TOLI Investment Policy Statement

A TOLI Investment Policy Statement (herein TIPS) is the single-most important document to demonstrate a prudent "best practices" risk management process for new, in-force, and restructured TOLI policy determinations. It safeguards all insurance trust parties – grantor, trustee, beneficiary, professional advisors, and life insurance agent – in clarifying trust objectives, product suitability considerations, beneficiary communication, and expected professional advisor and/or third-party policy performance monitoring assistance.

TIPS is generally prepared and periodically updated by a TOLI trustee to affirm trust operation objectives and procedures to systematically monitor trust asset performance. It is based on the grantor's objectives and expectations as well as guidance set out in the trust agreement and trust operation memo prepared by the attorney drafting the trust agreement. Since an insurance trust may span a 10 to 50 year time horizon, TIPS provides practical guidance in dealing with changes in trust objectives, tax law, grantor gifting capacity, and life insurance products.

Trustee Considerations

TIPS should outline the trustee's policy selection and management process, including asset evaluation criteria. Most institutional trustee, lawyer-trustee, professional advisor co-trustee, and family member personal trustee arrangements delegate the asset management and/or monitoring functions; hence, TIPS should set out the terms of delegation along with the trustee's provider screening and annual monitoring process.

Provider selection warrants special comment. Over the past 25 years, non-guaranteed death benefit policies have become the TOLI policy-of-choice, especially for larger death benefit policies. Most third-party providers lack the expertise to credibly evaluate non-guaranteed policies, particularly "indeterminate" premium adjustable life, universal life, and variable universal life policies. Even fewer providers offer volatility simulation expertise requisite to defensible variable universal life policy management. A trustee is well-advised to <u>annually</u> request provider confirmation that its report is actuarially certified and that premium adequacy evaluations are volatility tested. Finally, a trustee should not rely on a life insurance agent for policy performance monitoring unless the scope of such responsibilities are summarized in the TIPS and contractually affirmed.

Beneficiary Considerations

TIPS serves an essential beneficiary communication purpose that, properly undertaken, evidences the trustee's care, skill, and caution in carrying out a reasoned investment strategy to achieve the trust's purpose and needs of the beneficiaries. The trust agreement typically provides for an annual accounting to trust beneficiaries. TIPS should set out the form of such accounting and facilitate informed annual asset management communication.

If a beneficiary does not have a TIPS copy, it should be requested. A discussion of fiduciary law and

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professional practice management guidance is beyond the scope of this report; however, a written Investment Policy Statement and periodic beneficiary communication (per the trust agreement) are essential to evidencing a prudent process. Moreover, institutional trustees who *"possess a degree of skill greater than that of an individual of ordinary intelligence"* must demonstrate compliance with trust acceptance and asset management guidance set out by their functional regulator. ***If a TIPS and current policy evaluation report are not available, an independent policy evaluation should be obtained to review and update trust objectives, TIPS, and appropriate beneficiary communication going forward.***

Asset Restructure Considerations

The failing TOLI policy crisis usually creates an awkward situation for all insurance trust parties. A lapsed policy likely documents negligence and quantifies damages. A restructured policy recommendation following an unexpected lapse notice often documents a questionable ad hoc determination that warrants an independent second opinion. These situations generally can be avoided with a written TIPS and meaningful annual beneficiary communication.

Approximately 25% of in-force non-guaranteed TOLI policies are estimated to lapse during the insured's lifetime. A "wait-and-see" approach to taking corrective action does not demonstrate prudence. Rather, it seems more appropriate for trustees, beneficiaries, and their professional advisors to update their respective understandings in a TIPS, obtain defensible policy evaluation, analyze product suitability options, and communicate with grantors as appropriate per the trust agreement's "incidents of ownership" protection.

The duty to restructure and duty to delegate combine with the duties of loyalty and competence to undertake a prudent process that maximizes the probability of a favorable outcome to the trust estate. However, insurance regulators and experts concur that policy replacement generally is not in the policy owner's best interest. As a result, the ***burden of proof*** rests solely with the trustee to justify a replacement recommendation. Such justification should be prepared consistent with guidance in the updated TIPS, affirm reasonable and appropriate costs, avoid factual omissions, and confirm the policy monitoring process going forward.

A trustee should ***not*** rely on a replacement recommendation from a life insurance agent without obtaining third-party objective and impartial evaluation. "Trust-Owned" life insurance and its prudent risk identification and management process should not be confused with life insurance and its traditional sales and policy service marketing practices. An "agent" contractually represents the underwriting carrier in fulfilling requirements necessary to receive commission compensation. By comparison, a trustee represents the trust estate and has a duty to use care, skill, and caution in making policy acceptance, management, and restructure determinations consistent with the TIPS. This duty includes defensible policy evaluation, cost analysis (including agent compensation), and disclosure of all material facts resulting in the trustee's product suitability determination.

Lastly, properly drafted, TIPS should provide restructure guidance for several typical failing and/or unsuitable policy situations. For example, (1) a non-commissionable exchange with the existing carrier should be considered to maximize death benefit coverage by avoiding un-necessary costs when accumulation value is already minimal, (2) exchange to a non-commissionable policy underwritten by another carrier should be considered for the same reasons, (3) "no lapse guarantee" riders to UL and VUL policies should only be considered when rider terms are fully understood and policy accumulation value is no longer a TOLI management objective, and (4) policy sale in the secondary market should be considered to determine if its fair market value is more favorable than its accumulation or cash surrender value.

(Note: A sample IPS provided by a life insurance agent should be reviewed to determine if it is appropriate for the trust and provides for defensible policy performance evaluation.)