investor Act (UPIA) requires all trustees/fiduciaries to manage, monitor and evaluate trust assets and investments for the benefit of the beneficiaries of the trust. Yet mounting evidence is indicating a “ticking time bomb” of life insurance policy insolvency and lapse for non-guaranteed trust-owned life insurance (TOLI). This presentation will discuss the applicability of UPIA to TOLI and discuss the significance of the Cochran v, KeyBank Case, which is the watershed case applying UPIA to TOLI. Additionally, with the advent in the late 1970s and late 1980s of flexible premium, non-guaranteed universal life insurance, or any other policy whose performance is based on nonguaranteed elements, the risk of policy sustainability, performance and solvency was shifted from the life insurance carrier to the policy owner. Yet the nature of this risk shift, the risks assumed, the effect of volatility in investment returns, both for fixed accounts and equities, on policy account values, and the inadequacy of the traditional policy illustration tool to measure and account for these risks, is either, at best, completely misunderstood or, at worst, thoroughly ignored; resulting in policy insolvency and lapse. This is particularly a problem for the trustees – both professional and amateur trustees – of irrevocable life insurance trusts (ILITs), with the primary asset being the trust-owned life insurance (TOLI) policies, where the trustee is under a fiduciary duty to manage the risks and monitor the performance of the trust estate policy assets. This presentation will explore the risks in life insurance policies; provide a process for managing the life insurance policy risk, for both professional and amateur trustees; as well as the proper “dispute defensible” evaluation of non-guaranteed life insurance policies, which account for policy return volatility and place a statistical confidence of probability on policy results.

The Uniform Prudent Investor Act and Trust-Owned Life Insurance: The Impossible Dream or a Match Made In Heaven

Spokane Estate Planning Council
Spokane, Washington
May 12, 2015

Gary L. Flotron, MBA, CLU®, ChFC®, AEP®
University of Missouri – St. Louis
G. L. Flotron & Associates
St. Louis, Missouri

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

1

IMPORTANT DISCLAIMERS AND NOTICES

These materials are intended for educational purposes **only**. They are designed to provide accurate and authoritative information in regard to the subject matter covered. However, Gary L. Flotron is not offering any type of legal, accounting, insurance, investment or other professional advice in these materials. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

These materials are provided solely for educational purposes. These materials cannot be sold, copied, reproduced or distributed in any form or manner whatsoever without the express written consent of the authors.

IRS Circular 230 Disclosure:

To ensure compliance with requirements imposed by the U. S. Internal Revenue Service, we inform you that any tax advice contained in this document (including any attachments) was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (1) avoiding tax-related penalties under the U. S. Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

2

The Uniform Prudent Investor Act and Trust-Owned Life Insurance: The Impossible Dream or a Match Made In Heaven

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

3

Preface – The Ticking Time Bomb of the TOLI Insolvency Crisis

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

4

The Ticking Time Bomb of the TOLI Insolvency Crisis

- The TOLI Center, LLC (TTC), a Fee-Based Policy Administration and Risk Management Services Firm Since 1992, Whose Clientele Includes Skilled and Unskilled Trustees, Attorneys, Affluent Family Groups and ILIT Beneficiaries, Has Maintained Portfolio Statistics (TOLI Specific Statistics Are Unavailable From Traditional Life Insurance Sources)
- According to the TTC Statistics As of October 2013, Approximately 40% of In-Force Universal and Variable Universal Life Products Are Carrier Illustrated to Lapse Prior to the Insured's Estimated Life Expectancy or Within Five Years of the Insured's Estimated Life Expectancy
- Further, According to TTC Approximately 12% of Whole Life and Guaranteed Universal Life Policies Have Compromised Guarantees
- Reliable Data About Life Insurance Policies Owed in ILITs Is Unavailable

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

5

The Ticking Time Bomb of the TOLI Insolvency Crisis (Continued)

- Since 1993, TOLI Risk Management Articles Have Suggested That Unskilled, (Brother-In-Law Like Accommodation) Trustees Administer Up to 90% of the In-Force Policies in ILITs
- If The TOLI Center Statistics, Whose Clientele Are Extremely Sophisticated, Mostly Skilled Professionals, Suggest a 40% Insolvency or Lapse Rate with TOLI Policies, What Is That Statistic For the Vast Majority of Unskilled, Accommodation Trustees? 60%? 70%? 90%?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

6

The Ticking Time Bomb of the TOLI Insolvency Crisis (Continued) Why Should You Care?

- First, You Should Be Concerned If Your Client's ILITs Might Be At Risk of Insolvency Due to TOLI Policy Lapse
- As Advisors We Are All Fiduciaries and Owe A Duty to Act in The Best Interest of Our Clients
- Additionally, We Are All Held to a Standard of Competency – and Some of Us to a Suitability Standard - and To Fulfill that Standard We Need to Be Aware of the Risks, and the Causes of the Risks, Involved With Non-Guaranteed Trust-Owned Life Insurance Policies, the Proper Process of Managing the Risks and Evaluating Non-Guaranteed Life Insurance Policies
- Otherwise, You Could Potentially Expose Yourself to Un-Necessary Reputation And Litigation Risks Where You Could Potentially Be Held Liable

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

7

The Ticking Time Bomb of the TOLI Insolvency Crisis (Continued)

- The Purpose of This Presentation Is To Review Trustee Duties Through:
 - A Review of The Uniform Prudent Investor Act (UPIA), and A Few Provisions of the Uniform Trust Code (UTC), and Their Applicability to TOLI
 - Explore Life Insurance Policy Risks that Have and Can Cause TOLI Insolvency and Lapse
 - Discuss the Proper TOLI Risk Management Process That Can Prevent the TOLI Crisis
 - Examine the Proper Evaluation of Non-Guaranteed Life Insurance Products

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

8

The Uniform Prudent Investor Act (UPIA) and Trust-Owned Life Insurance (TOLI): Topics, Issues and Take Homes

- Review of UPIA and Its Applicability to TOLI
 - The Irrevocable Life Insurance Trust (ILIT) and the Unique Characteristics of Life Insurance
 - Review of UPIA with Comments
 - Review of UTC Provisions Affecting UPIA and ILITs
 - State Statutes Exculpating Trustees of ILITs
 - Four Court Cases Involving UPIA and TOLI
- Managing and Evaluating Life Insurance
 - Key Word is Managing
 - Risks of Life Insurance Policies
 - Process of Managing Life Insurance Policies
 - Evaluation of Life Insurance

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

9

Review of UPIA and Its Applicability to TOLI

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

10

The Irrevocable Life Insurance Trust (ILIT) and the Unique Characteristics of Life Insurance

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

11

ILIT and the Unique Characteristics of Life Insurance ILIT Transfer Tax Considerations

- Transfer Tax Issues for Gift, Estate and Generation-Skipping Transfer Taxes
- Estate Tax Issues
 - Section 2042 - Retained Incidents of Ownership by Grantor/Insured in Life Insurance Policy or Required Use of Policy Proceeds by Trust for the Estate
 - Section 2035 – Gratuitous Transfers of Policy Ownership within Three Years of Death
 - Potential Issues with Private Premium Financing or Private Split-Dollar
- Gift Tax Issues
 - Qualifying Gifts to Pay Premiums for Present Interest Annual Exclusion Using Crummey Withdrawal Powers
 - Is the Trustee Following Proper Administrative Procedures with Respect to Notices?
 - If More Than One Beneficiary – Handling of Crummey Withdrawal Powers Lapses Under 5 and 5 Rules – i.e. Hanging Powers
- Generation-Skipping Transfer Tax Issues
 - If the Trust Has Generation-Skipping Implications, Has the Grantor/Insured Allocated GST Exemption to Each Transfer to Produce Zero Inclusion Ratio?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

12

ILIT and the Unique Characteristics of Life Insurance

Unique Characteristics of Life Insurance

- Life Insurance Primarily Purchased for Death Benefit; Cash Value Can Be Secondary Consideration
- Need is Generally Permanent, With Goal of Maintaining Death Benefits Out To and Pass Life Expectancy
- Trustee's Ability to Acquire a Policy Requires the Active Participation of the Insured(s)
 - Unique In the Trust Investment World
- For Policies Requiring Premiums, Ongoing Transfers By the Grantor/Insured(s) Are Critical

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

13

ILIT and the Unique Characteristics of Life Insurance

Unique Characteristics of Life Insurance (Continued)

- For Policies Requiring Premiums, Ongoing Transfers By the Grantor/Insured(s) Are Critical – Some Policy Types More Sensitive Than Others
 - Term Insurance and No-Lapse Guaranteed Universal Life
 - Traditional Whole Life
 - Universal Type Policies – Regular, Variable, Indexed
 - Depends Heavily On Degree of Funding "Premium"
 - For Variable There is Additional Investment Management
 - If Premiums Are to be Paid Internally, Requires Additional Monitoring of Policy Performance
 - Loans or Term Riders Add Instability And Require Close Monitoring

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

14

ILIT and the Unique Characteristics of Life Insurance

Unique Characteristics of Life Insurance (Continued)

- But What If the Grantor Stops or Reduces Transfer of Fund Contributions to Pay Policy Premiums?
- Trustee Alternatives Where Premiums Are Due But Funds Are Not Transferred
 - Borrow
 - Withdraw
 - Surrender Paid-Up Additions
 - Use Other Trust Assets (If Any)
 - Reduce Face Amount
 - Surrender for Policy Cash Value
 - Life Settlement

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

15

Review of UPIA with Comments

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

16

Review of UPIA with Comments

Prudent Investor Rule

“All that is required of a trustee to invest is that he shall conduct himself faithfully and exercise sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.”

[Harvard College v. Amory, 9 Pick (Mass.) 446 (1830)]

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

17

Review of UPIA with Comments

Objectives of UPIA*

- 1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting the term “portfolio” embraces all the trust’s assets. [UPIA Section 2(b)]
- 2) The tradeoff in all investing between risk and return is identified as the fiduciary’s central consideration. [UPIA Section 2(b)]
- 3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays as appropriate roll in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing. [UPIA Section 2(e)]
- 4) The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing. [UPIA Section 3]
- 5) The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards. [UPIA Section 9]

* UPIA, Prefatory Note, Page1.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

18

Review of UPIA with Comments

UPIA Section 1. Prudent Investor Rule.

- a) Except as otherwise provided in subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule set forth in this Act.
- b) The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

19

Review of UPIA with Comments

Comments to UPIA Section 1.

- Section 1 (a) Establishes UPIA as a Default Rule
- However Section 1 (b) Says the Default Rule may be “ expanded, restricted, eliminated, or otherwise altered by the provisions of a trust”
- The Question Becomes To What Extent Should Any or All Provisions of UPIA Be Restricted or Eliminated for an ILIT?
 - Trustee’s Point of View – All Provisions
 - Beneficiaries Point of View – None of the Provisions
 - To What Extent Does the Trust Settlor Even Care About this Issue

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

20

Review of UPIA with Comments

UPIA Section 2. Standard of Care; Portfolio Strategy; Risk and Return Objectives.

- a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.
- b) A trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
- c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

21

Review of UPIA with Comments

UPIA Section 2(c) List of Circumstances that a Trustee Shall Consider in Investing and Managing Trust Assets.

- 1) General economic conditions;
- 2) The possible effect of inflation or deflation;
- 3) The expected tax consequences of investment decisions or strategies;
- 4) The role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;
- 5) The expected total return from income and the appreciation of capital;
- 6) Other resources of the beneficiaries;
- 7) Needs for liquidity, regularity of income, and preservation of capital; and
- 8) An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

22

Review of UPIA with Comments

UPIA Section 2. Standard of Care; Portfolio Strategy; Risk and Return Objectives.

- d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.
- e) A trustee may invest in any kind of property or type of investment consistent with the standards of this Act.
- f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

23

Review of UPIA with Comments

Comments to UPIA Section 2.

- Objective Standard – Requires Trustees to Invest and Manage Trust Assets as “a prudent investor would” – Standard is Relative
 - For Professional Trustees – Relative to Prudent Professionals
 - For Amateur Trustees – Relative to Prudent Amateurs
- “Investment and Management Decisions... Must Be Made As Part of an Overall Investment Strategy...”
 - Requires Written Plan to Document
- Duty to Monitor/Manage and To Investigate
 - To What Extent Should Amateur Trustees Be Relieved from Duty to Monitor/Manage and Investigate Life Insurance Policies
- Trustee Who Has Special Skills or Expertise Must Use Those Skills or Expertise
- Categorical Restrictions Eliminated
- It Seems Life Insurance is an Asset that Has “special relationship or special value,..., to the purposes of the trust...” in an ILIT – Section 2(c)8
- Effects of Inflation On Certain Types of Life Insurance – Section 2(c)2

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

24

Review of UPIA with Comments

UPIA Section 3. Diversification

A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Review of UPIA with Comments

Comments to UPIA Section 3

- Trustee is Required to Diversify the Investments of the Trust Unless “the trustee reasonably believes that, because of special circumstances, the purposes of the trust are better served without diversifying”
 - While Prudent Investing Ordinarily Requires Diversification, Circumstances Can “Overcome” the Duty to Diversify
 - Clear Purpose of ILIT Consistent with Settlor’s Intent Is to Own One or More Life Insurance Policies During the Life of the Settlor/Insured, It Appears the this is a Special Circumstance
 - However, What About Diversification of Life Insurance Policies Among Different Policy Types and Different Carriers?
 - Not Withstanding the Prior Point, Is There Any Reason During the Grantor/Insured’s Lifetime Not to Eliminate Or Restrict to Insurance Policies Only the Duty to Diversify

Review of UPIA with Comments
UPIA Section 4. Duties at Inception of Trusteeship

Within a reasonable time after accepting a trusteeship or receiving the trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this Act.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

27

Review of UPIA with Comments
UPIA Section 5. Loyalty, and
UPIA Section 6. Impartiality

Section 5. Loyalty.

A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

Section 6. Impartiality.

If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

28

Review of UPIA with Comments

UPIA Section 7. Investment Costs. and

UPIA Section 8. Reviewing Compliance

Section 7. Investment Costs.

In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.

Section 8. Reviewing Compliance.

Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

29

Review of UPIA with Comments

Comments to UPIA Section 7

- Given the Lack of “True” Transparency with Life Insurance Is It Possible to Apply Section 7 Where the Trustee is Asked to Only Incur Costs that Are Appropriate and Reasonable?
- Other Than a Maximum Guaranteed Cost of Insurance and Expenses, Current Cost of Insurance and Expenses Can Change
- Life Insurance Policy May Need to Be Analyze As a Whole and Not By Its Individual Cost Components

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

30

Review of UPIA with Comments

UPIA Section 9. Delegation of Investment and Management Functions

- a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill and caution in:
 - 1) Selecting an agent;
 - 2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and
 - 3) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.
- b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.
- c) A trustee who complies with the requirements of subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.
- d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

31

Review of UPIA with Comments

Comments to UPIA Section 9

- Allows A Trustee to Delegate Investment and Management Functions that a Prudent Trustee Could Properly Delegate
 - Trustee Must Exercise Reasonable Care in Selecting an Agent, Establish the Scope of the Delegation and Periodically Review the Agent's Actions.
 - For the Amateur Trustee – As Well as Professional Trustees Who Lack Life Insurance Expertise – Delegation of the Investment and Management Function Would Seem Perfectly Appropriate
 - Question Becomes Who or What is a "Suitable Agent" and How They Will Be Compensated?
 - Note The Importance the Court In Cochran v. KeyBank (Discussed Later) Placed On the Independent Agent Chosen and the Fact that It Had No Financial Interest In the Outcome of The Policy Exchange
 - No Reason To Restrict or Eliminate the Power of the Trustee to Delegate the Management of the ILIT's Life Insurance to a Suitable Agent

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

32

Review of UPIA with Comments

UPIA Section 10. Language Invoking Standard of Act.

The following terms or comparable language in the provisions of a trust, unless otherwise limited or modified, authorizes any investment or strategy permitted under this Act: “investments permissible by law for investment of trust funds,” “legal investments,” “authorized investments,” “using the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition or their funds, considering the probable income as well as the probable safety of their capital,” “prudent man rule,” “prudent trustee rule,” “prudent person rule,” and “prudent investor rule.”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

33

Review of UPIA with Comments

UPIA Remaining Sections

Section 11. Application to Existing Trusts

This Act applies to trust existing on and created after its effective date. As applied to trusts existing on its effective date, the Act governs only decisions or actions occurring after that date.

Section 12. Uniformity of Applications and Construction

This Act shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this Act among the States enacting it.

Section 13. Short Title

This Act may be cited as the “[Name of Enacting State] Uniform Prudent Investor Act.”

Section 14. Severability

If any provision of this Act or its application to any person or circumstance is held invalid, the invalidity does not effect other provisions or applications of this Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are severable.

Section 15. Effective Date

This Act takes effect.....

Section 16. Repeals

The following acts and parts of acts are repealed: [None listed.]

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

34

Review of UTC Provisions Affecting UPIA and ILITs

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

35

Review of UTC Provisions Affecting UPIA and TOLI UTC Section 105. Default and Mandatory Rules.

- a) Except as otherwise provided in the terms of the trust, this [Code] governs the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary.
- b) The terms of the trust prevail over any provision of this [Code] except:
 - 1) the requirement for creating a trust;
 - 2) the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries;

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

36

Review of UTC Provisions Affecting UPIA and TOLI
UTC Section 105(b). Default and Mandatory Rules. (Continued)

- 3) the requirements that a trust and its terms be for the benefit of its beneficiaries, and that the trust have a purpose that is lawful, not contrary to public policy, and possible to achieve;
- 4) the power of the court to modify or terminate a trust under Sections 410 through 416;
- 5) the effect of a spendthrift provision and the rights of certain creditors and assignees to reach a trust as provided in [Article] 5;
- 6) the power of the court under Section 702 to require, dispense with, or modify or terminate a bond;
- 7) the power of the court under Section 708(b) to adjust a trustee's compensation specified in the terms of the trust which is unreasonably low or high;

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

37

Review of UTC Provisions Affecting UPIA and TOLI
UTC Section 105(b). Default and Mandatory Rules. (Continued)

- 8) [the duty the duty under Section 813(b)(2) and (3) to notify qualified beneficiaries of an irrevocable trust who have attained 25 years of age of the existence of the trust, of the identity of the trustee, and of their rights to request trustee's reports;]
- 9) [the duty under Section 813(a) to respond to the request of a [qualified] beneficiary on an irrevocable trust for trustee's reports and other information reasonably related to the administration of a trust;]
- 10) the effect of an exculpatory terms under Section 1008;

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

38

Review of UTC Provisions Affecting UPIA and TOLI
UTC Section 105(b). Default and Mandatory Rules. (Continued)

- 11) the rights under Sections 1010 through 1013 of a person other than a trustee or beneficiary
- 12) periods of limitation for commencing a judicial proceeding; [and]
- 13) the power of the court to take such action and exercise such jurisdiction as may be necessary in the interest of justice [;and]
- 14) the subject-matter jurisdiction of the court and venue for commencing a proceeding as provided in Sections 203 and 204].

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

39

Review of UTC Provisions Affecting UPIA and TOLI
UTC Section 801. Duty To Administer Trust.

Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this [Code].

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

40

Review of UTC Provisions Affecting UPIA and TOLI

UTC Section 813. Duty To Inform and Report.

- a) A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall promptly respond to a beneficiary's request for information related to the administration of the trust.
- b) A trustee:
 - 1) upon request of a beneficiary, shall promptly furnish to the beneficiary a copy of the trust instrument.;
 - 2) within 60 days after accepting a trusteeship, shall notify the qualified beneficiaries of the acceptance and of the trustee's name, address, and telephone number;

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

41

Review of UTC Provisions Affecting UPIA and TOLI

UTC Section 813. Duty To Inform and Report. (Continued)

- 3) within 60 days after the date the trustee acquires knowledge of the creation of an irrevocable trust, or the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument, and of the right to trustee's report as provided in subsection (c); and
- 4) shall notify the qualified beneficiaries in advance of any change in the method or rate of the trustee's compensation.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

42

Review of UTC Provisions Affecting UPIA and TOLI
UTC Section 813. Duty To Inform and Report. (Continued)

- c) A trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified or nonqualified beneficiaries who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values. Upon a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the qualified beneficiaries by the former trustee. A personal representative, [conservator], or [guardian] may send the qualified beneficiaries a report on behalf of a deceased or incapacitated trustee.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

43

Review of UTC Provisions Affecting UPIA and TOLI
UTC Section 813. Duty To Inform and Report. (Continued)

- d) A beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished under this section. A beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.
- e) Subsections (b)(2) and (3) do not apply to a trustee who accepts a trusteeship before [the effective date of this [Code]], to an irrevocable trust created before [the effective date of this [Code]], or a revocable trust that becomes irrevocable before [the effective date of this [Code]].

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

44

Review of UTC Provisions Affecting UPIA and TOLI UTC Section 1008. Exculpation of Trustee.

- a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it:
 - 1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or
 - 2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.
- b) An exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

45

State Statutes Exculpating Trustees of ILITs

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

46

State Statutes Exculpating Trustees of ILITs General Comments

- 14 States – Alabama, Arizona, Delaware, Florida, Maryland, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Tennessee, Virginia, Wyoming – Have Enacted Statutes that Exculpate Trustees Holding Life Insurance
- Statutes Either Limit the Liability for Management of Life Insurance Policies or Waive the Duty of Diversification within ILITs, or Both.
- May Be Limited to Life Insurance Only On the Grantor, the Grantor or the Grantor's Spouse As Joint Insureds, or Both Policies on the Grantor or the Grantor's Spouse.
- Implication is that Statutes Only Apply to Unfunded ILITs.
- Query: What About Funded ILITs?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

47

State Statutes Exculpating Trustees of ILITs Florida Statute 736.0902 Non-application of Prudent Investor Rule

- Florida Has Enacted a Statute That Virtually Eliminates Trustee Liability with Respect to
 - (1) Insurable Interest Issues Related to the Ownership of Life Insurance, and
 - (2) Managing, Monitoring and Investing In Life Insurance Policies.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

48

State Statutes Exculpating Trustees of ILITs Florida Statute 736.0902

Non-application of Prudent Investor Rule (Continued)

- Trust Must Own Insurance On the Life of a “Qualified Person”
 - “a person who is insured or a proposed insured, or the spouse of that person, **who has provided the trustee with the funds** used to acquire or pay premiums with respect to a policy of insurance on the life of that person or the spouse of that person, or on the lives of that person and the spouse of that person.” (Emphasis Added)
 - Presumably “funds” Refers to Transfers by Gift of Cash, Or of Money of Money’s Worth
 - Query
 - What About Transfers of Existing Policies?
 - What About Split-Dollar Agreements Between Third Party Employer or a Family Owned Entity?
 - What About Other Premium Financing Arrangements?
 - What About Indirect Transfers Such As Making ILIT Remainder Beneficiary of a GRAT?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

49

State Statutes Exculpating Trustees of ILITs Florida Statute 736.0902

Non-application of Prudent Investor Rule (Continued)

- Insurable Interest Non-Applicability of PIR:
- If
 - Trust Agreement Does Not Opt Out of the Statute;
 - The Insurance Was Not Purchase From an Affiliate of the Trustee and Neither the Trustee Nor an Affiliate of the Trustee Received Any Commission Unless Duties Have Been Delegated to Another Person Under Section 518.112;
 - The Trustee Did Not Have Knowledge That the Beneficiaries Lacked an Insurable Interest When the Policy Was Issued; and,
 - The Trustee Did Not Have Knowledge of a Stranger Owned Life Insurance (“STOLI”) Type Agreement.
- Then
 - The Trustee Has No Duty to Determine whether There Is or Was a Sufficient Insurable Interest In the Policy

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

50

State Statutes Exculpating Trustees of ILITs Florida Statute 736.0902

Non-application of Prudent Investor Rule (Continued)

- Managing and Investing Non-Applicability of PIR:
- If
 - Trust Agreement Does Not Opt Out of the Statute;
 - The Insurance Was Not Purchase From an Affiliate of the Trustee and Neither the Trustee Nor an Affiliate of the Trustee Received Any Commission Unless Duties Have Been Delegated to Another Person Under Section 518.112; and,
- Either
 - The Trust Agreement Opts In to The Application of The Statute; or
 - The Trustee Gives Notice to “Qualified Beneficiaries” [Not Defined In Statute] and There Is No Objection Within 30 Days of Receipt or the Objection Is Withdrawn
 - Query – If There is a Proper Objection Within 30 Days Does the Statute Not Apply?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

51

State Statutes Exculpating Trustees of ILITs Florida Statute 736.0902

Non-application of Prudent Investor Rule (Continued)

- Managing and Investing Non-Applicability of PIR (Continued):
- Then
 - The Trustee Has No Duty to:
 - Determine Whether the Life Insurance Is or Remains a Proper Investment
 - Investigate the Financial Strength of the Life Insurance Company
 - Determine Whether to Exercise Any Policy Option Available
 - Diversify with Respect to Life Insurance
 - Inquire About or Investigate the Health or Financial Condition of the Insured
- And,
 - The Trustee is Not Liable to the Beneficiaries or Any Other Person for Any Loss Sustained with Respect to the Life Insurance
- And,
 - A Trustee Who Performs Fiduciary or Advisory Services Relating to the Insurance Will Not Be Compensated for Performing the Services Listed Above Or the Determination of Insurable Interest

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

52

State Statutes Exculpating Trustees of ILITs Exculpating State Statutes Will Not Apply to Regulated Trust Departments

- OCC (Office of the Controller of the Currency) Regulates National Banks
- Most State Bank Regulators and Savings and Thrifts Regulators All Follow OCC Guidelines and Procedures
- The OCC August 2012 Handbook Requires Regulated Trustees to Actively Manage Policies in Their ILITs Regardless of State Laws Eliminating that Duty and Presumably Similar Exculpatory Trust Provisions
- Handbook Also Seems to Require Pre-Acquisition Policy Reviews
 - Would a Bank Trustee Refuse to Accept a Policy Applied For and Paid for By the Trust Grantor/Insured?
- OCC's Guidelines for Managing Policies Held in Trust by Regulated Trustees Are Also Helpful for Amateur Trustees

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

53

Four Court Cases Involving UPIA and TOLI

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

54

Four Court Cases Involving UPIA and TOLI

- **Cochran v. KeyBank** [*In re Stuart Cochran Irrevocable Trust*, 901 N.E.2d 1128 (Indiana Court of Appeals, March 2, 2009)]
- **Paradee v. Paradee** [W. Charles Paradee, III v. Eleanor Clement Paradee et al., No. CA No. 4988-VCL (In the Court of Chancery of the State of Delaware, October 5, 2010)]
- **French v. Wachovia Bank** [*French v. Wachovia Bank, N.A.*, 2011 U.S. Dist. LEXIS 72808 (E.D. Wisconsin 2011), 2013 U.S. App. LEXIS 14399]
- **Rafert v. Meyer** [Rafert v. Meyer, N.W.2d, 290 Neb. 219, 2015 WL 832590 (Nebraska Supreme Court February 27, 2015. No. S-14-003.)]

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

55

Four Court Cases Involving UPIA and TOLI

Cochran v. KeyBank Case

Basic Case Facts

- Prior Exchange of Policies Raise the Death Benefit to \$8 Million
- Last Policy Exchange Reduced the Death Benefit to \$2.8 Million, Guaranteed to Age 100
- The Insured Died Unexpectedly at the Age of 53
- The Beneficiaries Sued KeyBank for Breach of Fiduciary Duty

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

56

Four Court Cases Involving UPIA and TOLI

Cochran v. KeyBank Case

Court Decision

- The Court Stated, “Was it prudent for the trustee to move the trust assets from insurance policies with significant risk and likelihood of ultimate lapse into an insurance policy with a smaller but guaranteed death benefit?”
- The “process was certainly less than perfect”
- The Appeals Court Agreed, Based on KeyBank’s Reliance on Guidance from “an outside, independent entity with no policy to sell or any other financial stake in the outcome”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

57

Four Court Cases Involving UPIA and TOLI

Cochran v. KeyBank Case

Take-Aways for the Amateur Trustee

- While the Process Was “Not Perfect” There Was a Documented Process
- Reliance On the Advice of a Delegated Agent Which Had No Financial Incentive to Approve the Exchange
- KeyBank Examined Both the Existing and the Proposed Policy Before the Exchange
- For Amateur Trustees, This Suggests:
 - Having a Documented Process for Reviewing Policies Periodically
 - Delegating to an Appropriate Agent the Responsibility for Policy Management and Review of Policy Exchanges
 - Documenting the Comparison Between an Existing and Any Potential Replacement Policy

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

58

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Basic Case Facts

- Jlee Rafert Directed Attorney Robert J. Meyer To Prepare and Draft an ILIT That Named Meyer As Trustee for the Benefit of Rafert's Four Daughters On the Death of Rafert
- The Corpus of the Trust Consisted of Three Life Insurance Policies on the Life of Rafert Totaling \$8.5 Million in Face Amount
- Article II of the Trust Provided: "The Trustee Shall Be Under No Obligation To Pay the Premiums Which May Become Due and Payable Under the Provisions of Such Policy of Insurance, Or To Make Certain That Such Premiums Are Paid By the Grantor Or Others, Or To Notify Any Persons On Non-Payment [Sic] Of Such Premiums, and the Trustee Shall Be Under No Responsibility or Liability of Any Kind In the Event Such Premiums Are Not Paid As Required..."

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

59

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Basic Case Facts (Continued)

- Article IV of the Trust Provided: "... The Trustee Shall Not Be Required To Make Or File An Inventory Or Accounting To Any Court, Or To Give Bond, But the Trustee Shall, At Least Annually Furnish To Each Beneficiary A Statement Showing Property Then Held By the Trustee And the Receipts and Disbursements Made."
- Meyer Did Not Meet With Rafert To Explain the Provisions Of the Trust Or Who Would Be Responsible For Monitoring the Life Insurance Policies Owned By the Trust
- Trust Executed on 3/19/2009 And Meyer Subsequently Signed As Trustee Three Applications For Life Insurance Naming Trust As Owner of the Policy

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

60

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Basic Case Facts (Continued)

- On Each Of the Applications Meyer Gave the Insurers A False Address In South Dakota For Meyer As Trustee; Meyer Was A Resident of Falls City, Nebraska And Never Received Mail At the South Dakota Address
- Jlee Rafert Paid Initial Premiums On the Policies Totaling \$262,006
- In 2010 Policies Lapsed For Nonpayment Of Premiums
- Notices of Premiums Due, Subsequent Notices Of Dangers Of Policies Lapsing, And Subsequent Notices Of Lapse And Reinstatement Rights Were Sent To the False South Dakota Address

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

61

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Basic Case Facts (Continued)

- Jlee Rafert, Her Four Daughters and Meyer Did Not Receive Notice Of the Lapsed Policies From the Insurers Until August 2012 (How They Then Received Notice Is Undisclosed)
- At That Time Jlee Rafert Paid \$252,841 For Premiums By Issuing Checks To the Corporation Owned By the Insurance Agent; But Premiums Were Never Forwarded To the Insurers
- Jlee Rafert And Her Four Daughters Sued Meyer For Breach Of His Duties As Trustee Alleging That As A Direct And That As A Proximate Result Of the Breach The Policies Lapsed, Resulting In the Lost Of the Initial Premiums

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

62

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Basic Case Facts (Continued)

- Furthermore, The Rafert Daughters Stated, As Qualified Beneficiaries, They Had An Immediate Interest In the Premiums Paid By Jlee Rafert, Meyer Breached His Duties By Providing A False Address, Failing To Keep Beneficiaries Informed Of the Facts To Protect Their Interests, Failure To Provide Annual Statements, Failure To Communicate Terms Of the Trust To Jlee Rafert, and, Failure To Act In Good Faith And In Accordance With the Terms And Purposes Of the Trust And In the Interest Of the Beneficiaries
- Meyer Responded That His Duties were Limited By Article II And IV Of the Trust, Providing A False Address And Failing To Furnish Annual Reports Did Not Cause The Premiums Not To Be Paid, And, That He Had No Obligation To Monitor Or Notify Any Person Of the Non-Payment Of Premiums

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

63

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Basic Case Facts (Continued)

- The District Court Dismissed The Rafert's Complaint With Prejudice, Finding That Pursuant To the Terms Of the Trust Meyer Did Not Have A Duty To Pay the Premiums Or To Notify Anyone Of the Nonpayment Of the Premiums; Nor Did He Have Any Responsibility For the Failure To Pay the Premiums; The Lower Court Concluded the Pleadings Failed To Allege How Meyer's Actions Had Caused the Lapses Of the Policies
- Nebraska Is A State That Has Adopted the Uniform Trust Code, And, The Raferts Appealed To the Nebraska Supreme Court Stating the District Court Erred And That Meyer Breach His Duties As Trustee Under the Nebraska Uniform Trust Code (Code)

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

64

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Nebraska Supreme Court Decision

- The Nebraska Supreme Court Reversed the Decision Of the District Court And Remanded The Case For Further Proceedings Back To the Lower Court Consistent With the Supreme Court Opinion
- The Code Provides Deference To the Terms Of the Trust, But This Deference Does Not Extend To All Of the Trustee's Duties; And Those Duties To Which the Code Does Not Defer Are Described In Nebraska UTC Section 38-38025 [UTC Section 105]

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

65

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Nebraska Supreme Court Decision (Continued)

- In Drafting the Trust Meyer Could Not Abrogate His Duty To Keep Appellants Reasonably Informed Of the Material Facts Necessary For Them To Protect Their Interests
- The Court Observed That Notice Of Nonpayment Of the Premiums Would Have Profoundly Affected Appellants' Actions To Protect The Policies Such Notice Of Lapse Would Have Affected the Subsequent Payment By Jlee Rafert As Settlor

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

66

Four Court Cases Involving UPIA and TOLI Rafert v. Meyer Case Nebraska Supreme Court Decision (Continued)

- Commenting On Meyer’s Position, Including the Suggestion That He Did Not Have the Duty To Inform Appellants Even If He Had Received Notice Of the Nonpayment Of Premiums, the Court Succinctly Stated: “Such A Position Is Clearly Untenable and Challenges the Most Basic Understanding Of A Trustee’s Duty To Act For the benefit Of the Beneficiaries Under the Trust. Perhaps the Most Fundamental Aspect Of Acting For the Benefit OF the Beneficiaries Is Protecting the Trust Property. Article II Cannot Be Relied Upon To abrogate Meyer’s Duty To Act In Good Faith And In Accordance With the Terms An Purposes Of the Trust And the Interests Of the Beneficiaries.”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

67

Four Court Cases Involving UPIA and TOLI Rafert v. Meyer Case Nebraska Supreme Court Decision (Continued)

- Citing Code Section 30-38-97(a) [UTC Section 1008] the Court Stated: “Meyers Acted In Bad Faith And Reckless Indifference To the Purpose Of The Trust Or the Interest Of the Beneficiaries By Providing A False Address To the Insurers.”
- Noting That Meyer Never Met With Rafert To Explain the Terms Of the Trust And Citing Code Section 30-3897(b) [UTC Section 1008(b)], the Court Concluded That If Article II Is An Exculpatory Clause, It Is Invalid Because Meyer Failed To Adequately Communicate Its Nature And Effect to Rafert

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

68

Four Court Cases Involving UPIA and TOLI Rafert v. Meyer Case Nebraska Supreme Court Decision (Continued)

- Considering Meyer’s Duty To Furnish Annual Reports To the Beneficiaries, the Court Stated That Annual Reporting Was A Minimum Requirement, and, “A Reasonable Person Acting In Good Faith And In the Interest Of the Beneficiaries Would Not Wait Until Such Annual Report Was Due Before Informing the Beneficiaries That the Trust Assets Were In Danger Of Being Lost. Meyer’s Duty To Report the Danger To the Trust Property Became Immediate When the Insurers Issued Notices Of Nonpayment Of the Premiums.” Citing Code Section 30-3805(b)(8) [UTC Section 105(b)(8) Referring to UTC Section 813(a)] “As Trustee, Meyer Had A Statutory Duty ‘To Keep the Qualified Beneficiaries Of the Trust Reasonably Informed ... Of the Material Facts Necessary For Them To Protect Their Interests.”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

69

Four Court Cases Involving UPIA and TOLI Rafert v. Meyer Case Nebraska Supreme Court Decision (Continued)

- It Is Interesting To Note That the Court Observed And Mentioned: “This Is Not A Situation Where A Gratuitous Trustee, Who Had No Involvement In the Drafting Of the Trust Or the Administration Of the Insurance Policy, Undertook Only To Distribute Insurance Proceeds After Insured’s Death. The Trustee’s Duties Must Be Viewed In the Light Of the Trustee’s Alleged Involvement In These Matters. If There Was None, the Result Might Be Different.”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

70

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Take Aways From The Case

- In States That Have Adopted the Uniform Trust Code And Have Not Adopted Exculpation Statues For Unfunded ILITs, the Terms Of the Trust Cannot Prevail, Restrict Or Eliminate the Duty Of the Trustee To Act In Good Faith And In Accordance With the Terms and Purposes Of the Trust And the Interest Of the Beneficiaries
- This, Undoubtedly, Includes the Duty To Monitor And Manage the Assets Of the Trust And To Keep Qualified Beneficiaries Of the Trust Reasonably Informed About the Administration Of the Trust And Of the Material Facts Necessary For Them To Protect Their Interests

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

71

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Take Aways From The Case (Continued)

- Additionally, It Confirms That An Exculpatory Term Drafted Or Caused To Be Drafted By the Trustee Is Invalid Unless the Trustee Proves That the Exculpatory Term Is Fair Under the Circumstances And That Its Existence And Contents Were Adequately Communicated To the Settlor
- In Other Words, An Attorney Needs to Communicate And Explain the Terms Of the Trust To the Settlor And The Responsibility Of All Parties With Regard To Trust Assets; For ILITs, Who Is Responsible For Monitoring And Managing the Insurance Policies; Particularly Non-Guaranteed Policies

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

72

Four Court Cases Involving UPIA and TOLI

Rafert v. Meyer Case

Take Aways From The Case (Continued)

- Trust Provisions Relieving Trustees Of Liability For Breach Of Trust Are Not Adequate Protection For Negligent Acts Committed In Bad Faith Or With Reckless Indifference To the Purposes Of the Trust Or the Interest Of the Beneficiaries

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

73

Managing and Evaluating

Life Insurance

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

74

Key Word is Managing

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

75

Key Word is Managing Crossover Point – The Great Divide

- Prior to 1979
 - Buy and Forget
- 1979 and After
 - Buy and Manage
- The Great Divide Caused by the Introduction of Universal Life Insurance by E.F. Hutton Life Insurance Company in 1979
- Yes, Life Insurance Has Risks that Have to be Manage

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

76

Key Word is Managing But Who Does the Managing for TOLI Policies?

- The Trustee?
 - Professional Trustee
 - Amateur Trustee, i.e. The Brother-in-Law Trustee
- The Grantor?
- The Life Insurance Professional?
- The Beneficiaries?
- What About Delegation and to Whom?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

77

Risk of Life Insurance Policies

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

78

Risk of Life Insurance Policies

Risk In Life Insurance

- But Isn't Talking About Risk in Life Insurance Rather Ironic Since Life Insurance is a Risk Transfer Device?
- Risk Shift Started in the Great Divide of 1979
- Prior to 1979 Products Were All Guaranteed Products with the Risk of Sufficiency and Sustainability Retained and Maintained by the Insurance Carrier
- With the Introduction in 1979 of Indeterminate, "Flexible" Premium Non-Guaranteed Products the Risk of Sufficiency and Sustainability was Transferred from the Insurance Carrier to the Policy Owner
- This Risk Shift Has Mostly Either Been Completely Misunderstood or Thoroughly Ignored

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

79

Risk of Life Insurance Policies

What is Risk and What Are TOLI Expectations?

- Risk is a Variation from Expectations
- What are Expectations with Respect to TOLI?
 - Carrier Remains Solvent and Financially Viable
 - Life Insurance Product Performs According to the Policy Illustration
 - Premium is Sufficient
 - Policy will Sustain Itself
 - Life Insurance Product Remains Suitable
 - For Some, Purchasing Power Remains Constant

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

80

Risk of Life Insurance Policies Carrier Insolvency

- Rating Services
 - A. M. Best
 - Fitch
 - Moody's
 - Standard & Poor's
- Comdex
 - Recommend at least 85, Preferably 90 or Better
- State Guarantee Funds
 - Limited to \$300,000 to \$500,000 Face Amount Depending Upon State

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

81

Risk of Life Insurance Policies Some Life Insurance Basics

- Life Insurance Pricing and Assumptions
 - Cost of Insurance (COI)
 - Mortality
 - Expenses
 - Administration
 - Start-Up
 - Underwriting
 - Commissions
 - Investment Returns
 - Interest Credited
 - Earnings of Separate Accounts
 - Persistence (Lapse Rate)
 - Lack of Transparency
 - Integrated – View as Whole, Not Separately

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

82

Risk of Life Insurance Policies

Some Life Insurance Basics

- All Life Insurance Is Based on **ASSUMPTIONS**
- In Some Product Types the Methods of Calculating the Results of the Current Assumptions Is Guaranteed, But Not the Results
 - I.E. – **Performance Risk Transferred to Policy Owner**
- In Some Other Product Types the Results of the Assumptions Is Guaranteed
 - I.E. – **Performance Risk Retained by Insurance Carrier**

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

83

Risk of Life Insurance Policies

Some Life Insurance Basics

- Product Types
 - Fixed Premium “Guaranteed” Products
 - Term
 - Whole Life
 - No Lapse Guarantee Universal Life
 - Indeterminate “Flexible” Premium Products
 - Universal Life
 - Variable Universal Life
 - Indexed Universal Life
 - Blended Part “Guaranteed” Products
 - Base Whole Life with Combination Paid-Up Additions and Decreasing Term Dividend Option and/or Paid-Up Additions Rider

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

84

Risk of Life Insurance Policies

Some Life Insurance Basics

- Product Types
 - Fixed Premium “Guaranteed” Products
 - **PERFORMANCE RISK RETAINED BY CARRIER**
 - Indeterminate “Flexible” Premium Products
 - **PERFORMANCE RISK TRANSFERRED TO POLICYOWNER**
 - Blended Part “Guaranteed” Products
 - **SOME PERFORMANCE RISK RETAINED BY CARRIER (THE “GUARANTEED” PART) AND SOME PERFORMANCE RISK TRANSFERRED TO POLICYOWNER**

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

85

Risk of Life Insurance Policies

Some Life Insurance Basics

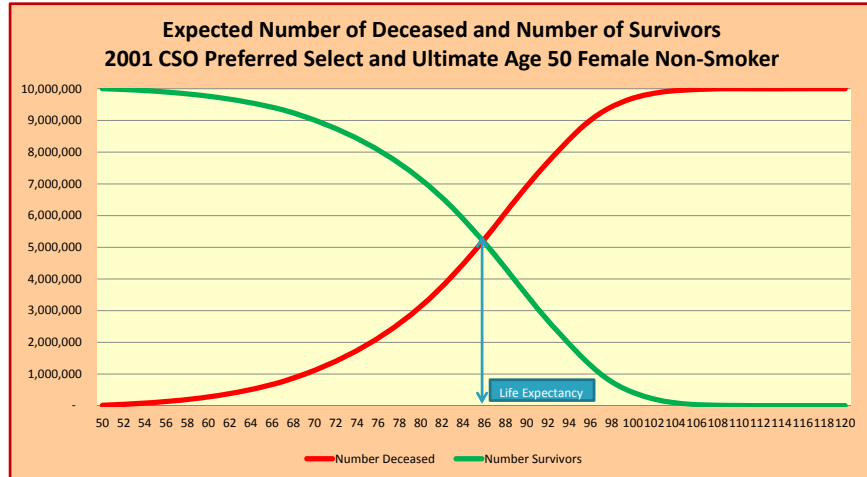
Mortality Tables

- Actuaries Construct Mortality Tables Based on the Ages of Death of Various Members of Population Groups
- Tables May be for Aggregate Groups, or Groups With Specific Characteristics and Criteria
- From Either the Aggregate Population or Specific Characteristic Groups Chosen, the Probability of Death at Any Age is Derived
- Probability of Death Increases with Age, Although There Have Been “Blips” at Young Ages and Some Smoothing is Involved
- Every Mortality Table Constructed Has a Maximum Age in Which Death is Assumed to be Certain (100% Probability)
 - For Official Tables Constructed Prior to 2001 the Maximum Age was 100
 - For Official Tables Constructed in 2001 the Maximum Age is 120
 - Will the Next Generation of Mortality Tables Have a Maximum Age of 150?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

86

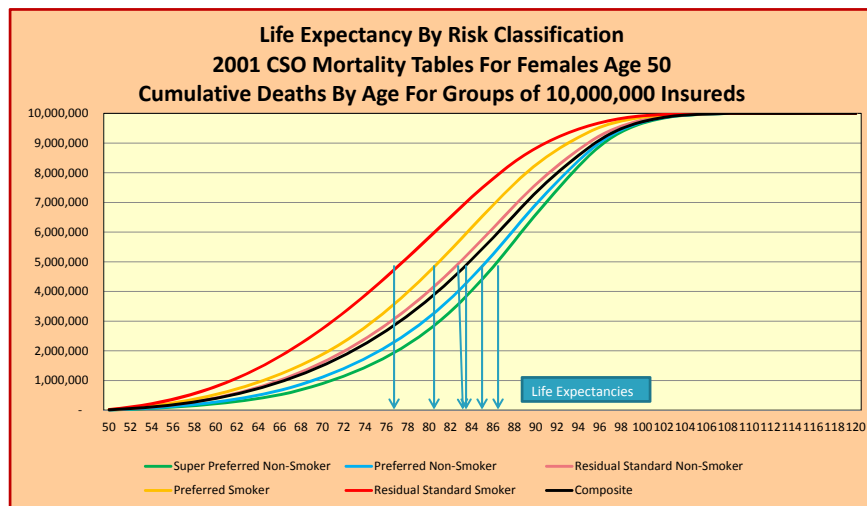
Risk of Life Insurance Policies Some Life Insurance Basics Mortality Tables and Life Expectancy



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

87

Risk of Life Insurance Policies Some Life Insurance Basics



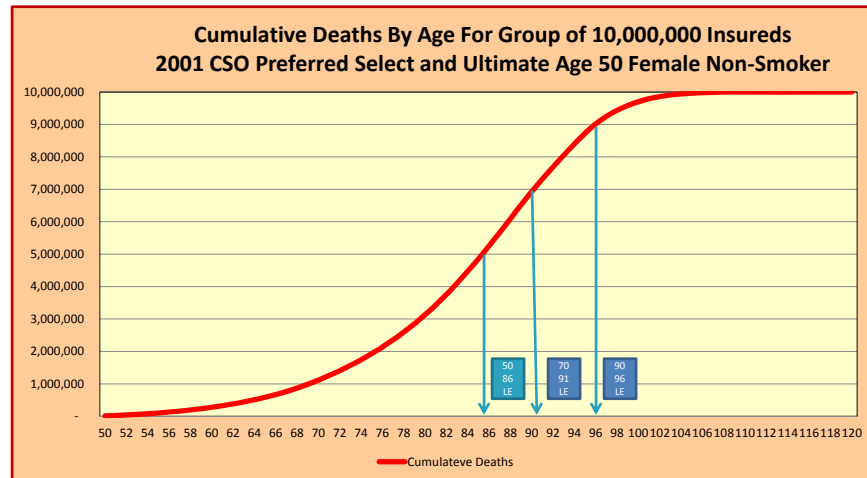
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

88

Risk of Life Insurance Policies

Some Life Insurance Basics

Life Expectancy - Percentile



89

Risk of Life Insurance Policies

Some Life Insurance Basics

Life Expectancy

- Life Expectancy Is Always Measured From A Starting Age and Is Dependent on That Starting Age
 - Generally Life Expectancy Increases With Starting Age
- Life Expectancy Is Generally Measured With Respect to Specific Groups With Common Characteristics or Risks
 - I.E., Preferred Risk Females Age 50 Nonsmokers, Standard Risk Males Age 25 Smokers
- Life Expectancy Can Also Be Measured With Respect to Large Aggregate Groups
 - I.E., All Males Age 45
- Life Expectancy Represents the Medium Age or Mid-Point Where Half of A Group Are Deceased and Half Have Survived; It, Therefore, Represents the 50% Percentile Mark
- There Also May Be A Shift In Life Expectancy Due to Changes in Health, Occupation and/or Avocation

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

90

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of the Cost of "Pure" Term Insurance

- Term Insurance is Best for "Temporary" Needs for Life Insurance
- What Constitutes a "Temporary" Need Time Period is Debatable
 - Clearly 10 Years Or Less
 - Possibility As Many As 30 Years
 - But Clearly Less Than Life Expectancy
- Essentially the Annual Cost of Term Insurance Is Based On the Probability of Death for Each Year
 - It Is "Pay As You Go" Life Insurance
 - Obviously Cost Increases Each Year and Over Time Escalates Exponentially
 - Reasonable Cost at "Younger" Ages, Unaffordable Cost at "Older" Ages
 - Cost, However, May Be Levelized Over 5, 10, 15, 20 or 30 Years, Or, To Age 55,60,65, 70 or 75

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

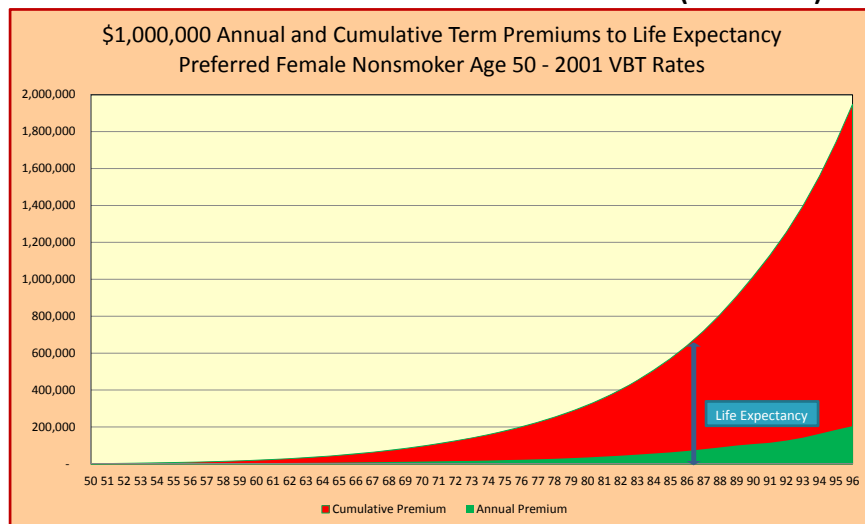
91

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of the Cost of "Pure" Term Insurance (Continued)

\$1,000,000 Annual and Cumulative Term Premiums to Life Expectancy
Preferred Female Nonsmoker Age 50 - 2001 VBT Rates



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

92

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of the Cost of "Pure" Term Insurance (Continued)

- Total Cumulative Annual Term Premium Costs For \$1,000,000 of Coverage For A 50 Year Old Female Preferred Non-Smoker Using Rates Based On the 2001 Valuation Basic Table (VBT) Non Interest Adjusted
 - To Life Expectancy of 86 Years is \$640,900
 - To Life Expectancy Plus 10 Years, Or Age 96 is \$1,948,420
 - To Age 100 is \$2,879,620
 - Beyond Age 100 – You Don't Want to Hear It
- For Life Insurance Needs Close To Life Expectancy and Beyond Clearly Term Insurance Is Not the Answer and Does Not Work

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

93

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of "Permanent" Types of Insurance

- Recognizing the Problems With Term Insurance, Actuaries Came Up With "Permanent" Insurance For Long-term Needs
- Goal Was to Make Permanent Insurance Affordable For the Insured's "Whole" Life By Levelizing Annual Premium Cost
- Simplified Explanation of Levelizing Computation Process:
 - Compute Net Present Value of All Annual Mortality (Term) Costs to Maximum Age of Mortality Table To Create A "Net Single Premium"
 - Take Net Single Premium and Amortized - Level It Out - Over Premium Paying Period, Which Is Generally to End of Mortality Table, To Create Net Level Annual Premium
 - Add Policy Expenses Levelized By The Same Above Process To Create Gross Level Annual Premium
 - All of Above Done With A Constant Assumed Rate Of Interest

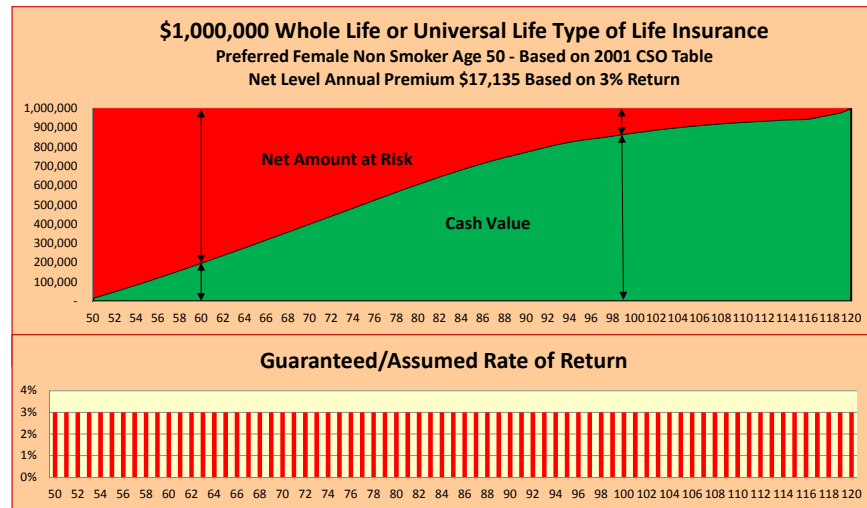
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

94

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of "Permanent" Types of Insurance (Continued)



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

95

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of "Permanent" Types of Insurance (Continued)

- With Level Premium Concept In Early Years The Premium Is Greater Than the Actual Cost of Insurance Protection and In Later Years the Cost of Insurance Is Greater Than the Premium
- The Excess Premium Is Put Into a Reserve Which Creates the Cash Value of the Policy
- In Fact, Anytime Premium is Levelized A Reserve, Or Cash Value, Is Created
- Cash Value Becomes Part of Death Benefit
- Over Time Cash Value Grows To Equal the Total Death Benefit Amount At The Maximum Age of the Mortality Table Used for the Policy

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

96

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of “Permanent” Types of Insurance (Continued)

- At the Same Time, Over Time, the “Pure Insurance Protection” Over and Above the Cash Value, Called “Net Amount At Risk” Decreases
- It Is this Relationship that Makes Permanent Life Insurance Affordable
- Thus, At Any Particular Point In Time The Total Death Benefit Is Equal to the Sum of The Cash Value Plus The Net Amount at Risk
- This Relationship, Like All Insurance, Is Based On Assumptions and Is A Very Delegate Balance

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

97

Risk of Life Insurance Policies

Some Life Insurance Basics

Mathematics of “Permanent” Types of Insurance (Continued)

- If the Life Insurance Product Is a Guaranteed Product, Or All the Assumptions – The Policy Earnings, Cost of Insurance, Policy Expenses and Premiums – In a Non-Guaranteed Product Remain Constant, Than the Previous Graph Is an Accurate Representation of the Life Insurance Policy
- Note That the Graph Represents a Picture of a Constant Assumption Policy Illustration
- However, What If in Non-Guaranteed Products the Assumptions Are Not Constant, But Volatile – Particularly Policy Earnings?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

98

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- Following Graph Represents a \$1,000,000 Hypothetical Variable Universal Life Policy for a Preferred Female Non-Smoker Age 50 With the Planned Assumed Funding Premium of \$6,056, Based on the 2001 CSO Mortality Table with Select and Ultimate Rates, No Expense Loading, and an Assumed Constant Rate of Return of 10%
- Second Following Graph is Based On the Same Parameters as the First Graph With the Exception that the Assumed Constant Rate of Return is 8% - Note that the Derived Planned Assumed Funding Premium is Now \$7,888
- Note Comparison of Premiums Derived at 10% and 8% and the Premium Derived of \$17,135 for Whole Life or Universal Life Using Same Assumptions As in Previous Graphs But with Assumed Constant Rate of Return of 3%

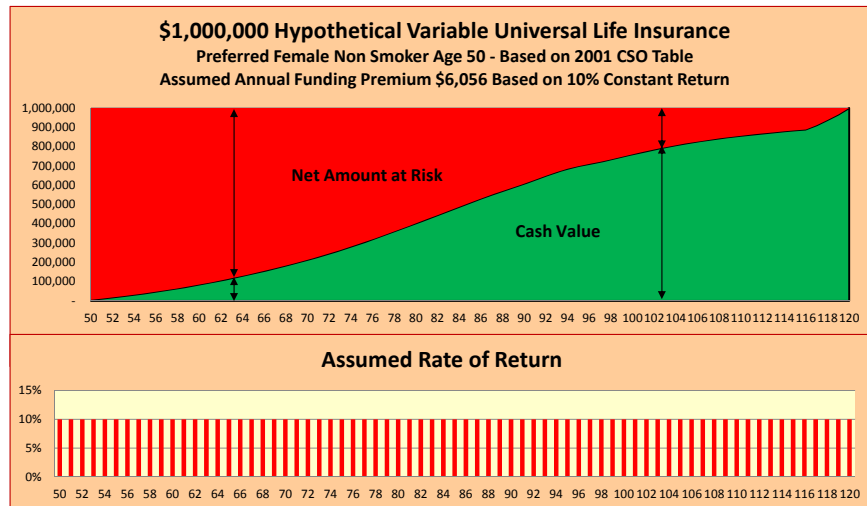
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

99

Risk of Life Insurance Policies

Constant Assumption vs. Reality

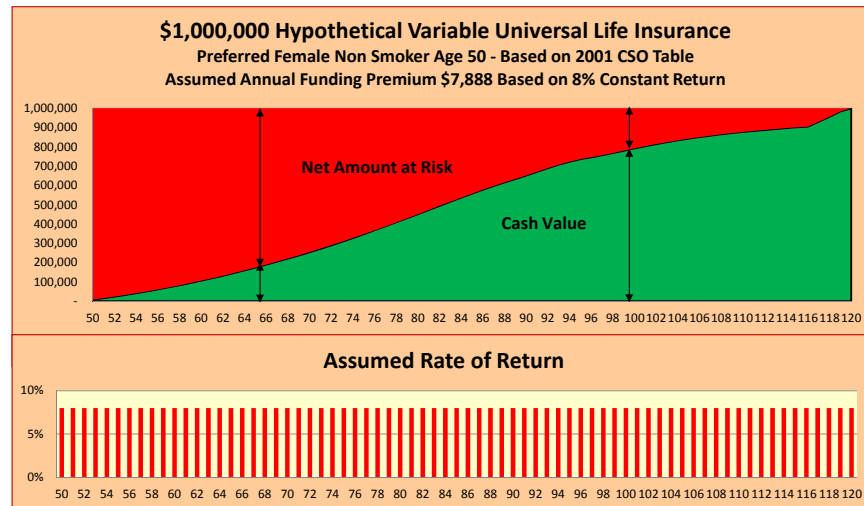
Mathematics of "Permanent" Types of Insurance (Continued)



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

100

Risk of Life Insurance Policies Constant Assumption vs. Reality Mathematics of “Permanent” Types of Insurance (Continued)



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

101

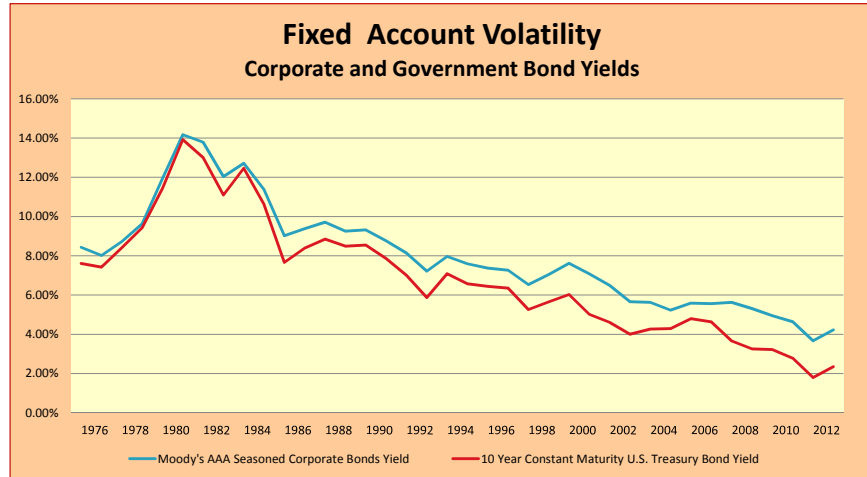
Risk of Life Insurance Policies Constant Assumption vs. Reality Mathematics of “Permanent” Types of Insurance (Continued)

- But for Variable Universal Life Policies (And Other Non-Guaranteed Products) Returns Are Not Constant Every Year But Changing and Volatile
- Thus, the Constant Average Return Life Insurance Policy Illustration Does Not Reflect Reality
- Keeping All Other Assumptions Constant But the Assumed Rate of Return, Let's Look at the Effect of Volatile Rates of Return

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

102

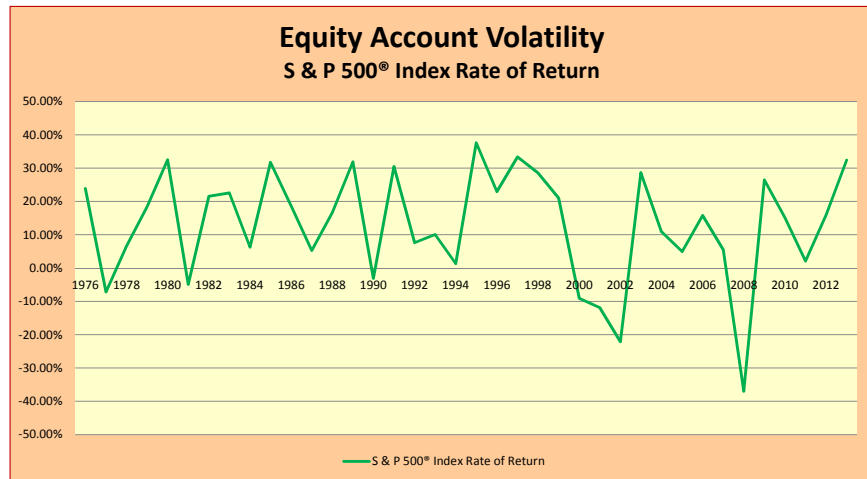
**Risk of Life Insurance Policies
Constant Assumption vs. Reality
Mathematics of "Permanent" Types of Insurance (Continued)**



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

103

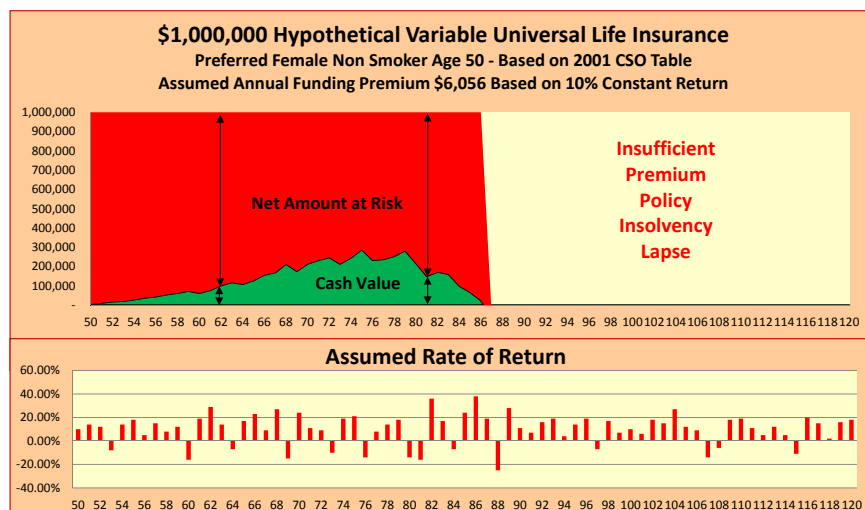
**Risk of Life Insurance Policies
Constant Assumption vs. Reality
Mathematics of "Permanent" Types of Insurance (Continued)**



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

104

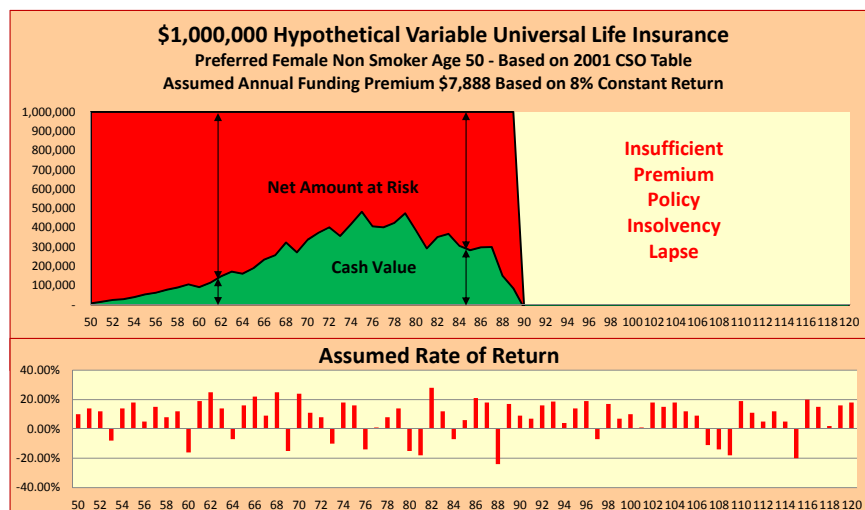
Risk of Life Insurance Policies Constant Assumption vs. Reality Mathematics of "Permanent" Types of Insurance (Continued)



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

105

Risk of Life Insurance Policies Constant Assumption vs. Reality Mathematics of "Permanent" Types of Insurance (Continued)



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

106

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- The First Preceding Graph Has an Average Overall Rate of Return of 10%, And an Average Rate of Return of 10% For Each 10 Year Period
- Note That the Assumed Funding Premium of \$6,056 Based On a Constant Return of 10% is Inadequate To Sustain the Policy Pass Age 86 Given this Pattern of Assumed Rates of Return, The Insufficient Premium Causes Policy Insolvency and Lapse

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

107

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- The Second Preceding Graph Has an Overall Average Rate of Return of Just Short of 9%
- However, Note that the Assumed Funding Premium of \$7,888, Based On a Constant Rate of Return of 8%, Is Inadequate To Sustain the Policy Pass Age 90 Given This Pattern of Assumed Rates of Return, The Insufficient Premium Causes Policy Insolvency and Lapse

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

108

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- What Causes This Policy Insolvency and Lapse?
- The Answer Is In the Very Delicate Relationship Between the Net Amount at Risk and Cash Value
- When Planned Assumed Funding Premiums Are Calculated With an Assumed Constant Rate of Return To Endow at Contract Maturity, Generally At or Near the End of the Mortality Table, As Long As Actual Rates of Return Remain At or Above the Assumed Rate of Return, Assuming No Change in Premiums, Cost of Insurance, Or Expenses, the Policy Will Endow or Mature

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

109

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- However, If the Rate of Return Falls Below the Assumed Constant Rate of Return the Very Delicate Balance Between the Net Amount at Risk and Cash Value Is In Danger, and the Whole Thing Can Go Eschew Causing the Policy to Become Insolvent, Or Lapse, Unless Sufficient Additional Premiums Are Added
- Lower Rates of Return Than the Assumed Constant Rate of Return Causes a Decrease In Cash Value And an Increase In Net Amount at Risk

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

110

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- This Results In an Increase In Cost of Insurance (COI) Because COI Is Determined By the Net Amount at Risk Multiplied By Mortality Rates For the Insured's Attained Age In Any Particular Policy Year (Note Mortality Rates Increase Constantly Each Year and Exponentially At Older Ages)
- Cost of Insurance Is Deducted From the Cash Value, Now At an Increased Amount, Further Reducing the Cash Value

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

111

Risk of Life Insurance Policies

Constant Assumption vs. Reality

Mathematics of "Permanent" Types of Insurance (Continued)

- With Volatile Rates of Return, And No Increase In The Funding Premium, The Result Can Be a "Death Spiral" Causing the Policy To Become Insolvent and Lapse
- The Policy Can Die Long Before the Insured
- The Following Two Graphs and Two Tables Represents An Extreme Example of the Effect of Return on Earnings (Rates of Return) On Net Amount at Risk and Cost of Insurance For a Variable Universal Life Policy For a Male Now 89 Years Old, Who Has Stopped Paying Premiums

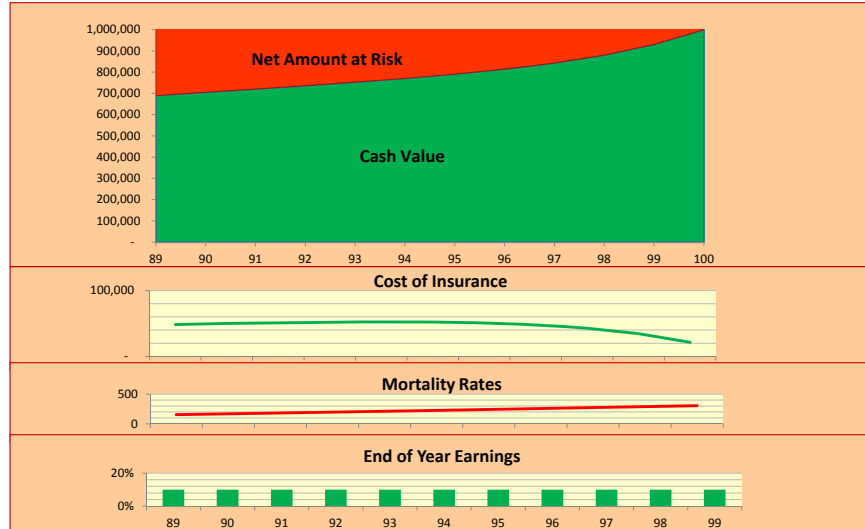
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

112

Risk of Life Insurance Policies

Effect of Earnings on Net Amount at Risk and Cost of Insurance

Variable Universal Life Policy - Constant 10% Earnings



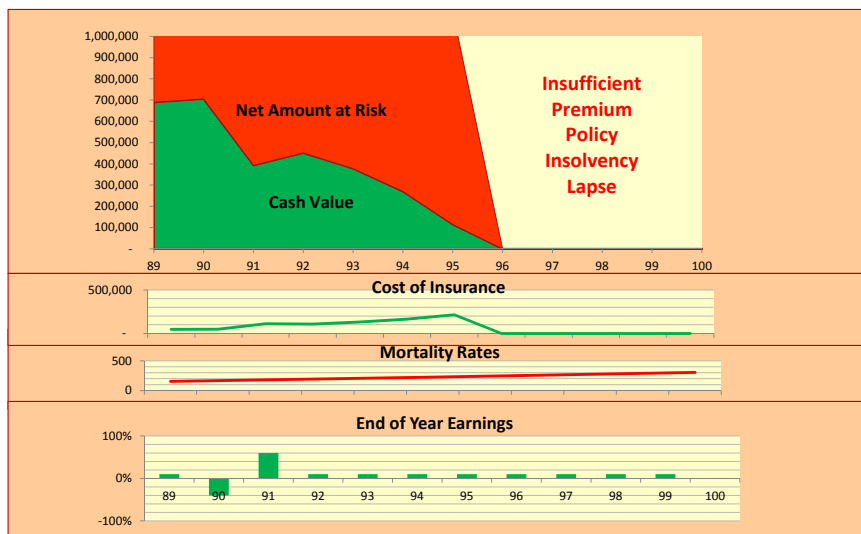
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

113

Risk of Life Insurance Policies

Effect of Earnings on Net Amount at Risk and Cost of Insurance

Variable Universal Life Policy - Average Earnings 10%



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

114

Risk of Life Insurance Policies

Effect of Earnings on Net Amount at Risk and Cost of Insurance Variable Universal Life Policy – Constant 10% Earnings

Attained Age BOY	End of Year Earnings	Policy Face Amount	Beginning of Year Cash Value	Amount at Risk	Mortality Rates Per 1,000	Cost of Insurance
89	10%	1,000,000	689,446	310,554	155.38	48,254
90	10%	1,000,000	705,312	294,688	169.81	50,041
91	10%	1,000,000	720,798	279,202	183.19	51,147
92	10%	1,000,000	736,616	263,384	197.07	51,905
93	10%	1,000,000	753,182	246,818	211.63	52,234
94	10%	1,000,000	771,043	228,957	226.96	51,964
95	10%	1,000,000	790,987	209,013	242.98	50,786
96	10%	1,000,000	814,221	185,779	257.32	47,805
97	10%	1,000,000	843,057	156,943	272.49	42,765
98	10%	1,000,000	880,321	119,679	288.55	34,533
99	10%	1,000,000	930,367	69,633	305.55	21,276
100	-	1,000,000	1,000,000	0	-	-

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

115

Risk of Life Insurance Policies

Effect of Earnings on Net Amount at Risk and Cost of Insurance Variable Universal Life Policy - Average Earnings 10%

Attained Age BOY	End of Year Earnings	Policy Face Amount	Beginning of Year Cash Value	Amount at Risk	Mortality Rates Per 1,000	Cost of Insurance
89	10%	1,000,000	689,446	310,554	155.38	48,254
90	-40%	1,000,000	705,312	294,688	169.81	50,041
91	60%	1,000,000	393,163	606,837	183.19	111,167
92	10%	1,000,000	451,194	548,806	197.07	108,153
93	10%	1,000,000	377,344	622,656	211.63	131,773
94	10%	1,000,000	270,129	729,871	226.96	165,652
95	10%	1,000,000	114,925	885,075	242.98	215,055
96	10%	-	-	-	257.32	-
97	10%	-	-	-	272.49	-
98	10%	-	-	-	288.55	-
99	10%	-	-	-	305.55	-
100	-	-	-	-	-	-

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

116

Risk of Life Insurance Policies

Effect of Earnings on Net Amount at Risk and Cost of Insurance Mathematics of "Permanent" Types of Insurance (Continued)

- With the First Graph and Table, Assuming Constant Earnings of 10%, The Policy Matures At Age 100
- Note With Constant 10% Earnings, While Mortality Rates Increase Over the Period Shown, The Cost of Insurance Decreases
- The Second Graph and Table Illustrates An Average Earnings of 10% Over the Ages of 89-100, But With a Decrease in Earnings of 40% For the Second Year Shown And an Increase In Earnings of 60% In the Third Year Shown

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

117

Risk of Life Insurance Policies

Effect of Earnings on Net Amount at Risk and Cost of Insurance Mathematics of "Permanent" Types of Insurance (Continued)

- The Result of This Change Is That Without Substantial Premium Contributions the Policy Is Insolvent At Age 96 And Lapses
- Note That While Mortality Rates Remain the Same In Both Graphs and Tables, The Application of Those Rates to the Increased Net Amount At Risk In the Second Graph and Table, Causes a Substantial Increase In the Cost of Insurance
- Later In This Presentation We Will Examine How To Address The Volatility Issue And Properly Evaluate Non-Guaranteed Flexible Premium Life Insurance Products, And Derive A Premium That, While Certainly Not Guaranteed, Can Accurately Reflect The Effect of Volatility In Rates of Return, With Statistical Probabilities of Confidence

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

118

Risk of Life Insurance Policies

Risk by Product Types

- Risks Vary by Product Types
 - Affected by What's Guaranteed and Not Guaranteed
 - Affected by Non-Guaranteed Policy Performance
 - Earnings or Interest Crediting Rates
 - Cost of Insurance
 - Expenses
 - Lapses
 - Affected by Policy Funding Adequacy
 - Universal Life
 - Variable Universal Life
 - Indexed Universal Life
 - Affected by Dividend Performance on Blended Base Whole Life with Combination of Paid-Up Additions and Decreasing Term Dividend Option and/or Paid-Up Additions Rider
 - What About Purchasing Power Risk?
 - Depends On Policy Type and Funding Adequacy

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

119

Risk of Life Insurance Policies

Purchasing Power Risk

Effect of 3% Inflation on \$1,000,000 Life Insurance Policy

Issue Age Female	Life Expectancy @ Issue Age	Value of \$1,000,000 @ Life Expectancy	Needed Now for \$1M Purchasing Power @ L.E.
45	90	\$264,438	\$3,781,596
55	91	\$345,032	\$2,898,278
65	91	\$463,695	\$2,156,591
75	92	\$605,016	\$1,652,848

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

120

Risk of Life Insurance Policies

Purchasing Power Risk

Effect of 3% Inflation on \$1,000,000 Life Insurance Policy

Issue Age Male	Life Expectancy @ Issue Age	Value of \$1,000,000 @ Life Expectancy	Needed Now for \$1M Purchasing Power @ L.E.
45	88	\$280,543	\$3,564,517
55	88	\$377,026	\$2,652,335
65	89	\$491,934	\$2,032,794
75	91	\$623,167	\$1,604,706

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

121

Risk of Life Insurance Policies

Purchasing Power Risk

Effect of 3% Inflation on \$1,000,000 Life Insurance Policy

Issue Age Joint Female/Male	Life Expectancy @ Issue Age	Value of \$1,000,000 @ Life Expectancy	Needed Now for \$1M Purchasing Power @ L.E.
45/45	95	\$228,107	\$4,383,906
55/55	95	\$306,557	\$3,262,038
65/65	95	\$411,987	\$2,427,262
75/75	96	\$537,549	\$1,860,295

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

122

Risk of Life Insurance Policies

Risk by Product Types – Term Insurance

What's Guaranteed	What's Not Guaranteed - Risks
<ul style="list-style-type: none"> • Premium for a Period • Death Benefit • Renewability for a Period • Conversion for a Period 	<ul style="list-style-type: none"> • Current Rates at End of Term Period • Insurability at End of Maximum Term of Term Insurance • Purchasing Power of Death Benefit

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

123

Risk of Life Insurance Policies

Risk by Product Types – Par Whole Life

What's Guaranteed	What's Not Guaranteed - Risks
<ul style="list-style-type: none"> • Premium • Premium Paying Period • Cash Values (Minimum Guarantee) • Death Benefit • Policy Sustainability • Premium Sufficiency 	<ul style="list-style-type: none"> • Dividends • Purchasing Power Depending on Dividend Amount and Option, Some Purchasing Power Protection can be afforded with Paid-Up Additional Insurance Dividend Option

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

124

Risk of Life Insurance Policies

Risk by Product Types – No Lapse Guarantee Universal Life

What's Guaranteed

- Premium amount if Paid Timely and Other Conditions
- Death Benefit Subject to Premium Conditions Above
- Policy Sustainability Subject to Premium Conditions Above
- Premium Sufficiency Subject to Premium Conditions Above

What's Not Guaranteed - Risks

- Carrier Solvency
- State Guarantee Fund Coverage
 - A.G. 38
- Purchasing Power

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

125

Risk of Life Insurance Policies

Risk by Product Types – Universal Life

What's Guaranteed

- First Year Death Benefit and Minimum Required Amount of Premium
- Minimum Interest Crediting Rate
- Maximum Cost of Insurance
- Maximum Policy Expenses

What's Not Guaranteed - Risks

- Premium Sufficiency
- Policy Sustainability
- Current Interest Crediting Rates
- Current Costs of Insurance
- Current Policy Expenses
- Purchasing Power
 - Depends on Factors Such As Level or Increasing Death Benefit Option, Policy Performance, Funding Adequacy and Section 7702 Corridor

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

126

Risk of Life Insurance Policies

Risk by Product Types – Variable Universal Life

What's Guaranteed	What's Not Guaranteed - Risks
<ul style="list-style-type: none"> • First Year Death Benefit and Minimum Required Amount of Premium • Maximum Cost of Insurance • Maximum Policy Expenses 	<ul style="list-style-type: none"> • Premium Sufficiency • Policy Sustainability • Earnings • Current Costs of Insurance • Current Policy Expenses • Purchasing Power <ul style="list-style-type: none"> – Depends on Factors Such As Level or Increasing Death Benefit Option, Policy Performance, Funding Adequacy and Section 7702 Corridor

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

127

Risk of Life Insurance Policies

Risk by Product Types – Indexed Universal Life

What's Guaranteed	What's Not Guaranteed - Risks
<ul style="list-style-type: none"> • First Year Death Benefit and Minimum Required Amount of Premium • Crediting Rate Formula <ul style="list-style-type: none"> – Based on Some Index Such as S&P 500 Without Dividend Component, with non-guaranteed Participation Rate and Caps; and Minimum Interest Crediting Rate (Typically 100 Basis Points or More Below UL Min. Rate but can be Zero) • Maximum Cost of Insurance • Maximum Policy Expenses 	<ul style="list-style-type: none"> • Premium Sufficiency • Policy Sustainability • Adequacy of Earnings • Participation Rate • Maximum Caps on Increase in Index • Current Costs of Insurance • Current Policy Expenses • Purchasing Power <ul style="list-style-type: none"> – Depends on Factors Such As Level or Increasing Death Benefit Option, Policy Performance, Funding Adequacy and Section 7702 Corridor

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

128

Risk of Life Insurance Policies

Risk by Product Types – Blended Base Whole Life with Combination Paid-Up Additions and Decreasing Term Dividend Option and/or Paid-Up Additions Rider

What's Guaranteed

- Base Whole Life Premium
- Base Whole Life Premium Paying Period
- Base Whole Life Cash Values (Minimum Guarantee)
- Base Whole Life Death Benefit
- Base Whole Life Policy Sustainability
- Base Whole Life Premium Sufficiency
- Paid-Up Additions Rider – The Right to Purchase on a Continuous Ongoing Basis at a Fixed Dollar Premium Amount, Single Premium Paid-Up Whole Life Additions at the Insured's Attained Age for Each Policy Year
- Paid-Up Additions Rider Face Amount Purchased at Each Year's Attained Age
- Paid-Up Additions Rider Cash Values (Minimum Guarantee)
- Paid-Up Additions Rider Death Benefit, Policy Sustainability and Sufficiency

What's Not Guaranteed - Risks

- Dividends for Both Base Policy and Paid-Up Additions Rider
- Inadequate Dividends Failure to Cover Term Cost Requiring Term Premium Contributions, Which Probably Could Increase in Subsequent Years
- Purchasing Power Depends on Dividend Amount , Some Purchasing Power Protection Can be Afforded with the Paid-Up Additional Insurance Dividend Option After Paid-Up Additional Insurance Face Amount Additions Are Equal to the Initial Decreasing Term Face Amount

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

129

Risk of Life Insurance Policies Product Suitability

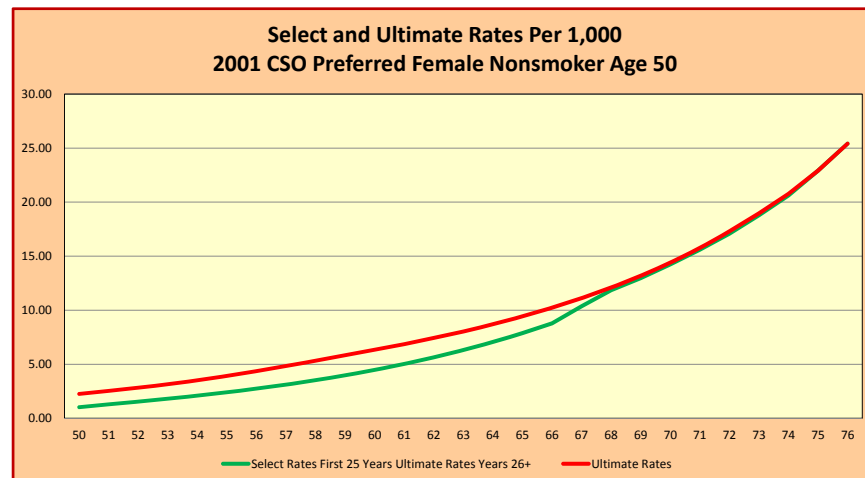
- Need for Life Insurance
 - Increase
 - Decrease
 - No Longer Needed
 - Consider Life Settlement
- Product Type Appropriateness
 - Risk Tolerance
 - Lowest Premiums vs. Growth in Death Benefit and Cash Values
- Premium Paying Capacity
- Policy Replacement
 - Insurability or Change in Insurability
 - Select and Ultimate Mortality Costs vs. New Acquisition Costs Such as Commissions
 - Society of Financial Service Professionals Replacement Questionnaire
 - Life Settlements

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

130

Risk of Life Insurance Policies

Some Life Insurance Basics



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

131

Risk of Life Insurance Policies

Diversification

- Life Insurance is a Concentrated Asset
- Life Insurance Diversification
 - By Multiple Policy Carriers, and
 - Multiple Policy Types Based on “Asset Allocation” by
 - Risk Tolerance
 - Preference for Lowest Premiums vs. Growth in Death Benefit and Cash Values
 - Trade Off Between Benefits of Diversification vs. Lower Cost Based on Premium Banding and Multiple Policy Fees
 - Depends on Total Face Amount of Life Insurance

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

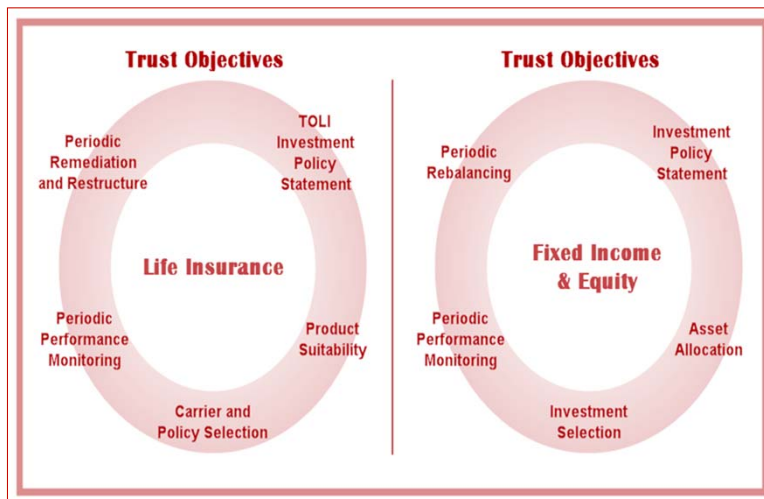
132

Process of Managing Life Insurance Policies

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

133

Process of Managing Life Insurance Policies TOLI Risk Management Process



Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

134

Process of Managing Life Insurance Policies TOLI Investment Policy Statement (TIPS)

- Formalizes the Trust’s Objectives and Grantor’s Expectations
- Identifies the ILIT Parties and Sets Out the Duties of Each Party
- Specifies Risk Tolerance Pursuant to Trust Objectives
- Provides for the Delegation of Life Insurance Expertise and Policy Evaluation Duties
- Summarizes the Risk Management Criteria to be Annually Evaluated and the Procedure to Monitor and/or Restructure Under-Performing or Unsuitable Policies
- Confirms the Annual Beneficiary Reporting, Accounting and Communication Schedule Functions

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

135

Process of Managing Life Insurance Policies TOLI Administration and Risk Management Duties May Be Delegated

- If ILIT Trustee Lacks Life Insurance Expertise and Policy Evaluation Ability, and/or Administration Capacity These Functions May and Should Be Delegated to Independent Qualified Parties
- Delegation Must Follow a Prudent Process Which Should Include Requests for Proposals (RFP) and the Procedures and Process Should Be Written in the TOLI Investment Policy Statement (TIPS)

Spectrum of TOLI Delegation	
<ul style="list-style-type: none"> ❖ Investment Policy Statement Review ❖ Carrier/Product Suitability Analysis ❖ Fact-Based Policy Risk Assessment ❖ Life Expectancy and Duration Analysis ❖ Policy Underwriting Oversight ❖ Policy Acceptance Oversight ❖ Portfolio “Watch List” Procedures ❖ Policy Remediation Consulting ❖ Policy “Rescue” Option Analysis ❖ Requests for Proposal Oversight ❖ Professional Adviser Communications 	<ul style="list-style-type: none"> ❖ ILIT Client Administration ❖ Policy Performance Evaluation ❖ Portfolio Risk Management Reporting ❖ Policy Performance Management Reports ❖ Actuarial-Certified Policy Evaluation <ul style="list-style-type: none"> ○ Premium Adequacy ○ Lapse Evaluation ○ Policy Cost Evaluation ❖ Monte Carlo Simulation Analysis ❖ Remediation Option Evaluation ❖ Grantor/Beneficiary Communications

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

136

Process of Managing Life Insurance Policies

Best vs. Predatory Practices For Professional and Amateur Trustees

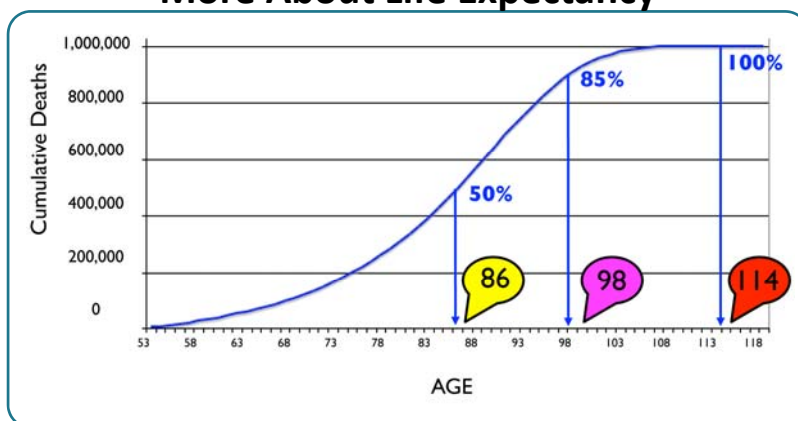
- Process the Same for Both Amateur and Professional Trustees.
- Amateurs Can Use Best Practices of Professional Trustees.
- Best Practices - Policy acceptance, management, and restructure decisions based upon the ILIT Agreement, TOLI Investment Policy Statement and TOLI-specific expertise.
- Predatory Practices - The conscious and willful inattention to, avoidance of and disregard for the ILIT Agreement, known ILIT trustee duties and known life insurance guidance. (Ignorance and lack of awareness are not defensible excuses.)

Spectrum of TOLI Risk Management Options			
	Predatory	Questionable	Best
Trustee	No Duties	Limited Duties	Active Oversight
IPS	No	No	Yes
Life Insurance Expertise	Unknown	Grantor Friend	Delegation per IPS
Policy Monitoring	No	Illustrations	Dispute Defensible per IPS
Annual Communication	No	Periodic	Yes per IPS
Restructure Evaluation	Unknown	Unknown	Yes per IPS

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

137

Process of Managing Life Insurance Policies More About Life Expectancy



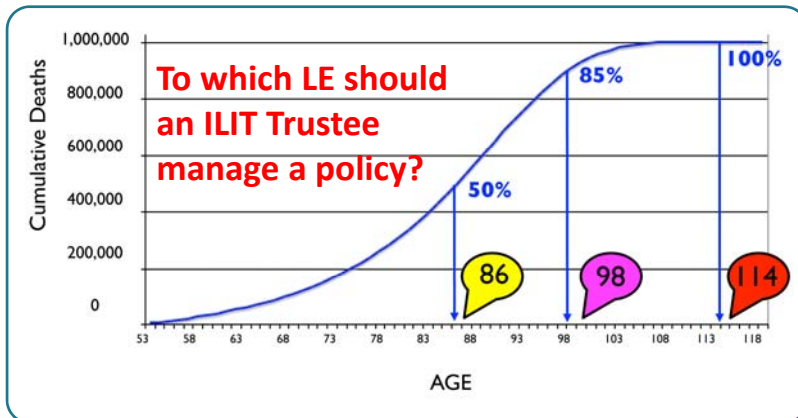
Underwritten Life Expectancy

Copyright 2012 Ethical Edge Insurance Services, LLC. All Rights Reserved.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

138

Process of Managing Life Insurance Policies The \$64,000 Question About Life Expectancy



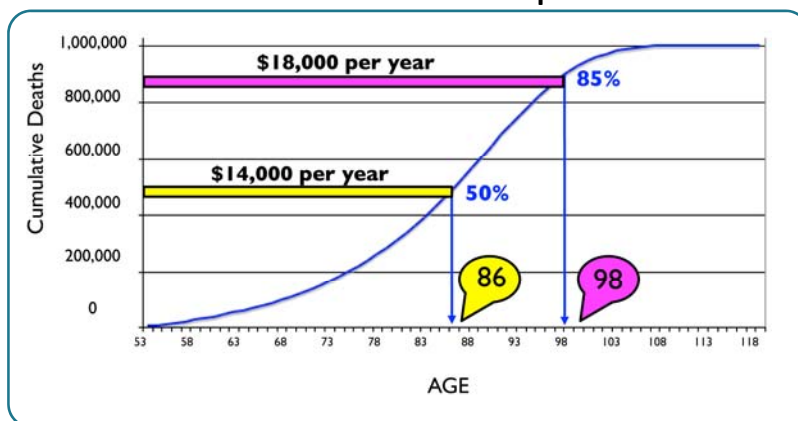
Underwritten Life Expectancy

Copyright 2012 Ethical Edge Insurance Services, LLC. All Rights

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

139

Process of Managing Life Insurance Policies Effect of Life Expectancy Objective On Universal Life Premium Requirements



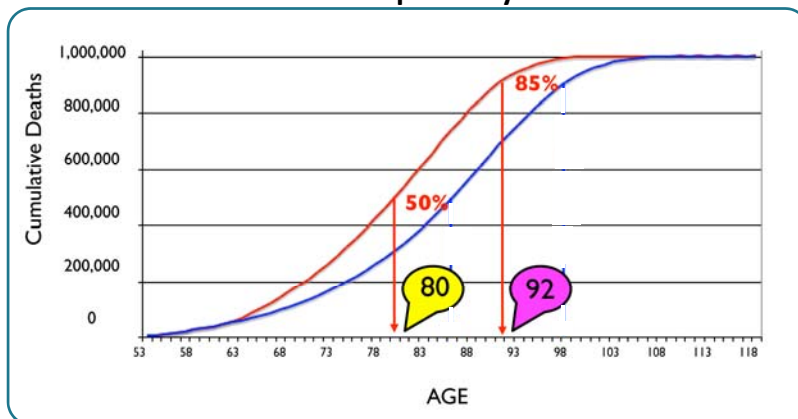
Underwritten Life Expectancy

Copyright 2012 Ethical Edge Insurance Services, LLC. All Rights Reserved.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

140

Process of Managing Life Insurance Policies Shifting Life Expectancy Curve Resulting from Updated Personalized Life Expectancy Assessment

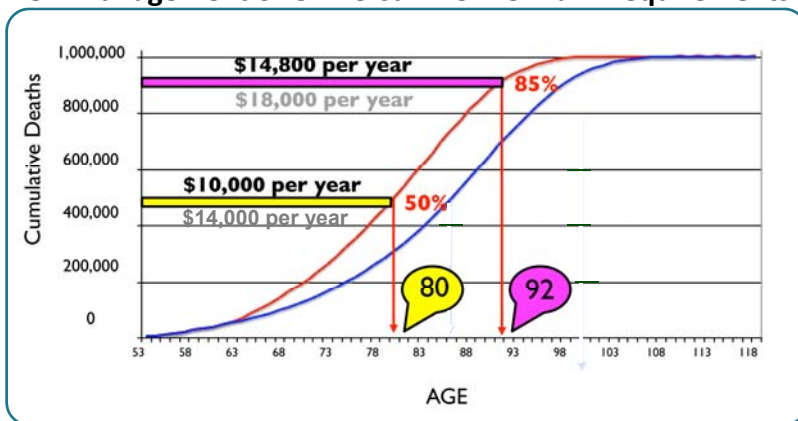


Underwritten Life Expectancy

Copyright 2012 Ethical Edge Insurance Services, LLC. All Rights Reserved.
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

141

Process of Managing Life Insurance Policies Effect of Updated Personalized Life Expectancy Assessment On Management of Universal Life Premium Requirements



Underwritten Life Expectancy

Copyright 2012 Ethical Edge Insurance Services, LLC. All Rights Reserved.
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

142

Evaluation of Life Insurance

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

143

Evaluation of Life Insurance

- Policy Illustration Comparisons: 1992 Society of Actuaries Task Force on Policy Illustrations Report
 - “[...] [when] illustrations are used to show the client how the policy works; [it is] a valid purpose of policy illustrations. Illustrations which are typically used, however, to portray the *numbers* based on certain fixed assumptions – and/or are likely to be used to compare one policy to another – are an improper use of a policy illustration.”
 - “...How credible are any non-guaranteed numbers projected twenty years in the future, even if constructed with integrity? How does the consumer evaluate the credibility of two illustrations if they are from different companies? Or even if they are from the same company if different products with different guarantees are being considered? *Most illustration problems arise because the illustrations create the illusion that the insurance company knows what will happen in the future and that this knowledge has been used to create the illustration.*” (Emphasis added.)

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

144

Evaluation of Life Insurance

- **FINRA Rule 2210 - IM-2210-2. Communications with the Public About Variable Life Insurance:**
 - IM 2210-2 (b)(5)(A)(i) "Hypothetical illustrations using assumed rates of return may be used to demonstrate the way a variable life insurance policy operates. The illustrations show how the performance of the underlying investment accounts could affect the policy cash value and death benefit. **These illustrations may not be used to project or predict investment results as such forecasts are strictly prohibited by the Rules."**
 - IM 2210-2 (b)(5)(C)" ... it is inappropriate to compare a variable life insurance policy with another product based on hypothetical performance as this type of presentation goes beyond the singular purpose of illustrating how the performance of the underlying investment accounts could affect the policy cash value and death benefit....."

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

145

Evaluation of Life Insurance

- Would a loan officer accept an unaudited financial statement from the bookkeeper of a company being considered as a loan candidate? Would the loan officers not want a financial statement audited and certified by a CPA? Than why would a trust officer not want an evaluation of a life insurance policy that is not certified by an actuary using actuarially-based principles?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

146

Evaluation of Life Insurance

What is Not an Acceptable Evaluation Method?

- Using Policy Illustrations to Project and/or Predict Non-Guaranteed Policy Values
- Using Policy Illustrations to Compare One Policy to Another (Even of the Same Type of Policy)
- Policy Audit Reports (They are all Based on Comparing Policy Illustrations)
- Premium Optimization Reports (Again, Based on Comparing Policy Illustrations)
- Any System that Uses Non-Guaranteed Constant Earnings or Interest Crediting Rates to Predict Values or Compare Policies
- All of the Above are not “Dispute Defensible”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

147

Evaluation of Life Insurance

What is Required for Acceptable Evaluation of Non-Guaranteed Life Insurance Products?

- Evaluation Must Be Unbiased, Credible, Impartial and Fact-Based
- Uses Objective Data
- Uses Actuarial Evaluation Using Generally Accepted Actuarial Methods (Note Parallel to Generally Accepted Accounting Principles)
- Use of Quantitative, Measurable Benchmark Comparisons and Policy Standards
- Is This Possible With Non-Guaranteed Life Insurance?

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

148

Evaluation of Life Insurance

What is Acceptable Evaluation of Non-Guaranteed Life Insurance Products?

- Actuarially Certified Policy Standards and Benchmarking Model to Access Cost of Insurance and Policy Expenses
- Accounting for Volatility in Earnings, Crediting Rates and Interest
- Applying Monte Carlo Methodology and Stochastic Analysis Techniques
 - Used In Trust Investment Portfolio Analysis For Many Years
 - Applied to Cash Value Reserve Accounts (General Asset Account, Separate Sub Accounts, or Point to Point Indexes) Backing Up Cash Value of Non-Guaranteed Policy, Which Are Like Portfolios
 - Assesses Probability of Successful Outcome As Defined by Policy Owner/Trustee

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

149

Evaluation of Life Insurance

What is Acceptable Evaluation of Non-Guaranteed Life Insurance Products? (Continued)

- Actuarially Certified Evaluation Includes
 - Accessing the Probability that Carrier's Illustrated Scheduled Premiums Are Adequate to Successfully Sustain the Policy to Contract Maturity, Or At the Very Least, to the Insured's Life Expectancy
 - Evaluation of the Most Likely Five Year Range of Policy Lapse Given Current Scheduled Premiums, As Well As Earliest Possible Lapse
 - Evaluation of the Competitiveness of Policy Pricing of Cost of Insurance and Policy Expenses Relative to the Benchmark Policy Standards
 - Correcting Premium to Sustain Policy to Desired Age Or Contract Maturity Given Policy Owner/Trustee's Risk Tolerance
- Proper Policy Monitoring Requires Annual Actuarial Certified Evaluation
- Is Available, Affordable, And, Is "Dispute Defensible"

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

150

Evaluation of Life Insurance

Example of Actuarial Evaluation of In-Force Policy

Insured Information	
Name:	Ms. Ilit Grantor
Current Age:	52
Gender:	Female
Risk Classification:	Preferred Non-Smoker
Life Expectancy (Calculated):	90

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

151

Evaluation of Life Insurance

Example of Actuarial Evaluation of In-Force Policy (Continued)

In-Force Policy Information	
Carrier:	XYZ Life Insurance Company
Year of Policy Issue	2000
Issue Age:	37
Face Amount:	\$2,000,000
Policy Type:	Variable Universal Life
Asset Allocations (Equity/Bond):	100%/0%
In-Force Policy Account/Cash Value:	\$80,000 (Originally Projected \$91,264)

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

152

Evaluation of Life Insurance

Example of Actuarial Evaluation of In-Force Policy (Continued)

In-Force Policy Illustration Data/Assumptions	
Current Annual Funding Premium:	\$7,250
Premium Paying Years:	48
Illustration Interest/Crediting Rate:	10.00%
Illustrated Lapse Age:	92

Premium Adequacy To Sustain Policy Risk Tolerance (Confidence Level):	90%
--	------------

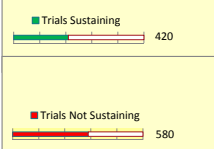
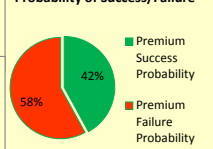
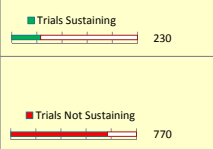
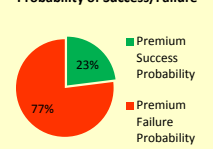
Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

153

Evaluation of Life Insurance

Example of Actuarial Evaluation of In-Force Policy (Continued)

Probability of Current Funding Premium Sustaining Policy To:

Life Expectancy		Age 100 Contract Maturity	
1,000 Randomly Generated Illustration Trials  ■ Trials Sustaining 420 ■ Trials Not Sustaining 580 0 200 400 600 800 1000	Current Funding Premium Probability of Success/Failure  ■ Premium Success Probability 42% ■ Premium Failure Probability 58%	1,000 Randomly Generated Illustration Trials  ■ Trials Sustaining 230 ■ Trials Not Sustaining 770 0 200 400 600 800 1000	Current Funding Premium Probability of Success/Failure  ■ Premium Success Probability 23% ■ Premium Failure Probability 77%
Current Funding Premium: \$7,250	Correcting Funding Premium @ 90% Confidence Level: \$16,564	Current Funding Premium: \$7,250	Correcting Funding Premium @ 90% Confidence Level: \$20,776
Life Expectancy Age: 90		Life Expectancy Age: 90	
Earliest Lapse: 69	Correcting Funding Premium Increase/(Decrease) Over Current Funding Premium: 128%	Earliest Lapse: 70	Correcting Funding Premium Increase/(Decrease) Over Current Funding Premium: 187%
Highest 5 Year Period of Concentrated Lapses: 81-85		Highest 5 Year Period of Concentrated Lapses: 80-84	
Calculated Average Return: 9.80%	Pricing Deviation Actuarial Policy Standards Database Relative to Illustrated Policy: +2%	Calculated Average Return: 9.72%	Pricing Deviation Actuarial Policy Standards Database Relative to Illustrated Policy: +2%

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

154

Evaluation of Life Insurance

Credit For Software Creation and Development

- The Actuarially Certified Benchmarking and Policy Standards Software, Which Applies Statistical Stochastic Analysis (Monte Carlo Simulation) to Universal Life Policies (Including Variable and Equity Index), Was Invented and Developed By Richard M. Weber, MBA, CLU®, AEP® (Distinguished) and Christopher Hause, FSA, MAAA, CLU® of Ethical Edge Consulting, LLC and Hause Actuarial Solutions, LLC

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

155

Evaluation of Life Insurance

“Dispute Defensible” Policy Evaluation Summary

- Illustrations for non-guaranteed products disclaim predictive value and, at best, offer a static picture of policy performance whereas actual future values depend on continually changing future conditions. ILIT fiduciaries that rely upon illustration-based analysis and related ‘subjective’ risk assessments paper their file with documents that demonstrate imprudence.
- Fact-based evaluation using generally accepted actuarial methods, impartial analysis, and objective data to assess the probability that an illustration’s scheduled premiums will successfully sustain the policy to contract maturity or insured life expectancy, as a minimum.
- A benchmark model tests the reasonableness of an illustration’s projected values given (1) interest rate conditions prevalent on the test date, and (2) lapse, mortality and expense assumptions approximating industry norms and appropriate for the policy type.
- The goal is to help determine the relative credibility of an illustration as opposed to predicting the actual performance of a specific policy.

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

156

Evaluation of Life Insurance

Results of Actuarially Certified Benchmark Policy Standards Evaluation Utilizing Monte Carlo Simulation for Non-Guaranteed Life Insurance

- Provides Unbiased, Credible, Impartial and Fact-Based Analysis
- Provides Quantitative, Measureable Actuarially Certified Benchmark and Policy Standards for Comparisons for Cost of Insurance and Policy Expenses
- Most Importantly, Monte Carlo Simulation Accounts for Volatility in Earnings for Sub Accounts, Crediting Rates and Interest
- Accesses Probability of Carrier Illustrated Scheduled Premiums Adequacy to Sustain Policy to Chosen Duration Based On Risk Tolerance of Policy Owner.
- Is Available, Affordable, and, is “Dispute Defensible”

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

157

Summary

For the Professional Trustee

- Keyword is Managing
- Risks of Life Insurance
- Process of Managing Life Insurance Policies
 - Sample TOLI Investment Policy Statement (TIPS)
 - Dispute Defensible ILIT Administration and TOLI Policy Evaluation Checklist
 - Delegate to TOLI Experienced Consultant with Life Insurance Product Knowledge and Expertise
- Evaluation of Life Insurance
 - Delegate to Qualified Independent Consultant
 - Actuarial Evaluation Using Policy Standards and Benchmarking Model

For the Amateur Trustee

- Keyword is Managing
- Risks of Life Insurance
- Process of Managing Life Insurance Policies
 - Sample TOLI Investment Policy Statement (TIPS)
 - Dispute Defensible ILIT Administration and TOLI Policy Evaluation Checklist
 - Delegate to TOLI Experienced Consultant with Life Insurance Product Knowledge and Expertise
- Evaluation of Life Insurance
 - Delegate to Qualified Independent Consultant
 - Actuarial Evaluation Using Policy Standards and Benchmarking Model

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

158

Questions???

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

159

Thank You for Your Attention!

Copyright (c) 2015 Gary L. Flotron, MBA, CLU, ChFC, AEP All rights reserved.

160

APPENDIX E*

EXCERPT FROM THE OFFICE OF THE COMPTROLLER'S HANDBOOK

Bank fiduciaries are responsible for protecting and managing the life insurance policy for the benefit of the beneficiaries for the life of the grantor. A bank fiduciary must understand each life insurance policy that the trust accepts or purchases, or the bank fiduciary must employ an advisor who is qualified, independent, objective, and not affiliated with an insurance company to prudently manage these assets. In addition, the bank fiduciary must periodically review the financial condition and rating of the insurance company. The majority of these policies are deposited into the trust by the grantor. Many states have recently passed legislation to limit the liability of bank fiduciaries, in certain situations, by rescinding requirements under state law to perform due diligence on insurance companies as a directed bank fiduciary. The OCC, however, continues to require bank fiduciaries to follow 12 CFR 9.6(c) and 12 CFR 150.220 and to conduct annual investment reviews of all assets of each fiduciary account for which the bank has investment discretion. This review should evaluate the financial health of the issuing insurance company as well as whether the policy is performing as illustrated or whether replacement should be considered.

Bank fiduciaries need to have well-developed risk management practices to evaluate and administer accounts with insurance policy holdings. A bank fiduciary with discretion over the account must complete formal pre-acceptance, initial post-acceptance and annual reviews of the insurance policy. Independent of these reviews, a fiduciary bank must have risk management systems and reviews that address the following.

- Sufficiency of premiums: The bank fiduciary must determine whether current premiums are sufficient to maintain the policy to maturity or to meet the insured's life expectancy.
- Suitability of the insurance policy: Consider replacing an insurance policy if the bank fiduciary identifies concerns with the condition of the insurance provider or if that provider does not meet the needs of the grantor or beneficiaries. Also assess any tax changes that could affect the suitability of the policy.

- Carrier selection: The bank fiduciary needs to evaluate the carrier's financial condition. To the extent insurance carrier ratings are available, they generally lag corporate and market events, and should be used principally as indicators of a firm's creditworthiness.
- Appropriateness of investment strategy: The bank fiduciary must evaluate the appropriateness of investments of any segregated account to support the cash value.

For policies with flexible premiums and nonguaranteed benefits, the trustee should obtain the original policy illustration, which shows planned premium strategies. This policy illustration is subject to a high degree of fluctuation. Periodically, the trustee should obtain an in-force illustration. This provides a measure of performance of a life insurance policy against what was initially illustrated. By obtaining an in-force illustration, the trustee can monitor the effectiveness of the policy to date and project how the policy may perform in the future and plan for any potential shortfall in premiums. This process assists the trustee in monitoring the economics of the policy.

Sample Irrevocable Life Insurance Trust Investment Policy Statement

by

E. Randolph Whitelaw, AEP® (Distinguished)

Sample Irrevocable Life Insurance Trust Investment Policy Statement

This Investment Policy Statement sets forth guidelines and procedures for systematic review and long-term management of the trust's assets. The purpose of this Investment Policy Statement (herein IPS) is to:

- Clarify the trust's objectives and the grantor's expectations;
- Specify the grantor's risk tolerance level pursuant to the trust's objectives;
- Set forth the trustee's risk management criteria to achieve the trust's objectives; and
- Establish a procedure for timely monitoring and systematic review of performance results;

This IPS evidences the careful consideration given by both the grantor and the trustee to the formulation and implementation of a prudent asset management strategy. It will serve as a guide to the trustee, outline procedures for prudent administration of trust assets invested in the sole interest of the beneficiaries, and set out the responsibilities of outside advisors and/or providers engaged in the trust operation. This statement will be revised and modified as appropriate on a periodic basis to reflect such factors as changes in the trust objectives, asset performance and suitability, trustee risk management procedures, beneficiary objectives, and tax laws.

Purpose of the Trust: The primary purpose of the Sample ILIT, as stated in Article [TBD] in the trust agreement, is to invest prudently in life insurance policies on the life of the grantor.

Trust Time Horizon: The trust was created in [date] and the insured was age [TBD] at the time of initial policy issue. The insured is attained age [TBD] and has a life expectancy of [TBD] years based on current mortality tables. The trust-owned policy(ies) should be/were designed to sustain coverage to contract maturity/insured age [TBD].

Contributions to the Trust: The grantor intends to annually transfer funds to the trust as annual exclusion gifts to the trust beneficiaries. Pursuant to the trust's terms, the trustee receives the transfers and sends notice to the beneficiaries of their temporary right to withdraw their respective pro rata shares of these gifts. To the extent these withdrawal rights lapse, the trustee may use the funds remaining to pay the annual life insurance premiums. These transfers from the grantor are voluntary and are not required under the trust or under the contract between the grantor and the trustee. There is no guarantee that the grantor or anyone else will contribute additional funds to the trust in future years.

Trust Distribution Provisions and Beneficiaries: The trust names the grantor's [number such as 4] children as equal beneficiaries. All are to receive equal distributions from the trust upon the grantor's death.

Diversification: In achieving the goals of the larger estate planning program, the trust shall limit the assets to insurance and investment products that can best accomplish the grantor's intent. The trustee shall diversify unless it is prudent not to do so. *(Note: Depending upon trust objectives, the trustee can set out asset allocation guidelines to allow for reasonable percentages of insurance coverage underwritten by 'no load' and 'commission paying' universal life, whole life, and variable carriers as well as mutual and stock insurance carriers. Also, for variable policies, the asset allocation*

strategy should be similar to traditional investment IPS documents. The selected strategy's volatility-simulated net expected return should reasonably approximate the accumulation rates projected on the policy illustration.)

Product Suitability and Risk Management Guide: This Guide outlines the risk/return expectations and asset management strategies to be employed by the trustee during the term of insurance policy administration. Exhibit #1 summarizes the different guaranteed and non-guaranteed policy types available to the trustee and the scope of periodic monitoring appropriate for each requiring the assistance of the Investment Advisor/Life Insurance Analyst. Selection of a policy type with non-guaranteed features should be based on an actuarially certified Benchmark Model Report's policy design parameters. Ongoing premium adequacy and policy performance monitoring should be actuarially certified.

- **Carrier Risk:** Unless constrained by health difficulties or other underwriting considerations, the trustee shall select among life insurance companies ranked among the largest 150 based on admitted assets, and shall be guided primarily by ratings issued by independent evaluation agencies including: A.M. Best, Fitch Credit Rating Company, Moody's, and Standard & Poor's. Preference shall be given to carriers with more favorable ratings from no less than three of these agencies. In the event of a ratings downgrade of the issuer, the trustee shall review the magnitude of the downgrade as well as its cause and shall determine what portfolio modifications, if any, are warranted.
- **Premium Adequacy and Contract Underperformance Risk:** The trustee shall make a policy suitability determination based on the trust's objectives and the grantor's risk tolerance. Selection and acceptance of a non-guaranteed death benefit contract requires annual actuarially-certified evaluation that scheduled premiums are adequate to sustain the policy to contract maturity or a time period approved by the grantor but no less than the insured's life expectancy as calculated by an independent life expectancy firm or set out in the 2001 CSO table. In the event that the contract is underperforming its acceptance benchmark evaluation, the trustee will communicate this underperformance to trust beneficiaries and policy management options to achieve the trust's objectives and grantor's expectations.

Carrier illustrations shall be obtained for informational purposes only. In 1994, the National Association of Insurance Commissioners stated, "Illustrations are not and cannot be predictions or estimates of future performance."

- **Liquidity Risk:** The trustee has a duty to investigate policy costs and determine that they are reasonable and appropriate. The trustee shall evaluate "load" insurance contracts that pay a commission to the selling agent and "no-load" contracts that do not generate a commission. At the time of initial policy acceptance and subsequent policy restructure, the trustee shall obtain written disclosure of commission payments and surrender charges, and retain the cost evaluation in the trustee's records.

The decision to purchase a commission-paying product may result in acquisition of a policy that offers little or no cash value for a lengthy period of time or the period of the contract. The trustee shall determine if the level of risk posed by illiquidity is appropriate to the purpose of the trust and the risk tolerance of the beneficiaries.

- **Underwriting Risk:** The trustee shall employ a Request for Proposal (RFP) process to solicit preliminary pricing inquiries from underwriting departments. The RFP will set out policy design parameters based on an actuarially-certified Benchmark Model Report, and evaluate proposals by comparison to the Benchmark Model. *(Note: The RFP process is especially important for the purchase of larger policies that involve reinsurance companies.)*

Delegation of Responsibilities: The trustee may delegate trust administration and operation responsibilities to various parties as described below:

Trustee: The trustee shall be responsible for the safe custody and investment of trust assets. The trustee's responsibilities include:

- Ongoing consultation with the grantor-insured to verify objectives, health status, and beneficiary needs;
- Determining an appropriate investment strategy to achieve the grantor's objectives;
- Monitoring investment performance to assure that performance results meet the guidelines set forth in this statement;
- Receiving all contributions and paying all benefits under the terms of the trust documents; and
- Performing administrative functions and fiduciary duties required of a trustee under applicable law and regulations.

Attorney: The attorney shall be responsible for performance of all tasks required under the terms of the engagement with his or her client in a manner which complies with the standards of practice prevailing in the community at the time such services are performed. The attorney's responsibilities include:

- Drafting and review of trust documents to determine that they are suitable and appropriate to the needs and objectives of the grantor-insured;
- Review of ownership and beneficiary designations of all trust-owned assets to determine that they confirm with the planning objectives of the grantor-insured; and
- Review of any transfers of existing assets to the trust to determine the tax and legal consequences thereof. This review encompasses any policy exchange that seeks to comply with the rules and IRC §1035.

The attorney shall not be responsible for rendering opinions that may be deemed to be investment or insurance advisory opinions.

Investment Advisor/Insurance Analyst: The advisor/analyst shall assist the trustee with the development and implementation of the Investment Policy Statement. The advisor/analyst shall be responsible for performance of all tasks required under the terms of the engagement with the trustee, including:

- Determining the amount of insurance required to meet the goals and objectives of the trust;
- Recommending suitable insurance carriers;
- Evaluating the risk/reward tradeoffs of selected insurance carriers;
- Determining appropriate policy types, designs, and funding levels;
- Supervising the life insurance agent to facilitate underwriting and policy implementation; and

- Monitoring and evaluation of the insurance portfolio's performance.

Life Insurance Agent: In addition to complying with the duties imposed by applicable insurance licensing regulation, the life insurance agent shall assist the trustee and advisor/analyst to apply for, underwrite, implement and service appropriate insurance contracts. The agent shall be responsible for performance of all tasks under the terms of the engagement with the trustee, including:

- Disclosure of any employment contract constraints, compensation schedules and other provisions that may materially influence the information and advice provided to the trustee, grantor, or other members of the estate planning team. The investment advisor/life insurance analyst shall provide a disclosure checklist for agent completion and retention in the attorney's and trustee's files;
- Provision of financial data and independent rating-company evaluations of selected carriers, contract illustrations, and other data necessary for the trustee to evidence "the exercise of reasonable care, skill and caution" required by law. The advisor/analyst shall consult with the agent regarding the scope of such materials and shall evaluate these materials.
- Investigation into health, avocation, and financial factors which may have significant affect on the pricing of insurance contracts so that the trustee can determine that coverage is available and is appropriately priced. The agent will consult with the advisor/analyst in the performance of these tasks;
- Completion of applications or pricing inquiry forms to selected insurance carriers, subject to advisor/analyst pre-submission review;
- Delivery of insurance contracts and collection of the premium amounts necessary to implement and sustain coverage;
- Preparation of annual in-force policy illustrations. The advisor/analyst will direct the agent regarding the required information and review such information as part of the ongoing systematic monitoring program; and
- Assistance in all policyholder service activities such as changes in premium schedules, processing of policy loans and distributions, beneficiary changes and so forth.

Policy Monitoring: The trustee intends to prepare/obtain annual reports that will reasonably conform to the standards of performance accounting enumerated in the Fiduciary Accounting Guide promulgated by the American Law Institute – American Bar Association. (*"Performance accounting, as applied in the trusts and estates area, has the twin objectives of promoting full and useful disclosure and fair representation of investment results on client assets and of instilling and maintaining client confidence in the corporate or individual's fiduciary investment abilities. These objectives may be best achieved when the fiduciary includes easily understood performance indicators in the client's periodic fiduciary statements."*) This annual report will compare the policy values reported by the carrier to the policy acceptance benchmark values, and review the carrier's independent ratings. Additionally, the trustee will provide an annual policy monitoring report to beneficiaries that identifies unfavorable trends and establishes a 'watch' period during which the concern will be assessed and, if necessary, corrected to achieve the trust's objectives.

Policy Modification: If continued retention of a policy appears imprudent because of contract underperformance, the trustee shall consider among the following options:

- Increased premium funding for under-performing contracts or decreased premium funding for over-performing contracts;

- Replacement of the coverage and acquisition of a new policy either by IRS § 1035 policy exchange or by other suitable means;
- Election of an appropriate non-forfeiture provision with the option to devote premiums allocated to the policy to acquisition of supplemental coverage of a type and amount suitable to the trust; or
- Disposition of the life insurance benefit either through policy sale, annuity income elections or surrender of the contract for its cash surrender value.

If continued retention of a policy appears imprudent because of a high likelihood that the grantor's gifting program underlying the premium funding will be discontinued, the trustee shall consider among the following options:

- Election of an appropriate non-forfeiture provision; or
- Disposition of the life insurance benefit either through policy sale, annuity income elections, or surrender of the contract for its cash surrender value.

If continued retention of a policy appears imprudent because of carrier downgrades by independent rating agencies, the trustee shall consider among the following options:

- Replacement of the coverage and acquisition of a new policy either by IRS § 1035 policy exchange or by other suitable means;
- Election of an appropriate non-forfeiture provision with the option to devote premiums allocated to the policy to acquisition of supplemental coverage of a type and amount suitable to the trust; or
- Disposition of the life insurance benefit either through policy sale, annuity income elections or surrender of the contract for its cash surrender value.

Review of this Investment Policy Statement: Each time the life insurance policies or other trust assets are reviewed for performance and suitability, the trustee may also review the Investment Policy Statement. If changes are needed, the trustee should revise the Statement and communicate these changes to the trust beneficiaries.

Date

Trustee

Exhibit #1 – Product Suitability Matrix

The following matrix sets out a TOLI trustee’s primary policy acceptance and management considerations, and the annual policy performance verification expected by beneficiaries and their professional advisors.

Trustee Acceptance Considerations Policy Management Features	Guaranteed Products				Non-Guaranteed Products			
	Whole Life	No Lapse Guarantee Universal Life	Level Premium Term	Yearly Renewable Term	Adjustable Life	Universal Life	Variable Universal Life	Variable Life
Premium Schedule	Fixed	Fixed	Fixed Period	Increasing	Flexible	Flexible	Flexible	Fixed
Specified Death Amount	Fixed	Fixed	Fixed	Fixed	Flexible	Flexible	Flexible	Fixed
Account Value Management	Carrier	Carrier	None	None	Trustee	Trustee	Trustee	Trustee
Asset Allocation Required	N/A	N/A	N/A	N/A	No	No	Yes	Yes
Illustration Credibility	Yes	Yes	Yes	Yes	No	No	No	No
Actuarial Evaluation	N/A	N/A	N/A	N/A	Yes	Yes	Yes	Yes
Volatility Simulation	N/A	N/A	N/A	N/A	Yes	Yes	Yes	Yes

Trustee Management Requirements								
Investment Policy Statement	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
TOLI – Specific Procedures	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Product Suitability	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Premium Adequacy Risk	No	No	No	No	Yes	Yes	Yes	Yes
Monitoring Cycle	N/A	N/A	N/A	N/A	Annual	Annual	Annual	Annual
Carrier Solvency Risk	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Monitoring Cycle	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Asset Allocation Review	N/A	N/A	N/A	N/A	N/A	N/A	Annual	Annual
Conversion Review	N/A	N/A	As Directed	As Directed	N/A	N/A	N/A	N/A
Rating and Rider Review	Annual	Annual	Annual	Annual	Annual	Annual	Annual	Annual
Regulatory Review (Institutional)	Annual	Annual	Annual	Annual	Annual	Annual	Annual	Annual

Professional Advisor Annual Verification								
Product Suitability	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Premium Adequacy	N/A	N/A	N/A	N/A	100%	100%	100%	100%
Death Benefit Adequacy	N/A	N/A	N/A	N/A	Yes	Yes	Yes	Yes
Carrier Solvency	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Investment Performance Rebalancing	N/A	N/A	N/A	N/A	N/A	N/A	Yes	Yes

Monte Carlo Simulation and Actuarially Certified Policy Standards Analysis*

Gary L. Flotron, MBA, CLU®, ChFC®, AEP®

In all fair types of evaluation, a comparison must be made to a known, objective (non-subjective), quantitative measurable standard or benchmark. Can we make such a comparison with non-guaranteed life insurance and what do we use as the policy standard or benchmark model? To answer this question, let's go back and consider the three main pricing components of life insurance policies: That is, the cost of insurance, i.e. the mortality costs; expenses of administration and operation, including startup costs and commissions; and, investment returns, the interest credited to the policy or the earnings of separate accounts.

Is a benchmark model available for life insurance? Yes. The Society of Actuaries accumulates and annually publishes actual, current and past, experience data from life insurance companies that represent almost 80% of all life insurance sold in the United States. This data includes mortality experience and policy expenses, including lapse experience. Further, other statistical type studies are available from credible sources from which industry norms may be derived and construed. The data is broken down by not only issue age of policies and sex but by smoking status, underwriting classifications, policy type, policy size, etc. This readily available data allows the construction of statistical expectations for mortality costs and policy expenses from which policy standards can be created as well as policy pricing benchmark models. In fact, Asset Share model software programs used by actuaries to design and price life insurance products have incorporated this type of benchmark model for these two components in life insurance pricing.

However, what do we use as a benchmark for investment returns; either interest credited or the earnings of separate accounts? We already know that policy investment returns are not constant, and, therefore, we cannot use any type of constant return assumption. We also need to consider the volatility of

investment earnings over time. The answer to this investment return question is that we borrow a technique used by corporate trust companies and large investment portfolio managers for over 40 years to statistically estimate probable portfolio returns that is called Monte Carlo Simulation. It is a means of statistically evaluating an unknown future outcome based on numerous random samples of prior experience.

The insurance company's reserve that backs up the cash value of a policy is nothing more than a portfolio of securities. If the policy is a whole life or traditional universal life policy, the general asset account backing up those policies is mostly a fixed income portfolio made up of government and corporate bonds and securities. If the policy is a variable universal life policy, the separate sub accounts - which themselves are portfolios of types of securities – make up the account value of the policy and depend on the asset allocation chosen by the policy owner based on the policy owner's risk tolerance.

Thus, we combine the actuarially certified policy standards for cost of insurance and expenses with the use of Monte Carlo Simulation to derive expected returns which account for volatility. The result is a bench mark model that can predict results to which we can attach a statistical probability of confidence. This benchmark is in effect a generic life insurance policy standard. It cannot be purchased but nonetheless represents industry norms and expectations that can be compared to life insurance company-generated policy illustrations.

To create one hypothetical "trial illustration" we start with the actuarially certified policy standards database for the cost of insurance and policy expenses. Depending on the type of universal life insurance policy, we create a database of past rates of investment returns as far back as the 1920s and up to the present. For example, in the case of an all equity asset allocation variable universal life policy, there is a database of the Standards and Poor's® (S & P) 500 index returns, with dividends, by month from the 1920s to the present. Since regular and variable universal life policies are credited each month with investment earnings we do the same with the "trial illustration" we are creating except the rate of investment return for each month will be randomly selected.

To understand the monthly investment return randomization calculation process, think of all these rates of returns as electronic bingo cubes with a single bingo cube for each monthly return data. To calculate policy values for the first month we randomly select an investment rate of return bingo cube from the database which acts like an electronic drum cage holding the bingo cubes. We calculate the policy values at the end of the first month using the randomly selected “bingo cube” rate of investment return and applying it to the proposed premium payment, face amount of the policy, and, the cost of insurance and expenses from the actuarially certified policy standards database. We replace the first bingo cube back into the electronic drum cage and repeat the entire process for the second policy month, than the third month and so forth, accumulating policy account values along the way. This is done until either the policy matures or the policy lapses due to insufficient policy account values. For example, if we have a 50 year old insured and a policy maturing at age 100 the above process would be repeated 600 times to create one hypothetical trial policy illustration assuming the policy does not lapse. That is, 12 months in a year times 50 years. For variable universal life policies, asset allocations are rebalanced every 12 months. This is how one “trial illustration” is created.

However, one created hypothetical policy trial illustration - even though the investment returns have been randomized for each month of the policy - has no creditability. In order to be statistically creditable we generate 1,000 separate hypothetical trial illustrations. We note the number of times each trial illustration made it to the testing point for premium adequacy and policy sustainability – such as life expectancy, life expectancy plus 5 years, or policy maturity – and count that as a success. We also note the number of times the trial illustrations did not make it to the testing point and count that as a failure. Thus, with these 1,000 hypothetical trial illustrations – each with randomized investment rates of return by month – we are able to compute the probability of a propose premium’s success in adequately sustaining the policy to the testing point we choose.

Let’s consider an actual example. Suppose we have an irrevocable life insurance trust (ILIT) created by Ms. ILIT Grantor, a 52 year old female with an underwriting risk classification of preferred non-smoker, who’s calculated life expectancy is 90.

Fifteen years ago the trust purchased a \$2,000,000 variable universal life insurance policy from XYZ Life Insurance Company when she was 37. Ms. Grantor is an aggressive investor with a high risk tolerance and, hence, has an asset allocation for the policy of 100% equity investments, which she wants to continue throughout the life of the policy. Based on an original policy illustration projected at 10% the planned and current annual funding premium is \$7,250 with premiums being payable to age 99 with the policy maturing at age 100. The account value for the 15th policy year was projected to be \$91,264 in the original policy illustration from XYZ Life Insurance Company. However, the actual account value in the 15th policy year is \$80,000. An in-force policy illustration projected at 10% with the current funding premium shows that the policy will lapse at age 92, two years past Ms. Grantor's life expectancy.

With the past 15 years of market volatility the trustee is concerned with the policy's performance. The trustee wants to know the probability of success of this policy sustaining to life expectancy and to contract maturity. The trustee's risk tolerance is such that he would like to see a 90% probability confidence level for premium adequacy to sustain the policy. He also wants to know, if the current funding premium is inadequate, what would be the correcting premium such that the probability of success would be at least 90%.

We generate 1,000 randomized hypothetical illustration trials to determine the probability of the policy sustaining to the insured's life expectancy of age 90. Of those 1,000 trial illustrations 420 of the illustrations sustained the policy to age 90 and 580 failed to sustain the policy to age 90. Thus, from this we derive a 42% probability of successfully sustaining the policy to life expectancy with the current premium.

Of these 1,000 randomly generated illustration trials the earliest lapse occurred at age 69 and the highest five year concentration range of lapses was between ages 81 through 85. It is interesting to note that the XYZ Life Insurance Company in-force illustration projected a lapse at age 92.

The same process used to create 1,000 randomly generated hypothetical illustration trials to solve for the probability of premium adequacy to sustain the

policy can be “reversed” to solve for the correcting funding premium such that there is a 90% probability that the premium will sustain the policy to the testing point. The correcting funding premium to sustain the policy to life expectancy with a 90% probability in this example is \$16,564, which represents a 128% increase over the current funding premium of \$7,250. Additionally, the pricing deviation of the actuarially certified policy standards for the cost of insurance and expenses from the XYZ Life Insurance Company in-force policy illustration can be calculated and in this example that deviation was plus 2% which is a negligible difference. Interestingly enough was the fact that the average rate of return of the 1,000 randomly generated hypothetical illustration trials was 9.80%. However, this average - like a regular policy illustration – does not account for volatility. Whereas, the correcting funding premium, using 1,000 randomly generated hypothetical policy illustration trials does take into account volatility, and, hence, results in the significant correcting funding premium increase.

In testing whether the illustrated XYZ Life Insurance Company variable life insurance policy will sustain to contract maturity at age 100, we again generate 1,000 random hypothetical illustration trials. Of those 1,000 trial illustrations 230 of the illustrations sustained the policy to age 100 and 770 failed to sustain the policy to age 100. Thus, from this we derive a 23% probability of successfully sustaining the policy to contract maturity at age 100 with the current premium.

Of these 1,000 randomly generated hypothetical illustration trials the earliest lapse occurred at age 70 and the highest five year concentration range of lapses was between ages 80 through 84, statistically comparable to the lapse data derived from testing for sustaining to life expectancy for the current funding premium.

Using the process to solve for the correcting funding premium to sustain the policy to contract maturity at age 100, such that there is a 90% probability that the premium will sustain the policy to the testing point, we find that premium to be \$20,776, or an increase of 187% over the current funding premium of \$7,250. The pricing deviation of the actuarially certified policy standards for the cost of insurance and expenses from the XYZ Life Insurance Company in-force policy

illustration remains at 2% as previously calculated in the testing for sustaining the policy to life expectancy. The average rate of return of the 1,000 randomly generated hypothetical illustration trials in testing the premium adequacy of the policy sustaining to contract maturity at age 100 was 9.76%, again statistically comparable to the average rate of return derived from testing for sustaining to life expectancy for the current funding premium.

It should be pointed out that the goal of the Monte Carlo Simulation Actuarially Certified Policy Standards analysis is to objectively determine the relative credibility of an illustration as opposed to predicting the actual performance of a specific policy. In addition, the correcting funding premium is not a precise amount and is in no way a guaranteed premium in any sense of the word. Rather it is a suggested revised premium that meets, in the example above, the 90% statistical confidence level requirement. It is a reasonable guess using a more sophisticated approach than a constant average traditional policy illustration. It is to help the client set more reasonable expectations and set the stage for ongoing policy review and management.

All statistical analysis has margins of error, generally in the range of plus or minus 5% or less as is the case with this analysis process. While this tool and technique is not perfect – and improvements and sophistication of the technique and the data behind the technique will improve over time – it is the best method available to set benchmarks for policy expectations that are actuarially certified; and is a far superior tool to the linear, constant assumption policy illustration, which is known to be neither credible nor appropriate for predictive value determinations.

* Full and very grateful acknowledgement needs to be given to Richard M. Weber, MBA, CLU®, ChFC®, AEP® (Distinguished) and Christopher Hause, FSA, MAAA, CLU® of Ethical Edge Insurance Solutions, LLC who are the inventors and developers of the Historical Volatility Calculator software and pioneers in the Monte Carlo simulation and actuarially certified policy standards technique.

Dispute Defensible ILIT Administration and TOLI Policy Evaluation Checklist

by

Lawrence Brody, JD, LLM, AEP® (Distinguished)

Gary L. Flotron, MBA, CLU®, ChFC®, AEP®

Richard A. Schwartz, FSA, MAAA, CLU®

Richard M. Weber, MBA, CLU®, AEP® (Distinguished)

E. Randolph Whitelaw, AEP® (Distinguished)

Dispute Defensible ILIT Administration and TOLI Policy Evaluation Checklist

State Uniform Prudent Investor Act (UPIA) provisions generally place fiduciary-level responsibilities on trustees - whether institutional or personal - yet nowhere has there been as much a “disconnect” between duties and activity as with Irrevocable Life Insurance Trust (ILIT) policies. Fiduciaries are expected to demonstrate a prudent and reasoned asset management process to maximize the probability of a favorable outcome to the trust estate, and yet it is estimated that 90% of Trust-Owned Life Insurance (TOLI) policies are administered by unskilled trustees who lack life insurance and policy management expertise, and have likely volunteered to the task out of friendship or family duty. No matter how well-intended, unskilled trustees provide minimal, if any, credible performance monitoring of these life insurance policies, and are in turn vulnerable to questionable unwarranted policy replacement proposals¹.

An ILIT involves the interaction of a number of parties with different responsibilities and loyalties. As a ‘buy-and- manage’ financial asset, life insurance carriers and their contracted agents provide the ‘buy’ function, but not the management function. As a result, it is essential for ILIT beneficiaries or their representatives to understand the role and requisite expertise of each party. Further, since delegation of the life insurance product and policy evaluation expertise is to be expected, vendor “due diligence” at the time of selection and annually thereafter, is critical in demonstrating and documenting informed asset management determinations and a dispute defensible process.

The purpose of the following checklist is to summarize how an ILIT fiduciary - skilled or unskilled - can nonetheless document a prudent ILIT administrative process that can in turn facilitate dispute defensible policy evaluation determinations.

Checklist

Trust Agreement Administration: Most attorneys provide the grantor and trustee with a memo that summarizes all administration activities and, often, the form they

¹ 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.

should take. Is this Memo available and does it set out criteria for the management of life insurance assets and annual accounting to trust beneficiaries?

Trust File Documentation: As a minimum, the ILIT file should contain a

- (1) copy of the attorney memo,
- (2) signed copy of the trust agreement,
- (3) policy contract and a signed copy of the ‘as sold’ policy delivery illustration,
- (4) current TOLI Investment Policy Statement,
- (5) signed grantor letter guidance at the time of policy issue concerning the policy purpose and long-term performance expectations,
- (6) carrier and product suitability evaluation prepared and signed by the writing agent that summarizes
 - (a) carriers and products considered,
 - (b) specific reasons for the selected carrier/product,
 - (c) performance risks that require annual monitoring,
 - (d) form of analysis appropriate for this monitoring, and
 - (e) compensation earned (including commission, override and office support),
- (7) copy of annual performance monitoring reports, and
- (8) copy of annual beneficiary communication.

‘Hold Harmless’ Protection: If the Trust Agreement or Trustee arrangement or state statutes provide for ‘hold harmless’ protection, how are customary asset management decisions made, recognizing that the trustee has the sole responsibility for trust and asset management decisions? If the Trust Agreement has a successor trustee provision and the existing trustee is not providing any administrative services, successor trustee appointment should be considered.

Investment Policy Statement: If a TOLI Investment Policy Statement (TIPS) has not been prepared and currently maintained, it should be established and set out carrier and product suitability monitoring criteria. Further, if the ILIT owns a non-guaranteed death benefit policy, the TIPS needs to establish credible and dispute defensible policy evaluation criteria along with vendor screening and annual monitoring criteria. Finally, the TIPS should provide restructure guidance and criteria if the policy becomes un-needed or unaffordable.

Policy Performance Monitoring Evaluation: In 1992, the Society of Actuaries clarified that the purpose of an illustration was only to show how a policy works, not to provide predictive value and policy comparison determinations. In 2006, the 4-Part ACTEC article explained in detail the inappropriate use of current assumption illustrations as well as the appropriate use of benchmarks and policy standards in making informed fact-based risk management determinations: *“Just as the use of appropriate benchmarks levels the playing field between investment managers and facilitates accurate measurement of investment skills and risks so, also, benchmarks can put competing insurance products on a level playing field to generate meaningful risk/reward insights and comparisons.”*

Policy Restructure: A TOLI policy is usually purchased for a 10-50 year duration. Trust objectives, tax legislation, carrier financial strength and life insurance products continually change. Restructure should be expected especially if the policy is no longer suitable per current trust objectives, or affordable, or needed. The TIPS should set out the restructure process and criteria.

Life Insurance Expertise: If the trustee lacks life insurance carrier, product and policy performance monitoring expertise, this expertise should be delegated to a third-party. A request for proposal should be used for delegation of the policy evaluation function to affirm the credibility of the vendor’s reports. For example, policy evaluation should be fact-based using generally accepted actuarial principles and should not solely rely on in-force or sales illustrations.

Red Flags to Monitor and Consider a Second Opinion:

- An empty trust file;
- A file lacking an annually reviewed Investment Policy Statement;
- Non-existent or infrequent policy performance monitoring reports;
- Policy performance reports that employ subjective ratings such as competitive/non-competitive or “1-to-5” ratings based upon proprietary (aka unexplainable) methodology, or analysis known to be inappropriate for policy comparisons and predictive value determinations;
- An unsolicited policy replacement recommendation, and
- No beneficiary communication.

Initial Client Questions & Document Checklist

(CPAs and Attorneys providing personal or business advice to their clients may want to add the following questions to periodic reviews of client assets.)

1. Do you have life insurance on your and/or your spouse's life - including policies owned by you personally, by a business, by an insurance trust, by a retirement plan, or by a charity?
2. What is the death benefit of the policy(ies)?
3. Why did you purchase the policy(ies) and why that amount(s)?
4. Does the "why" still exist?
5. What kind of life insurance do you have on your life? There are lots of variations - whole life, universal life, guaranteed death benefit, variable, indexed and term.
6. How are you paying the premiums? Out of personal income? Out of an investment portfolio's resources? Gifts to insurance trusts? Or are you *not* currently paying premiums on any of these policies?
7. If there is a life insurance trust - who is the trustee?
8. When is the last time you had the policy(ies) independently reviewed, and what process was utilized for this review? Was the process dispute defensible?
9. How much estate tax do you want to pay?
10. Other than possibly funding estate taxes costs with life insurance, what are you doing to minimize the effect of loss of estate value at death?

If there are policies that should be reviewed, the following information will be very useful. Of course, this information can be independently obtained from the insurance company if not readily available from the client:

- Most recent annual statement for each policy
- Initial policy illustration
- Any "in-force" policy illustrations recently provided to you
- Copy of the policy

The Uniform Prudent Investor Act and Trust-Owned Life Insurance: The Impossible Dream or a Match Made in Heaven Suggested Reading List

Gary L. Flotron, MBA, CLU®, ChFC®, AEP®

The following list is comprised of readings that I have found to be exceptionally beneficial and interesting to the overall topic of the Uniform Prudent Investor Act (UPIA) and trust-owned life insurance (TOLI). This reference list will be useful to anyone interested in exploring the subject matter in more depth.

The first two articles are by my good friend Randy Whitelaw who was one of only two expert witnesses for the plaintiff in the Cochran v. KeyBank case. Both articles deal with practical solutions and techniques for the unskilled irrevocable life insurance trust (ILIT) trustee to manage and prevent trust insolvency and the lapsing TOLI policy crisis:

E. Randolph Whitelaw, AEP® (Distinguished), "How to Relieve the Plight of Unskilled Irrevocable Life Insurance Trust Trustees Unfamiliar with Their Duties," *Journal of Financial Professionals*, Volume 68, No. 2, (March 2014)

E. Randolph Whitelaw, AEP® (Distinguished), "The Need for a Fresh Look at Irrevocable Life Insurance Trust (ILIT) Fiduciary Practices," *Estate Planning Section Newsletter*, August 2014, Society of Financial Service Professionals

In my opinion, every professional adviser, no matter what his or her particular discipline is, needs to read the Harvard College v. Amory case. This is the 1830 case that created the "Prudent Man Rule" which became the "Prudent Investor Rule" that later revolved into the Prudent Investor Act and then UPIA. What is amazing about this case is how readable it is and how insightful Judge Putnam's analysis is. The case speaks of balance between income and principle and risks. However, the term risk is not used but instead is referred to as hazard: "Do what you will but the capital is at hazard." The case also speaks of how the trustee is not liable for trust decisions in hindsight provided the trustee's decisions were conducted "honestly and discreetly and carefully, according to the existing circumstances, in discharge of their trusts." The court notes: "If this were held otherwise, no prudent man would run the hazard or losses which might happen without any neglect or breach of good faith:"

Harvard College v. Amory, 9 Pick (Mass.) 446 (1830)

While all of the individual statues of UPIA are contained in the PowerPoint presentation, including the preface to UPIA, the comments to some of the individual statues, which are mostly short, are contained in this original model act publication. Also, the basis for UPIA was

the *Restatement (Third) of Trusts*, which is not cited here but contains lengthy detailed analysis for each of the resulting individual sections of UPIA:

National Conference of Commissioners on Uniform State Laws, *Uniform Prudent Investor Act (UPIA)*, 1994

The following two articles provide an excellent historical reference for UPIA. The Shattuck article, written in 1951, discusses the historical background for the prudent man rule decision and the evolution – and, indeed, abandonment of the principles of – the prudent man rule. The Schanzenbach and Sitkoff article discusses, among other things, the influence of Harry Markowitz’s “Modern Portfolio Theory” on UPIA and *Restatement (Third) of Trusts*:

Mayo Adams Shattuck, “The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century,” *12 Ohio State Law Journal*, Page 491-521 (1951)

Max M. Schanzenbach and Robert H. Sitkoff, “The Prudent Investor Rule: A Theoretical and Empirical Reassessment,” Unpublished White Paper at <http://www.utexas.edu/law/wp/wp-content/uploads/centers/clbe/schzenback-the-prudent-investor-rule.pdf>

The Trent S. Kiziah article is a thorough discussion and comparison of the various state statutes that attempt to exculpate unfunded ILIT trustees in the management of life insurance in these trusts:

Trent S. Kiziah, “Statutory Exculpation of Trustees Holding Life Insurance Policies,” *47 Real Property, Trust and Estate Law Journal*, Fall 2012, Pages 327-365

The following list of articles are excellent commentaries on each the four cases that involved UPIA and TOLI, and all of them can be found on the LISI (Leimberg Information Services, Inc.) website:

Patrick J. Lannon and Barry D. Flag, “Cochran v. KeyBank – TOLI Case Law Guidance (Part 1 of 2),” *LISI Estate Planning Newsletter #1486* (June 9, 2009), at <http://www.leimbergservices.com>

Barry D. Flagg and Patti S. Spencer, “Cochran v. KeyBank – TOLI Case Law Guidance (Part 2 of 2),” *LISI Estate Planning Newsletter #1499* (August 5, 2009), at <http://www.leimbergservices.com>

Lee J. Slavutin, MD, CLU®, “Slavutin on French v. Wachovia Bank: Beneficiaries of ILIT Unsuccessfully Sue Trustee for Breach of Fiduciary Duty Over 1035 Exchange Causing ILIT to Lose Over \$846,000 in Cash Value,” *LISI Estate Planning Newsletter #1960* (May 15, 2012), at <http://www.leimbergservices.com>

Stephan R. Leimberg, "French v. Wachovia Bank: Bank Did Not Breach Fiduciary Duties," *LISI Estate Planning Newsletter #2117* (July 22, 2013), at <http://www.leimbergservices.com>

L. Paul Hood, Jr., "Paradee v. Paradee: Breach of Trust Results in Estate Planning Disaster," *LISI Estate Planning Newsletter #1749* (January 5, 2011), at <http://www.leimbergservices.com>

Howard Zaritsky, "Howard Zaritsky on Rafert v. Meyer: Nebraska Supreme Court Rejects ILIT's Attempt to Excuse Trustee from Duty to Maintain Policies and Inform Beneficiaries," *LISI Estate Planning Newsletter #2286* (March 2, 2015), at <http://www.leimbergservices.com>

Lee J. Slavutin, MD, CLU®, "Lee Slavutin & Practical Guidance for ILIT Trustees and Their Advisers," *LISI Estate Planning Newsletter #2302* (April 15, 2015), at <http://www.leimbergservices.com>

The following four part ACTEC article series from 2006 is a seminal body of work in the application of the Uniform Prudent Investment Act to trust-owned life insurance. The "Uniform Prudent Investor Act and Trust-Owned Life Insurance: The Impossible Dream or a Match Made in Heaven" various presentations are to a certain extent based on this series of articles and represent an update to such articles:

Kathryn A. Ballsun, Patrick J. Collins and Dieter Jurkat, "Trust Administration of Life Insurance (Part 1 of 4)," *31 ACTEC Journal (2006)*, Pages 280-301, American College of Trust and Estate Council

Kathryn A. Ballsun, Patrick J. Collins and Dieter Jurkat, "Standards of Prudence and Management of the Insurance Portfolio (Part 2 of 4)," *32 ACTEC Journal (2006)*, Pages 66-90, American College of Trust and Estate Council

Kathryn A. Ballsun, Patrick J. Collins and Dieter Jurkat, "Evidencing Care, Skill and Caution in The Management of ILITs (Part 3 of 4)," *32 ACTEC Journal (2006)*, Pages 145-158, American College of Trust and Estate Council

Kathryn A. Ballsun, Patrick J. Collins and Dieter Jurkat, "ILIT Asset Management: The Written Investment Policy Statement (Part 4 of 4)," *32 ACTEC Journal (2006)*, Pages 229-259, American College of Trust and Estate Council

This following "Replacement Checklist (RQ)" form is an excellent checklist as to whether or not a policy replacement is justified. The form starts out with the comment "Replacing an existing life insurance policy with a new one generally is not in the policyholder's best interest." The comments go on to say that "most replacements cannot be justified." However, the RQ needs updating to include no lapse secondary guarantee universal life insurance products and indexed

universal life insurance. The Society of Financial Service Professionals is working on a new version of the RQ but it is unclear as to when the new RQ will be available:

“Replacement Questionnaire (RQ): A Policy Replacement Evaluation Form,” *Society of Financial Service Professionals*, 1992, www.financialpro.org

The following two articles were each co-authored by my close friend the late Bob, or Bobby, Alexander, Larry Brody, and myself; and in the case of the first listed article only, Randy Whitelaw. Part of the first listed article deals with the management of TOLI in the Beneficiary Defective Inheritor’s Trust (BDIT) and is highly based on the material used by Larry Brody, Randy Whitelaw and myself in a panel version of “The Uniform Prudent Investors Act and Trust-Owned Life Insurance: The Impossible Dream or a March Made in Heaven” presentation for the National Association of Estate Planners & Councils 49th Annual Conference and for a subsequent presentation for the Society of Financial Service Professions Video Training Conference. In the second cited article Larry Brody wrote the bulk of the section on Split-Dollar and Premium Financing and I wrote the section on Modern Portfolio Theory and Life Insurance. The later section discusses the application of modern portfolio theory and asset allocations, the nature of different types of life insurance policies, and the nature of assets that are used to fund most BDIT trusts. It also expands on Dick Weber and Chris Hause’s work by doing a thorough analysis of whether life insurance is a separate and distinct asset class, and adds enhancements to their work in creating a portfolio of life insurance policies based on risk tolerances and preference for either lowest outlay or purchasing power protection:

Lawrence Brody, Robert G. Alexander, Gary L. Flotron and E. Randolph Whitelaw, “The Cash Value Beneficiary Defective Inheritor’s Trust: Creating a More Flexible and Comprehensive Wealth Accumulation and Retirement Plan – Advanced Planning Issues, Part 4: Managing Trust-Owned Life Insurance (“TOLI”) – The Uniform Prudent Investor Act (“UPIA”) and TOLI: The Impossible Dream or a Match Made in Heaven,” *New York University Review of Employee Benefits and Executive Compensation 2013*, Chapter 12

Lawrence Brody, Robert G. Alexander and Gary L. Flotron, “The Cash Value Beneficiary Defective Inheritor’s Trust: Advanced Planning Issues – Split-Dollar and Premium Financing Arrangements and Modern Portfolio Theory and Life Insurance,” *New York University Review of Employee Benefits and Executive Compensation 2010*, Volume 2, Chapter 17

Dick Weber and Chris Hause are the co-inventors and co-creators and developers of the Benchmark Policy Standards and Monte Carlo Analysis technique for evaluating non-guaranteed flexible premium life insurance policies. These following two books apply financial and investment management techniques in a very innovative manner to life insurance planning and management and contain some extremely unique and creative ideas:

Richard M. Weber and Christopher Hause, *Life Insurance as an Asset Class: A Value-Added Component of an Asset Allocation*, Ethical Edge Insurance Solutions, LLC, Pleasant Hills, California, 2009, www.ethicaledgeconsulting.com

Richard M. Weber and Christopher Hause, *Life Insurance as an Asset Class: Managing a Valuable Asset*, Ethical Edge Insurance Solutions, LLC, Pleasant Hills, California, 2010, www.ethicaledgeconsulting.com