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TOLI Product Suitability

Product suitability is a TOLI trustee's most important policy acceptance and management decision, and fundamental to the basic fiduciary duty to maximize the probability of a favorable outcome to the trust estate.

The prudent investor rule instructs a trustee to design and carry out a reasoned investment strategy that will fit within the trust's unique purposes and the beneficiaries' expectations to make the trust property productive. The creation of an insurance trust usually results from an analysis of wealth preservation, estate liquidity, and income planning objectives. This economic analysis, prepared by the grantor's legal and/or tax advisor, evaluates the cash flow, liquidity timing, and tax trade-offs of different planning options. Further, it usually confirms the expected death benefit proceeds "return" and acceptable level of premium adequacy "risk", if any. At the time of trust acceptance, a trustee should formalize its reasoned investment strategy in a TOLI Investment Statement.

Guaranteed versus Non-Guaranteed Death Benefit Products

Life insurance is ideally suited for trust ownership and risk management. A trustee can transfer all premium adequacy and policy performance risk to the underwriting carrier by accepting a guaranteed death benefit policy and paying scheduled premiums timely. Alternatively, a trustee can contractually retain these risks by accepting an indeterminate premium non-guaranteed death benefit policy and actively managing policy values (see policy Suitability Matrix on page 2).

"Indeterminate" flexible premium universal life, variable universal life, and adjustable life policies have been the TOLI product-of-choice for the past 25 years, and represent 35% to 40% of in-force TOLI policies. Indeterminate premium policies do not have a "premium" in the conventional sense and carrier illustrations do **not** evaluate premium adequacy risk. TOLI policy acceptance, management, and restructure determinations should be based on actuarially defensible premium adequacy evaluation; hence, most trustees outsource the policy monitoring function.

In-Force TOLI Policy Management

A product suitability determination is implicit with **each** premium payment. Today TOLI trustees are confronted with the failing TOLI policy crisis, as 25% of in-force non-guaranteed policies are predicted to lapse during the insured's lifetime. A lapsed policy usually documents trustee negligence and quantifies damages. This dilemma is due to (1) policy mispricing, (2) mistaken reliance on carrier illustrations for predictive performance decisions, and (3) wait-and-see remediation and restructure decisions.

TOLI product suitability determinations should be based on (1) the trustee's life insurance management expertise and capabilities, (2) the trust's current objectives and premium payment capacity, and (3) the needs and risk tolerance of trust beneficiaries. These factors should be reviewed annually, preferably prior to scheduled premium payment, along with the following considerations:

- If the policy experiences higher than expected expenses and/or lower than expected returns, will the grantor increase the premium gift to the trust necessary to achieve the policy acceptance benchmark values or should the death benefit be reduced to keep the policy in-force?
- Is the policy suitable for the trust purpose and risk tolerance of the beneficiaries? If trust objectives have changed, should a policy exchange or a life settlement be considered?
- Is a variable life policy's current asset allocation strategy appropriate? Are the investment subaccounts performing competitive with relevant asset class benchmarks? Is the annual premium adequacy evaluation volatility tested?

Policy Restructure

A TOLI trustee is expected to review trust policies and, if necessary, “formulate a plan for restructuring the portfolio to achieve a suitable level of risk and expected return.” It is not uncommon for an insurance trust to span a 10 to 50 year time horizon; hence, restructure should be expected as family situations, trust objectives, tax laws, and life insurance policies change. Restructure recommendations should be based on credible policy evaluation and trustee affirmation that costs are reasonable and appropriate.

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 Perf. Rebalancing	N/A	N/A	N/A	N/A	N/A	N/A	Yes	Yes
Term Conversion	N/A	N/A	As Directed	As Directed	N/A	N/A	N/A	N/A

*implicit with each premium payment