

# MANAGING ILITs

## FOR BANKS AND TRUST COMPANIES

A GUIDE TO SUCCESS



# PolicyCheck Alert

## ILIT Guidelines

Trust owned life insurance has quickly become a problem for many banks and trust companies that assume oversight responsibilities over life insurance. For the most part, this business represents relatively low fees compared with exaggerated risk if the policy is not managed properly over time to assure the trust actually receives the death benefits once the Grantor dies. With somewhere between 40-50% of in-force institutionally owned life insurance at risk (meaning the policy is not properly funded to last until maturity), this problem is becoming a huge issue for the trust industry.

Most trust officers recognize that life insurance is a very complicated product with numerous moving parts. Most also realize they have not received proper training to understand the various forms of policies and what actions and decisions they should be taking periodically to meet prudent standards of care.

We now have Supreme Court precedence from Nebraska that ruled in favor of the trust beneficiaries and included direction for trustees to follow to limit their risk.



The critical issues addressed in this ruling are:

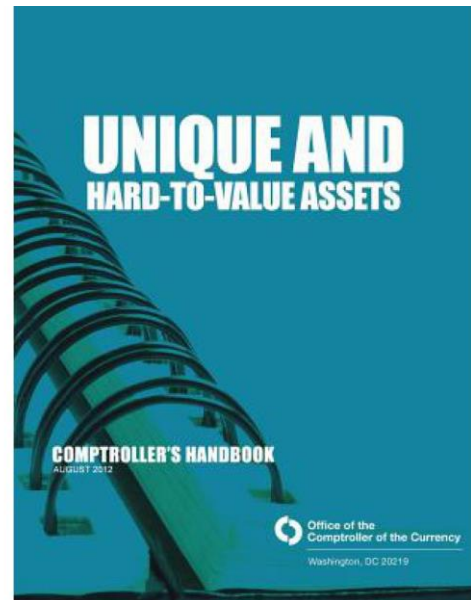
1. When the trust is established, the ILIT trustee has an obligation to meet with Grantor "to explain provisions of the trust or who would be responsible for **monitoring** the insurance policies owned by trust."
2. The ILIT trustee has an obligation to "act in good faith and in accordance with the terms and purposes of the trust and in the **best interests of the beneficiaries.**"
3. As a general rule, the authority of a trustee is governed not only by the trust instrument but also by statutes and common-law rules pertaining to trusts and trustees, and
4. A trustee has a duty to **fully inform the beneficiary of all material facts so that the beneficiary can protect his or her own interests where necessary.**



ACT IN GOOD FAITH...AND IN THE BEST INTERESTS OF THE BENEFICIARIES.

-Supreme Court of Nebraska Majority Opinion

Another source for trustees who are fiduciaries on ILIT's is the "Unique and Hard-To-Value Assets Comptroller's Handbook"  
(August 2012 Updates)



It states:

- Bank fiduciaries are responsible for protecting and managing the life insurance policy for the benefit of the beneficiaries for the life of the grantor. **A bank fiduciary must understand each life insurance policy that the trust accepts or purchases, or the bank fiduciary must employ an advisor who is qualified, independent, objective, and not affiliated with an insurance company to prudently manage these assets, and**
- Many states have recently passed legislation to limit the liability of bank fiduciaries, in certain situations, by rescinding requirements under state law to perform due diligence on insurance companies as a directed bank fiduciary. The OCC, however, continues to require bank fiduciaries to follow 12 CFR 9.6(c) and 12 CFR 150.220 and to conduct annual investment reviews of all assets of each fiduciary account for which the bank has investment discretion. **This review should evaluate the financial health of the issuing insurance company as well as whether the policy is performing as illustrated or whether replacement should be considered.**

Court Precedence and OCC Guidelines show that it makes good business sense to demonstrate a prudent process. Below are the steps an ILIT trustee should take when maintaining an insurance policy held within an HIT. We believe by following these steps, the ILIT trustee will mitigate their risk and easily demonstrate they are in compliance with the Nebraska court case and OCC guidelines.



## Step 1

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Document the entire process in writing – train staff on the process and document training.



## Step 2

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Retain an independent 3<sup>rd</sup> party to conduct annual or periodic policy reviews. We recommend conducting policy reviews at least every 2 years.



## Step 3

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90 days prior to policy anniversary:

- **Review in force policy illustrations** to determine if the policy is at risk of being non-competitive.
- **Request gift of premium** from grantor/premium payer.
- **Prepare and send Crummey notice to beneficiaries** once gift has been made to trust.



## Step 4

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For policies determined to be competitive and not at risk, review policy riders and provisions to determine if any changes to policy should be made to most effectively accomplish trust objectives. Have 3<sup>rd</sup> party conduct a Competitive Analysis to assure highest and best use of the policy asset.



## Step 5

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For at risk or non-competitive policies, conduct general health assessment on insured to determine mortality risk and remediation alternatives. Also obtain HIPAA form signature from insured(s). Provide these documents to a trusted resource to assess life expectancy and potential insurability.



## Step 6

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For at risk or non-competitive policies, deploy the following process for remediation:

- On existing policy, determine revised funding amount necessary to carry current policy face amount to maturity or target date.
- On existing policy, determine face amount reduction necessary to carry current policy to maturity or target date at current funding.
- If insurable, pursue open market suitability alternatives to determine if replacement insurance at current face amount would be in Client's best interest.
- If insurable, pursue open market suitability alternatives to determine if replacement insurance at a reduced face amount and current funding would be in Client's best interest.



## Step 7

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Meet with trust interested parties to determine best course of action. Have your advisor attend meeting as a technical resource to answer questions and explain policy provisions, take meeting notes to document discussion and provide proof of third party oversight. Retain copies of all illustrations, notes and any other materials reviewed.



## Step 8

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If decision is to modify current policy, have advisor assist in preparing necessary documents to facilitate remediation.



## Step 9

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If decision is to replace existing insurance, have advisor prepare necessary documents and handle all aspects of application, underwriting, issuing new policy and handle policy delivery. Request an independent 3<sup>rd</sup> party perform a replacement analysis confirming the replacement is in good order prior to policy replacement.



## Step 10

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Engage an independent 3<sup>rd</sup> party to provide a Suitability Analysis or equivalent to compare the existing policy and recommended alternatives.



## Step 11

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Carefully review final illustration to understand underlying risks within that particular policy. Retain original illustration and in-force ledger on replaced policy for future reference. Compare declaration page on policy to final illustration to make sure the carrier issued the policy as applied by the trust.

# IN CONCLUSION...

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The Nebraska court ruled that an ILIT trustee must "act in good faith and in accordance with the terms and purposes of the trust and in the interests of the beneficiaries". It would be hard to argue that if the ILIT trustee:

- manages the policy so that the grantor pays a reasonable premium for the insurance, and
- upon death, the trust receives the death benefit on behalf of trust beneficiaries would be anything other than satisfying the court's assessment of acting in good faith and in the interests of the beneficiaries.

The court did rule that the trustee must explain who would be responsible for monitoring the insurance, but did not define what a proper monitoring process would be. If the trustee follows the steps included in this document, we believe he would be properly monitoring the policy in the best interests of the beneficiaries.



For more information on how to properly establish a trust owned life insurance policy or structure a life insurance policy review and remediation process, contact Mike Smith at [mike@tfpbrokerage.com](mailto:mike@tfpbrokerage.com) or call 678.338.4384

*Mike is President of TFP Brokerage, a member of the PolicyCheck Network and Author of "Tread Lightly, A Life Insurance Guide for the Affluent Client"*

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