



LIFE INSURANCE POLICY REVIEW FOR TRUSTEES



Be Life Confident

Life Insurance: Is Not a Deposit of Any Bank • Is Not FDIC Insured • Is Not Insured by Any Federal Government Agency • Is Not Guaranteed by Any Bank or Savings Association

A REVIEW OF STANDARDS FOR TRUSTEES

Life Insurance is an asset that has historically been part of a ‘buy and hold’ strategy used by Trustees, which is similar to how many individuals have viewed their life insurance policies. However, in the past decade, The Uniform Prudent Investor Act (UPIA) and the Office of Comptroller of the Currency (OCC) have established higher standards for trustees.¹ Trustees are fiduciaries, and are held to a higher standard than an individual owning his or her own life insurance policy. Fiduciaries are held to act solely for the benefit of the trust’s beneficiaries, impartially carrying out the trust’s objectives.

The UPIA has been adopted in a majority of states and establishes a more detailed, higher standard of care. This model act states:

“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.”²

The model act goes on to list eight specific circumstances that a trustee shall consider in investing and managing trust assets, and further requires:

“Within a reasonable time after accepting or receiving 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...”³

The OCC establishes standards that apply to national banks. New regulations require, for all trust accounts, and of all trust assets⁴:

- Pre-acceptance review
- Initial post-acceptance review
- Annual review

In summary, both the UPIA and the OCC impose upon a trustee the obligation for all trust assets, including life insurance to:

- Investigate
- Monitor and
- Manage

If the trustee breaches this duty of care and the trust’s beneficiary is monetarily harmed, the trustee could be liable to pay those money damages.

¹ A discussion of the minor state variations is beyond the scope of this piece.

² Uniform Prudent Investor Act, Section 2 (a)

³ Uniform Prudent Investor Act, Section 2 (c)

⁴ 12 CFR 9, Section 9.6

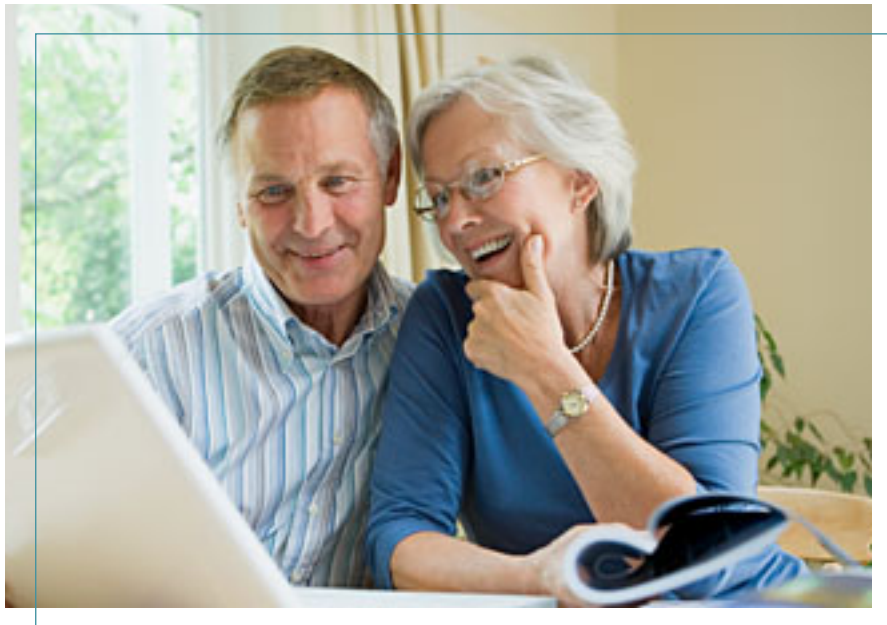
DEVELOP AN INVESTMENT POLICY STATEMENT

Consider developing an Investment Policy Statement (IPS) which establishes the ground rules for the trust assets to be investigated, monitored and managed. At a minimum, the IPS should include:

- Duties of trustee with respect to life insurance (Crummey notices)
- Purpose of coverage, including death benefit needed, with a statement of objectives that is periodically updated
- Type of policy coverage to be purchased based on the designated risk tolerance
- Risk tolerance
- Desired premium schedule, based on the grantor's gifting program

It may also include:

- Asset allocation guidelines
- Required minimum life insurance company ratings
- All current assets and investment options
- Name insurance advisors, investment managers, and custodians
- Any other relevant information not covered above



QUESTIONS TRUSTEES SHOULD ASK

For trusts that have owned the same life insurance for several years, there are several areas that warrant investigating:

Is the policy performing as illustrated? If the policy was first purchased at a time when interest rates were high, it is likely that the initial illustration assumed a relatively high interest rate for the life of the policy. In recent years, interest crediting rates (on universal life) or participating life dividends have been lower. Similarly, the market downturns have affected performance of variable policies. Even small variations from the initial policy illustration will cause a difference over time.

Is the policy sufficient for current needs? A life insurance policy should be monitored to keep pace with the client's changing situation. Invariably, client's life and needs change over time and a different amount of death benefit is needed.

Is there a more competitive policy available? Like any other business, life insurance carriers are continually using market innovations to offer more competitive products. Improved life expectancies, lower mortality costs, better underwriting and expense control continue to drive pricing.

Do newer products offer better features? Newer products can offer an array of features that may better meet the clients' needs. For example, a new generation of products offer 'Secondary Guarantees' contracts guarantee that as long as the scheduled premium is paid, the death benefit is guaranteed for the time specified. This can be to a specified age (90, 95, or even 120 years). New riders are also available, such as return of premium, accelerated death benefits, long term care, and guaranteed death benefit riders.

Is the insurance carrier financially strong and stable? Carriers are rated by several ratings services (Moody's, A.M. Best, Standard and Poor's) for financial strength and stability. A significant change in ratings may signal a need to move to another carrier.

CASE STUDIES

Estate Liquidity Need Has Increased. John and Cathy began their estate planning when their business was doing quite well. They anticipated an estate liquidity need of \$6 million. Over the years, the business has done extremely well and their liquidity need is now \$15 million. As a result of reviewing their situation, they learned that their estate would not have sufficient cash to pay estate taxes and keep the business going. Their trustee is in the process of comparing the choices of adding an additional \$9 million of coverage or purchasing one policy to consolidate costs.

Underperforming UL Policy: Charlie is a 54-year-old whose estate has grown over the years. His irrevocable life insurance trust (ILIT) purchased a \$3.85 million policy 15 years ago. Because interest rates were higher then, the design assumptions showed the premium could be stopped when Charlie is 65. A recent review of the policy revealed that because interest rates had not continued at the initial higher rate, premiums must continue for all of Charlie's life. In addition, the total death benefit of \$3.85 million is short of the \$5 million Charlie now needs for estate liquidity. The trustee was able to find a new policy that offered \$5 million guaranteed death benefit to age 100.

Variable Policy in Danger of Lapsing: Melissa's ILIT purchased a variable product in the mid-1990's, with a feature that the death benefit would increase as the subaccount variable portfolio increased. Unfortunately, the market declined for a number of years. Melissa's trustee recently reviewed the policy and found that it is in danger of lapsing unless substantial additional premiums are paid. Melissa's trustee has found a new policy that gives Melissa the assurance that regardless of future market performance, her policy will stay in force for her life.

More Competitive Product: Rosalie and Al's ILIT purchased a survivorship contract years ago. The premiums needed to maintain the policy have increased over the years, and last year they had to pay gift taxes because the premium exceeded their total available annual exclusions. They wanted to look into alternatives to prevent having to pay gift taxes in the future. Their health is still good, and the trustee was able to find a new survivorship policy for a slightly higher death benefit and the premiums were able to fit within their allowable annual exclusions.



CONTACT YOUR FINANCIAL PROFESSIONAL

As a fiduciary, it is important to conduct a review of the policies you oversee. The policy may not be performing to meet current needs and the insurance industry has experienced numerous changes over the years creating newer products that may meet the needs of your clients more effectively. Your financial professional/insurance licensed agent can provide a policy review to help you determine the next steps for you and your clients.

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