Wealth Advisors as Life Insurance Trustee—a Good Idea?

By Jay W. Freiberg, Michael Brohawn and Judith Pearson

The mood in the conference room was somber.

John McArthur, the family attorney for over 25 years, sat at the head of the table. To his right, his clients' firstborn, Natalie, and her attorney. To his left, her sister Kim with her attorney. All were there to discuss a topic that had become a family sore spot.[1]

For many years, John worked with the sisters' parents, crafting an estate plan to pass the family wealth to future generations. At the heart of that plan was a life insurance trust with a $25 million survivorship life policy that would pay its benefit at the death of both parents.

As the estate plan architect, John felt obligated to take the trustee's role in the life insurance trust that held the policy. That was a little over 20 years ago.

While the family patriarch had died seven years back, the matriarch was still healthy, approaching age 94. Unfortunately, the trust policy was not healthy, bringing the group together to discuss the next steps.

None of the options were palatable. Low interest rates had decimated the policy's cash value, and without a large infusion of cash, the policy would lapse in less than a year.

Natalie and Kim first became aware of the issue only a few months back. Over the years, they had given up $15 million in gifts to pay policy premiums, and their first order of business was to ask John how this happened.

Wealth advisors (attorneys, CPAs, family offices, financial advisors) who hold themselves out as trustee—either as an accommodation or for profit—often find themselves in the uncomfortable position of defending themselves.

The Problem

Most permanent life insurance is backed by fixed investments, which have been declining for over 30 years. Today's historically low interest rates have intensified the problem. And low interest rates are not likely to go away soon.

The dissipation of cash value caused by lower than expected interest rates combined with longer life expectancies has left some trustees with policies that will not outlive the insured, leaving grantors and beneficiaries confused and disappointed.

Trustees that have not adequately monitored and adjusted policies during the last 15 years face unpleasant realities that leave them exposed to litigation.

Many non-corporate trustees have neither the expertise nor the systems to adequately monitor and manage life insurance policies that have grown more sophisticated over the years. Some will find themselves at the end of a long table, like John McArthur, trying to explain what went wrong.

Questions to Ask

If you are a wealth advisor who has taken on managing a life insurance trust, you should ask yourself these questions:

- Are you aware of all of the responsibilities of a trustee? Have you documented them so that the grantor and beneficiaries are also aware?
- Do you understand the policies under your care? Are you aware of all of the nuances of today's more sophisticated policies?

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- Have you put in place a prudent process to mitigate your liability? What do you do when you accept a policy? How often are policies reviewed? How do you determine how to maximize the value of a policy when client goals change?
- Do you consider your role as trustee to be active or passive when requesting gift notices to pay premiums? Are you sure the beneficiaries are served well by passing up these gifts?
- Do you have the infrastructure in place to administer the trust?
- Does your liability insurance cover you for your service as trustee? Are you aware of the limitations of your current coverage?

John McArthur took on the role of trustee because he felt obligated to do so as the family's estate planner. But whether you take on the role out of obligation or for a fee, you are taking on a role that requires careful attention to a process and personal liability. Trustees of life insurance trusts, no matter the trust's size, are fiduciaries to the trust beneficiaries. Accordingly, you owe a duty of care and undivided loyalty to your beneficiaries, who rely on you as a trustee to always act for their sole benefit. Carrying out these duties may not be as simple as it seems at first blush.

Every year, the trustee must analyze the policy or policies in the trust to determine whether maintaining the policies as is, modifying or selling them, or allowing them to lapse is in the beneficiaries' best interests. Note that the trustee need not personally have the expertise to make this determination. A trustee may delegate the analysis to an expert. But, this is not the end of the trustee's work.

Indeed, in properly carrying out his or her role, the trustee must demonstrate several prongs of a prudent process. First, the delegation itself must demonstrate thought and the delegatee must be appropriate for the task at hand. Second, the trustee is ultimately responsible for all decisions regarding the policies. While a trustee can delegate functions, the trustee can never delegate decision-making authority. Thus, the trustee must also demonstrate that he or she understood the expert's advice and thereafter acted accordingly.

Finally, note that the trustee does not guarantee an outcome. In fact, John McArthur will have no liability to Natalie and Kim if he or his delegatee properly analyzed the policies each year and thereafter decided to pay the premiums based on a good faith determination that this was in Natalie's and Kim's best interests. And it is extremely important that he document this process. A trustee must prove with contemporaneous notes that he or she acted attentively and solely in the beneficiary's best interest. If so, even if the decision turns out to be the wrong one, the trustee has no liability to the beneficiaries but may have to defend the decision which could be costly.

Insuring Against Liability

Many professional liability policies appear to have coverage for advisors when acting as a trustee; however, the devil is in the details.

- Does the policy require that you serve in your professional capacity? When serving as a trustee, are you serving personally and not in a professional capacity?
- Does the insurance cover all professional services you provide as well as the roles that you serve? As an example, a trust protector is different from a trustee.
- Is the carrier required to defend you in the case of allegations of misconduct?
- Professional service organizations often have large deductibles for their insurance policy. Will the organization indemnify you for the expenses incurred under that deductible?

Your Next Steps

While the role of a trustee is fraught with liability, there are steps that you can take to mitigate that liability.

- Make sure you understand the life insurance policies that you take in. Life insurance policies today are more sophisticated, with many moving parts.
- Make sure the assumptions used at policy issue are reasonable. Permanent life insurance relies on an underlying cash value return. Unreasonable investment assumptions create disappointed clients when the policy underperforms.
- Review each policy annually, and if it is off track, adjust accordingly.
- Create a central location for all trust information and document all aspects of trust and policy management.
- Keep active lines of communication open with all pertinent parties. Make the grantor immediately aware of any policy issues. Never alter the policy benefit without alerting the beneficiaries.
- Collaborate with knowledgeable risk management professionals to identify risk and investigate ways to mitigate that risk. For those risks that cannot be mitigated, hire an experienced broker to implement a comprehensive insurance policy to transfer the remaining risks.

Resources

Trustees of life insurance trusts surely have significant responsibilities, but the good news is that help is available. Indeed, trustees are required to reach out to other professionals if the trustee is unable to fulfill their obligations. Of course, the buck will always stop with the trustee, who cannot delegate away their fiduciary duty.

Policy reviews are available from many sources. Life insurance agents often offer free reviews in the hope that a non-competitive policy can be replaced. While competitive analysis is an important consideration, trustees should have a compelling reason to replace an existing life insurance policy.

Veralytic (http://www.veralytic.com) provides a benchmarking system rating policy competitiveness against peers. The $500 service is available directly from the company or through a negotiated fee from advisors who subscribe to the service.

A policy review is more than a competitive analysis. It should include a re-examination of trust goals and changes to clients' health or financial situation that could affect the policy funding. Administrative details should be reviewed to confirm correct ownership and beneficiary designations, and policy details (including riders) should be listed.

Current policy performance should be evaluated. Inforce ledgers showing projected outcome at current funding should be compared with the sales illustration to see if the policy is still on track to reach its goals. If the policy is off track, additional modeling should occur to map out funding options.

Two firms that provide fee-based review services to life insurance trustees are LifeTrust3D (http://www.lifetrust3d.com) and ITM TwentyFirst (http://www.ITM21st.com). Through a web-based administrative system, contracted policy reviews can be obtained for an annual fee from approximately $200-300.

ITM TwentyFirst also offers a fully outsourced service, including trust administrators and policy review and remediation experts, for $850 per trust.

An ITM TwentyFirst affiliated company, the Life Insurance Trust Company (http://www.lifeinsurancetrust.com), is a single asset trust company specializing in life insurance. For those advisors wishing to offload their trustee responsibility, the firm provides an advisor-friendly trust company that will not compete in other areas.

Where there is an expense for the foregoing resources, it is properly chargeable to the trust. Again, a trustee does not need to have life insurance expertise, and oftentimes the trustee is a family member or a long-standing advisor like John McArthur. Trustees without the requisite experience should utilize third party services even when there is a cost associated with such services.

Finally, note that a trustee *always* needs to mind their trust assets. Accordingly, engage outside help at appropriate intervals. In some instances this may be annually and in others it may be more infrequent. Here too, rely on your experts for determining how often a comprehensive review is in order.

Conclusion

While the responsibilities of an advisor acting as trustee are set at a somewhat lower bar than a corporate trustee, they remain quite high. An attorney, CPA, family office, or other wealth advisor acting as a trustee for a life insurance trust still has an obligation to the beneficiaries to act in their best interest and maximize the value of the life insurance policy in the trust. Also, specific administrative details must be followed to ensure that the trust's full tax advantages are obtained.

With the current market stress on life insurance policies, taking on these responsibilities in a highly litigious society should not be taken lightly. While the grantor may be a favored client, it is the beneficiaries and their advisors who may find fault with your actions one day and seek redress in court.

For the advisor who is not comfortable providing all facets of life insurance trust service, outside experts should be retained, or the trust should be moved to a trustee with greater knowledge and resources.

Endnote

1. The scene depicted is not based on one situation but on several cases that the authors have been made aware of over the years. All the names have been changed.