



**TAC**  
Trust Asset Consultants, LLC

TOLI Fiduciary Risk Management Consulting • The TOLI Center • Large Case Specialty Analysis and Products • Litigation Support

Premium Adequacy Percent - 0%  
1,000 Random Trial Illustrations

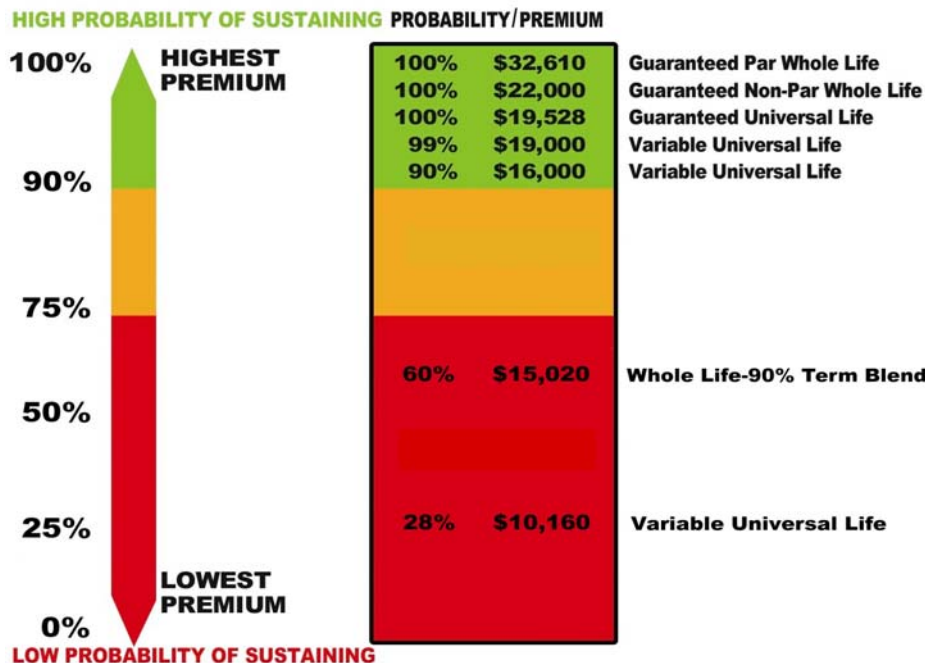
0%  
■ Sustains  
■ Does Not Sustain

## Actuarially Defensible Policy Evaluation

Defensible TOLI product suitability determinations require credible policy evaluation and appropriate comparisons. To meet this test, a trustee's policy acceptance, management, and restructure evaluation of non-guaranteed policies should be based on actuarially defensible policy evaluation.

Actuarial evaluation uses generally accepted actuarial standards, 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.

- **Premium Adequacy:** If the probability is less than 100% or the trustee's risk tolerance, actuarial evaluation calculates the risk-appropriate premium adjustment.
- **Policy Comparisons:** If a TOLI policy warrants restructure, actuarial evaluation facilitates a credible analysis of restructure options as shown in the following graphic.



"Just as 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." (ACTEC Journal, *Evidencing Care, Skill and Caution in the Management of ILITs.*)

## Carrier Illustration Primer

It has been “knowable information” since 1992 that carrier illustrations for indeterminate “flexible” premium non-guaranteed policies do not evaluate premium adequacy, disclaim predictive value, are not appropriate for policy comparisons, and do not assess the reasonableness of agent and carrier controlled hypothetical assumptions. The purpose of a carrier illustration for an indeterminate premium policy is only to depict how the policy works.

## The TOLI Center Outcome Probability Analysis<sup>sm</sup>

Our reports for non-guaranteed policies are actuarially certified. We use a benchmark model against which a carrier-generated illustration can be compared to determine its mispricing risk (failure of scheduled premiums to fund projected non-guaranteed benefits).

## Variable Universal Life Policy Evaluation

Variable universal life (VUL) policies offer a TOLI trustee the added policy management flexibility to asset allocate premium payments and the policy accumulation account. Over the long-term, a VUL equity allocation should be more favorable than a UL fixed income return so that VUL requires less premium outlay. However, this risk-return trade-off analysis is not customarily available to a trustee because carrier illustrations assume a constant crediting rate. A trustee familiar with modern portfolio theory and accustomed to using credible portfolio modeling knows that investment returns are *never* constant.

Volatility simulation allows a trustee to “test” the premium outlay implications of different asset allocation strategies over a 10 to 50 year time horizon depending on the insured’s age. For example, the volatility of an 80/20 equity/fixed income allocation may require less premium outlay than an all-equity allocation.

Asset allocation strategy can be used to volatility-test the reasonableness of an illustration’s gross crediting rate assumption. For example, our Sample VUL Policy Management Report evaluates an illustration with an 8% hypothetical gross crediting rate and \$50,000 annual premium payment. The constant rate illustration projects this premium will sustain the policy to insured age 99. By comparison, an 80/20 asset allocation calculates only a 21% probability this premium will sustain the policy to contract maturity, and predicts the earliest policy lapse at insured age 83.

Our benchmark modeling process integrates volatility simulation so that a trustee can clarify the grantor’s premium risk tolerance at the time of policy acceptance as well as calculate and communicate risk-appropriate premium adjustments annually thereafter. Further, our VUL **Policy Management Report** summarizes the carrier’s investment subaccounts by asset class and provides return and peer universe performance data.

## Policy Restructure

Replacement or exchange of a TOLI policy warrants special consideration because experts generally concur that replacement is *not* in the client’s best interests. Therefore, the burden of proof rests *solely* with the trustee to demonstrate credible and appropriate policy evaluation, affirm reasonable and appropriate costs, and avoid misrepresentations and factual omissions.

*Note: Illustration credibility concerns for indeterminate premium non-guaranteed death benefit policies were resolved in 1992, and NAIC illustration reform in 1995. For a more comprehensive discussion of carrier illustrations, illustration methodology, illustration marketing practices, and illustration-based replacement recommendations, please refer to our articles or contact E. Randolph Whitelaw.*