Life Insurance:

Your Blueprint for Wealth Transfer Planning

Trust Owned Life Insurance (TOLI) Producer Guide

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The Estate Planning Market Has Expanded

Your state legislature may have quietly expanded the estate planning market in a manner that can help you find more estate planning sales. During the last 15 years 90 percent of states have increased the duties required of trustees in managing trust assets. These increased duties are important to trustees of irrevocable life insurance trusts (ILITs) and as a result ILIT trustees may need to consider purchasing new policies to meet these new state standards.

In addition to changes in the demands being made of trustees, ILIT trustees are attractive prospects because they are already:

- Experienced with life insurance policies
- Committed to purchase at least one policy
- Setting aside money to pay policy premiums
- Able to benefit from the advice of a life insurance professional
- Vested with a strong personal financial interest in taking action.

The policies in these ILITs are often called TOLI policies (**"TOLI" is a nickname for Trust Owned Life Insurance**). Over the last fifteen years, three trends have converged to make it possible to sell new TOLI policies to ILIT trustees:

- **Performance of policies currently in ILITs** – Many policies may not have performed as well as illustrated at the time they were originally purchased.
- **Development of more efficient policies** – Insurance companies have developed new policies, many of which have valuable features unavailable at the time the original policy was purchased. These new policies may provide ILIT trustees with lower premiums, higher cash values and some performance guarantees.
- **Changes in trustees' legal responsibilities** – Many states have adopted new laws (i.e. the Uniform Prudent Investor Act) which change the duties of trustees. These changes require much more active management from the trustee and have increased the potential for a trustee to be held personally responsible for failing to properly manage the trust.

The Demanding Job of the ILIT Trustee

The trustee's job of managing an ILIT may appear relatively simple on the surface. We know that the trustee has to send out the Crummey withdrawal notices, pay the policy premiums while the insured is alive, and collect the death benefits when he or she dies. However, that is deceptively simple and managing an ILIT can be much more complicated.

The trustee of an Irrevocable Life Insurance Trust (ILIT) is a "fiduciary" who is responsible to the beneficiaries for the trust's performance. As a fiduciary, he or she can be held to a very high standard in managing the trust's assets. Serving as the trustee of an ILIT can be quite demanding because life insurance policies are complex financial products. Trustees who do not have a working knowledge of life insurance products may have difficulty in analyzing different policies to determine how well they are performing and which one(s) may be best suited for the trust.

Challenges an ILIT trustee can face are:

- Following the rules of a trust they did not write
- Managing life insurance policies they did not select
- Having to pay premiums with money the trust does not yet have
- Inability to revise the terms of the trust.

Many trustees are not aware they may be held personally responsible if something goes wrong with the trust. If the trust does not work out as the beneficiaries expect, they may demand that the trustee pay for any shortfall. In today's litigious world, **serving as an ILIT trustee can be hazardous to a trustee's personal wealth**.

ILIT trustees may be called upon to deal with many types of difficult situations:

- Funds to pay premiums may not come into the trust
- A life insurance policy may not perform as originally illustrated
- The original policies may become outdated as new policies with potentially more benefits become available
- Federal and/or state tax law changes may negatively impact the policy or the trust
- Personal developments in the life of a beneficiary may create an "emergency" that needs attention.

New State Laws Change the Rules of Trust Administration

For many years, most states had laws requiring that trustees meet the standards of the "Prudent Man Rule" when investing the trust's assets. Under this rule the trustee had to treat each asset separately and manage each one to preserve its value. This rule provided that asset preservation was more important than asset growth. Trustees could only be personally liable if an asset lost value. This philosophy encouraged trustees to invest conservatively to preserve principal; diversification of trust assets was not required. In fact, trustees were not encouraged to get the advice of professionals to help them manage trust assets because they could not delegate their duties to others, even those who were smarter and who had more experience.

In 1994, the Uniform Prudent Investor Act (UPIA) was introduced and states began to adopt it. It replaced the Prudent Man Rule with the "Prudent Investor Rule." The Prudent Investor Rule applies modern investment practices to trust investments. Rather than focus on assets individually, the Prudent Investor Rule requires the trustee to manage all the trust assets together as a single portfolio. It requires the trustee to position the trust assets in a combined strategy to produce a reasonable total return. Diversification of assets is now strongly encouraged. The performance of individual assets is secondary to the combined performance of all the trust assets as an integrated portfolio. Hiring professionals to advise the trustee is encouraged.

Most state legislatures have adopted some form of the UPIA since it was introduced in 1994. Trustees of trusts domiciled in those states that follow the UPIA must obey the Prudent Investor Rule in managing the trust's assets. The specific language of a trust dictates whether the UPIA applies to it. The trust usually contains a paragraph or section declaring which state's laws should be applied in administering and interpreting the trust. The state(s) where the grantor, the trustee or the beneficiaries reside may be irrelevant. The standards in the UPIA are "default" standards. They are used if the trust document does not establish other standards for the trust to follow. More than 40 states have adopted some form of the UPIA.

Impact of the UPIA

Under the outdated Prudent Man Rule, the trustee's job was relatively simple – just maintain the current policies owned by the trust. This is known as the "buy & hold" strategy. In states that have adopted the Prudent Investor Rule of the UPIA, the buy & hold strategy may no longer work. *The trustee needs to check both the trust and state law to determine his or her exact responsibilities*. In most states, the UPIA has dramatically changed the trustee's duties. If the trust involved is an ILIT, the trustee may not be able to passively maintain the life insurance policy(ies) the trust currently owns. Instead, the trustee should actively review the policy(ies) to make sure it provides reasonable value for the beneficiaries. Any policy that is underperforming should be evaluated. The trustee should also survey the marketplace to see if better policies are available that would increase the ILIT's total return.

The UPIA generally applies to all trusts, even "old" trusts that were created before the state adopted the UPIA. Unless the trust states otherwise, the UPIA changes the trustee's duties from the date it was enacted onward. This means that trustees of "old" trusts should revise their practices to meet the new standards.

But, trustees do not have to be experts in life insurance to perform their duties. The UPIA generally allows them to hire professionals to make recommendations on how they should handle trust assets. As long as the people they hire are professionals and they are properly supervised, the trustee can accept and implement their recommendations without great fear of personal liability. Of course, hiring experts costs money. In an ILIT, this money can come from new contributions to the trust or from policy cash values.

Trustees Need to Protect Themselves

To reduce the risk of personal liability and maximize the benefits for the beneficiaries, an ILIT trustee may use strategies like these:

- Create a written investment policy explaining how the trust assets will be managed.
  This written statement is often known as an Investment Policy Statement (IPS).
- Regularly review the trust's life insurance policies and track their performance.
- Review the marketplace to see if better policies are available.
- Hire a professional(s) to assist with reviewing the trust's life insurance policies.

The Investment Policy Statement

One of the biggest duties the Prudent Investor Rule imposes on trustees is the need to create a formal investment policy. This formal investment policy should be put in writing. An Investment Policy Statement (IPS) is a written statement of the investment practices the trustee intends to use in managing the trust assets. In a state that has adopted the UPIA, the need for an IPS applies to all varieties of trusts.

An IPS is not a legal agreement. Rather, it is a statement by the trustee of how he/she/it expects to manage the trust assets in order to meet the trust's objectives. An IPS is a flexible document that can be changed at any time to improve the manner in which the trust's investments will benefit the trust beneficiaries.

There are many ways to write an IPS. It may address a variety of issues for the trust. ING has created a specimen IPS to demonstrate one of the possible ways an IPS could be drafted. It is entitled: "A Trust Investment Policy Statement." This prototype was created for an irrevocable trust that was designed to invest exclusively in life insurance (an ILIT). There is no preferred specimen form or IPS template that is commonly used. Each IPS has to be created for the specific trust and beneficiaries involved. The trustee's investment advisor or tax advisor may have useful insights that may help the trustee in drafting the IPS customized for that trust.

The IPS can be useful to a trustee in two ways. First, it serves as a guide in making investment decisions for the trust during the years of trust administration. Second, if the procedures in the IPS are reasonable and have been followed, the trustee has proof of his or her compliance with the UPIA, regardless of the trust's eventual investment results.

Tracking Policy Performance

Monitoring the performance of the life insurance policies owned by the trust is a crucial part of an ILIT trustee's responsibilities under the UPIA. This is important in determining if any policy is underperforming as well as in evaluating whether a new policy may provide greater benefit to the trust.

The following is a sequence of steps that can be used to evaluate an ILIT's current life insurance policies and to assess their performance:

- Obtain and review inforce policy illustrations.
- Compare inforce illustrations to the original illustration issued when the policy was purchased.
- Compare to previous years' inforce illustrations to determine performance trends.
- Assess policy performance to date and estimate likely performance in the future.
- Review the current ratings of the insurer; note any changes since the last review.
- Complete and submit an application for one or more new policies from an insurer whose ratings meet the standard in the Investment Policy Statement.
- Compare the projected premiums, death benefits, cash surrender values and provisions of the current policy(ies) with any new policy(ies).
- Assess the competitiveness of the current policy with potential new policies.
- Decide whether to add, subtract or exchange policies owned by the trust.
- Document all actions made in this review process.
- Re-evaluate all trust-owned policies every two to five years.

Diversification and the ILIT

The UPIA applies modern portfolio theory to the investment of trust assets. Diversification of the trust assets into different asset classes is a strategy that is commonly used in creating modern investment portfolios. In many ILITs, however, the use of diversification may reduce rather than improve the trust's performance. There are two ways the trustee could choose to diversify. First, he or she could diversify among different varieties of life insurance products (i.e. term, whole, variable, and universal life policies). This can be a questionable strategy because some types of life insurance are not well suited for an ILIT. With term insurance, for example, the insured may outlive the term of the policy and it may not be possible to convert the term policy into a cash value policy. With variable life, the cash value sub-accounts produce returns that can be volatile, and could underperform the hypothetical returns in the illustration. This could result in a smaller-than-expected policy death benefit.

The second way to diversify is for the trustee to purchase policies from different insurance companies. For example, a trustee who needs a $3,000,000 total death benefit could purchase a $1,000,000 policy from three different insurers. This can make sense when the ILIT needs a large amount of total coverage (i.e. $5,000,000 or more).

A trustee who chooses not to diversify among different carriers may be vulnerable to criticism. In such cases, the trustee may be able to protect him/herself by addressing the diversification issue in the IPS. In most states, the trustee need not diversify trust investments if there are "special circumstances" in which diversification would likely reduce the total investment return. Purchasing several policies to diversify the life insurance coverage may trigger such "special circumstances" by increasing the total cost of the coverage, and increasing the cost to administer the trust. Furthermore, there is a possibility that the insured may not be willing to undergo multiple physicals and underwriting procedures from different insurers. In these cases, the trustee needs to address the diversification issue and state why he or she made the decision not to spread the coverage among several carriers. If the trustee has hired a life insurance professional to advise him or her on this issue, the professional's recommendation can be included in the IPS.

ILITs in Non-UPIA States

Most states that have not yet adopted the UPIA still use the Prudent Man Rule as the fiduciary standard for measuring a trustee's performance. The Prudent Man Rule does not prohibit trustees from actively managing the policy(ies) in the ILIT; it simply does not require them to do so. There are at least three reasons why an ILIT trustee in a non-UPIA state should consider using UPIA-like strategies:

- It is quite possible that state will adopt the UPIA and change the fiduciary standard within the next several years; the trustee can position him/herself to meet this change early.
- Using the UPIA's active approach to manage the policies may produce greater benefits to the trust beneficiaries than the "buy & hold" strategy of the Prudent Man Rule. (By the way, that is why so many states have adopted the UPIA.)

- Some of the new life insurance products available in the marketplace may actually *increase the trustee's personal security in non-UPIA states*. Trusts that have underperforming policies may lapse before the insured's death. A policy that lapses pays no death benefits; this is a loss under the Prudent Man Rule, for which the trustee could be held responsible. Today's secondary-guarantee universal life policies present an attractive alternative. By switching to one of these policies, the trustee gets much more assurance that the trust will receive life insurance death benefits. In these policies, the insurer gives the trustee a guarantee that if certain conditions are met, the policy death benefit will be paid. Secondary-guarantee products can be very attractive to ILITs in both UPIA and non-UPIA states.

Avoiding the UPIA Standards in "New" ILITs

A grantor creating an ILIT may not want the trustee to be held to a high fiduciary standard (i.e. not have to worry about the Prudent Investor Rule). When this is the case, the grantor can include provisions in the ILIT to avoid this result. If the trust contains specific guidelines for the trustee, then the state's Prudent Investor Rule will be pre-empted and will not be used to define the trustee's duties. For example, the trust can specifically allow the trustee to retain the original policy(ies) the trust purchases. It can state that the trustee has no duty to monitor and track policy performance. It can also state that the trustee has no duty to search the marketplace to see if "better-performing" policies become available during the course of the trust's administration. Of course, it is very rare to find such provisions in existing ILITs. Such provisions can be included in new ILITs that would otherwise be subject to the Prudent Investor Rule.

Marketing the TOLI Concept

The TOLI sale can be made with either of two messages: (1) Protecting the trustee from personal liability, or (2) maximizing the value the trust will provide for its beneficiaries.

You can use either or both of these messages to create sales through any of five potential audiences:

- Trustees who administer trusts
- Attorneys who draft trusts
- CPAs, attorneys and others who recommend trusts
- Grantors who create trusts
- Beneficiaries who will ultimately receive the trust's distributions.

Of these audiences, the attorneys who draft the trusts will probably be the easiest to identify, locate and contact. If they like you and believe your message, they can refer you to several grantors, trustees and beneficiaries. Attorneys and CPAs are often asked to serve as trustees. Also, many of them have partners or associates who may be trustees. In dealing with attorneys and CPAs, consider using some of the questions in Appendix I.

It would be nice to be able to go back to all the people you know who created ILITs during the last ten to fifteen years. You could review their situations to see if a new policy might increase the benefits their trust can pass on to its beneficiaries. You could then get referrals to all the ILIT trustees your attorney and CPA centers of influence have set up over the last ten to fifteen years. That is the potential in the TOLI sales opportunity. It expands your sales potential in the estate planning marketplace by possibly giving you access to estate planning cases that were sold many years ago.

You will not be dealing with people who are merely considering whether they should set up their first ILIT. ILIT trustees have already purchased policies and paid years of premiums. You have the opportunity to disturb them and demonstrate how you may be able to enhance the value of their trusts and reduce their potential personal liability.

ING's TOLI Marketing Materials

Several unique marketing materials have been created to help you take advantage of the TOLI sales opportunity:

1. **The Demanding Job of an ILIT Trustee (#136772)** — This brochure is designed to explain the trustee's potential problem of personal liability and describes strategies the trustee may use to minimize the problem.

2. **Get the Most from Your ILIT (#136771)** — This brochure is designed for ILIT grantors and beneficiaries. It explains the need for a formal investment process and offers to help the trustee maximize what the trust delivers to its beneficiaries.

3. **A Checklist for ILIT Trustees (#136770)** — This piece is designed to help the trustee summarize the facts about the trust. It also suggests a series of steps for managing the ILIT's life insurance policies.

4. **A Trust Investment Policy Statement (#136769)** — This piece is a sample Investment Policy Statement (IPS) for an ILIT. The trustee may consider the language to create a custom written IPS for his or her trust.

5. **TOLI Presentation on ING Presents** — Approved for use with the public, this presentation can be made to trustees, grantors, or beneficiaries to explain the TOLI opportunity.

6. **Questions Trustees May Consider in a Policy Review Analysis (#147448)** — This series of questions can help a trustee evaluate the trust's current life insurance policies.

7. **Life Insurance Policy Review Factfinder for Trustees (#147449)** — This factfinder helps the trustee gather important information about the trust.

The TOLI concept can help you provide a wonderful service to ILIT trustees and beneficiaries. ING has highly competitive life insurance products that can provide excellent value to ILIT trustees. Couple these products with ING's new TOLI marketing materials and you have a powerful combination. If you have questions about TOLI sales opportunities or other life insurance subjects, call ING Life Sales Support at 866-ING-SELL (866-464-7355).

Appendix I

Sample Questions for Attorneys

This approach can also work with CPAs and other tax advisors. The main difference is that, unlike attorneys, they do not draft the trust documents. However, they can advise clients to set up trusts and they can serve as trustees.

Mr. or Ms. Attorney, I work with trustees of established trusts. I counsel them on how to invest the trust's assets in ways that meet their duties. As you know, trustees are fiduciaries under the law and are held to a very high standard in managing trust assets for the beneficiaries.

Question #1

Who in your firm drafts wills and trusts for clients to use in their estate planning? Does your firm draft and implement irrevocable life insurance trusts (ILITs)?

Question #2

What state law is usually specified in these trusts as the standard for making, interpreting and administering the trust? (AL, DE, GA, KY, LA, MS are non-UPIA states; all other states have adopted all or part of the UPIA.)

Question #3

Most states have adopted the Uniform Prudent Investor Act and its "Prudent Investor Rule" as the standard for investing and managing trust assets. The Prudent Investor Rule generally requires the trustee to have a written investment procedure in place and be able to document that the procedure has been followed. Without a written procedure and documentation, the trustee has an increased risk of personal liability if something goes wrong in the trust. Do you or your firm advise new trustees about their fiduciary responsibilities and the potential financial risks of serving as a trustee? What do you tell them?

Question #4

Are you or any of your partners or associates trustees of any trusts? Any Irrevocable Life Insurance Trusts (ILITs)?

Question #5

When you or your partners serve as a trustee, do you have any formal procedure that you use to show you complied with the Prudent Investor Rule? Do you have a checklist listing the things you have to do? Do you have an Investment Policy Statement for the trusts you are responsible for?

You might want to review your states' trust administration rules. Many states have recently increased the standards trustees must satisfy in administering trusts. I may be able to help you, your partners and the trustees of the trusts that your office creates to better understand and limit some of their risks in acting as a fiduciary.

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