

# Ten Mistakes Many TOLI Trustees Make

## *Part 1 (Mistakes 1-5)*

*May 7, 2015*

***The Educational Series  
Insurance Trust Monitor, Inc.***

809 W. 1st Street, Suite B Cedar Falls | IA | 50613  
www.youritm.com  
866.384.2766

This course qualifies  
for One Credit Hour of  
Continuing  
Education for both  
CFP® and CTEA (under  
Financial Planning)  
Designations.

The Institute of Certified Bankers (ICB), a subsidiary of the American Bankers Association, is dedicated to promoting the highest standards of performance and ethics within the financial services industry. This statement should not be viewed as an endorsement of this program or its provider.

# Ten Mistakes Many TOLI Trustees Make

## *Part 1 (Mistakes 1-5)*

### **Mistake #1: Failing to Understand Your Responsibilities as a Trustee**

To understand the responsibilities of a TOLI Trustee we can look to a few sources of information.

#### **Uniform Prudent Investor Act**

##### **SECTION 1. PRUDENT INVESTOR RULE.**

(a) Except as otherwise provided in subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to **comply with the prudent investor rule** set forth in this [Act].

##### **SECTION 2. STANDARD OF CARE; PORTFOLIO STRATEGY; RISK AND RETURN OBJECTIVES.**

(a) A trustee shall invest and manage trust assets **as a prudent investor would**, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise **reasonable care, skill, and caution**.

##### **SECTION 4. DUTIES AT INCEPTION OF TRUSTEESHIP.**

**Within a reasonable time** after accepting a trusteeship or receiving trust assets, a trustee shall **review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance** with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this [Act].

##### **SECTION 5. LOYALTY.**

A trustee shall invest and manage the trust assets **solely in the interest of the beneficiaries**.

##### **SECTION 7. INVESTMENT COSTS.**

In investing and managing trust assets, a trustee may only **incur costs that are appropriate and reasonable in relation to the assets**, the purposes of the trust, and the skills of the trustee.

##### **SECTION 8. REVIEWING COMPLIANCE.**

Compliance with the prudent investor rule is determined **in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight**.

##### **SECTION 9. DELEGATION OF INVESTMENT AND MANAGEMENT FUNCTIONS.**

(a) A trustee may **delegate investment and management functions** that a prudent trustee of comparable skills could properly delegate under the circumstances.

## OCC Handbook

- ...”provides guidance for examining these types of discretionary assets held in fiduciary accounts in asset management areas **of national banks and federal savings associations**...The guidance **provides bank examiners with expanded examination procedures**, which supplement the core assessment standards in the “Large Bank Supervision” and “Community Bank Supervision” booklets of the Comptroller’s Handbook. The examination procedures are optional but may be used when a bank has a significant number of unique assets to manage or has hard-to-value assets for reporting purposes.”
- **“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.”

### § 9.6 Review of fiduciary accounts.

(c) *Annual review.* At least once during every calendar year, a bank shall conduct a review of all assets of each fiduciary account for which the bank has investment discretion to evaluate whether they are appropriate, individually and collectively, for the account.

### § 150.220 Are any other account reviews required?

At least once every calendar year, you must conduct a review of all assets of each fiduciary account for which you have investment discretion. In this review, you must evaluate whether the assets are appropriate, individually and collectively, for the account

- “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.”
- “The bank fiduciary must periodically review the **financial condition and rating** of the insurance company.”
- “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.**”
- “Bank fiduciaries need to have **well-developed risk management practices** to evaluate and administer accounts with insurance policy holdings.”
- “A bank fiduciary with discretion over the account must complete **formal preacceptance, initial post-acceptance and annual reviews** of the insurance policy.....“Independent of these reviews, a fiduciary bank must have **risk management systems and reviews.**”

## Case Law

**Cochran vs. Keybank:** Trustee was sued after replacing Variable Universal Life policies providing \$8,000,000 in death benefits with one \$2,536,000 Guaranteed Universal Life policy. Shortly after the transaction, the insured died prematurely at age 53. The beneficiaries sued KeyBank as trustee for breach of fiduciary duty.

- Most believe that the courts set a low bar.
- The court ruled that there was no breach by working with the grantor and agent which often happens and acknowledging that there must be cooperation with grantor for underwriting, etc.
- Though the courts said the trustee “could have done more,” they found the product due diligence was enough even though only one carrier/one product was reviewed.
- The court believed the fact that the "an outside, independent entity with no policy to sell or any other financial stake in the outcome" was a plus.
- Outside consultant told trustee that the old policy had surrender charges.
- The court determined that the beneficiaries were kept sufficiently informed and that a lack of knowledge of the beneficiaries would not have changed/affected the decision.

**Schwab, et al. v. Huntington National Bank:** 2012 case where it was found by the court that the *grantor of an irrevocable trust even lacked the standing to sue the trustee* for alleged breach of fiduciary duties.

**Paradee v. Paradee:** The trustee and a non-fiduciary family member were found liable to the beneficiary because of a trust transaction. The court ruled that **“instead of evaluating what was in the best interests of the Trust, (the trustee) evaluated whether he could please his long-time clients.”** While the trustee in this case was not a bank or trust company, the lesson should be learned by those in the corporate trust community.

FOR PUBLICATION

ATTORNEYS FOR APPELLANTS

DALE W. EIKENBERRY  
DANIEL D. TRACHTMAN  
Wooden & McLaughlin LLP  
Indianapolis, Indiana

SHAWN P. RYAN  
South Bend, Indiana

ATTORNEYS FOR APPELLEE

JEFFERY A. JOHNSON  
PATRICIA E. PRIMMER  
ROBERT J. PALMER  
May Oberfell Lorber  
Mishawaka, Indiana

FILED  
Mar 02 2009 9:05 am  
OIR

IN THE  
COURT OF APPEALS OF INDIANA

IN RE: MATTER OF THE STUART COCHRAN  
IRREVOCABLE TRUST,  
CHANELL and MICAELA COCHRAN,  
Appellants-Petitioners,  
v.  
KEYBANK, N.A.,  
Appellee-Respondent.

No. 71AD4-0806-CV-384

APPEAL FROM THE ST. JOSEPH CIRCUIT COURT  
The Honorable Michael G. Gosch, Judge  
Cause No. 71C01-0404-3B-0039

March 2, 2009  
OPINION - FOR PUBLICATION

BAKER, Chief Judge

# Rafert v. Meyer... Required Reading for a TOLI Trustee

Posted on March 25, 2015 by mbrohawn

## **Rafert v. Meyer: (see ITM Blog at <http://youritm.wordpress.com/> for more info):**

A suit was filed alleging that the TOLI trustee “breached his fiduciary duties as trustee” and, as a result, “the policies lapsed, resulting in the loss of the initial premiums.” The Trustee was also the Attorney who drafted the trust document. The document contained a section which stated....“The Trustee shall be under no obligation to pay the premiums which may become due and payable under the provisions of such policy of insurance, or to make certain that such premiums are paid by the Grantor or others, or to notify any persons of the non-payment [sic] of such premiums, and the Trustee shall be under no responsibility or liability of any kind in the event such premiums are not paid as required.” The court ruled that the exculpatory language in the trust document did not relieve the trustee of all of his duties. Citing “common law rules,” the court stated: “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 laid out some of those duties:

- “A trustee must administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries.”
- “A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.”

## **Mistake #2: Failing to Price Your Services Correctly**

### **Why are you in the ILIT business?**

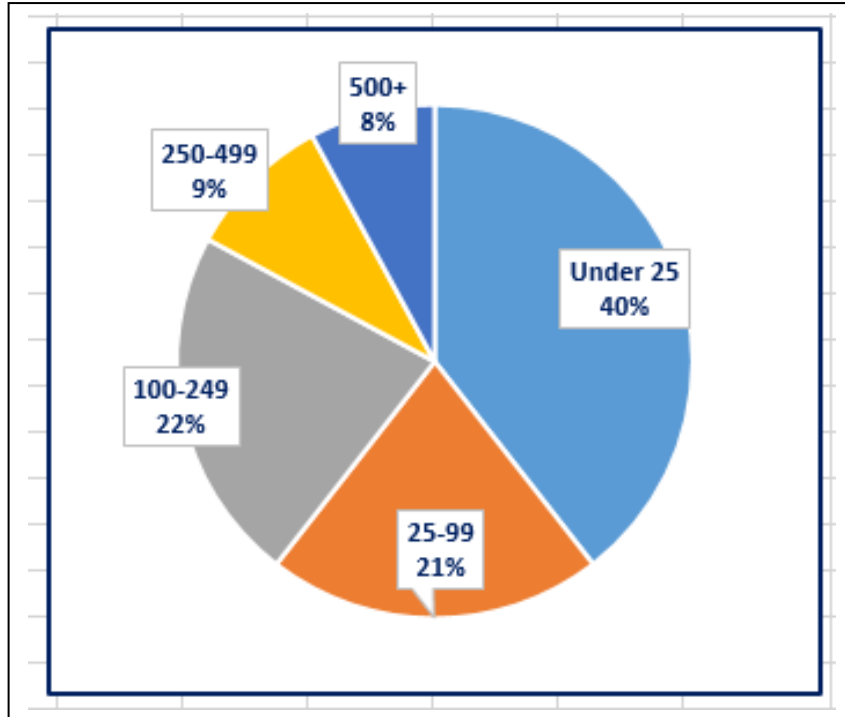
- You inherited the business because of an acquisition.
- You make a profit on the business year to year.
- You (hope to eventually) make a profit on the business year to year.
- You hope to develop a relationship with the beneficiary and manage the death benefit after the grantor(s) pass.
- You really have no idea.

**Survey of Your Peers: 81 TOLI Trustees surveyed across the country**

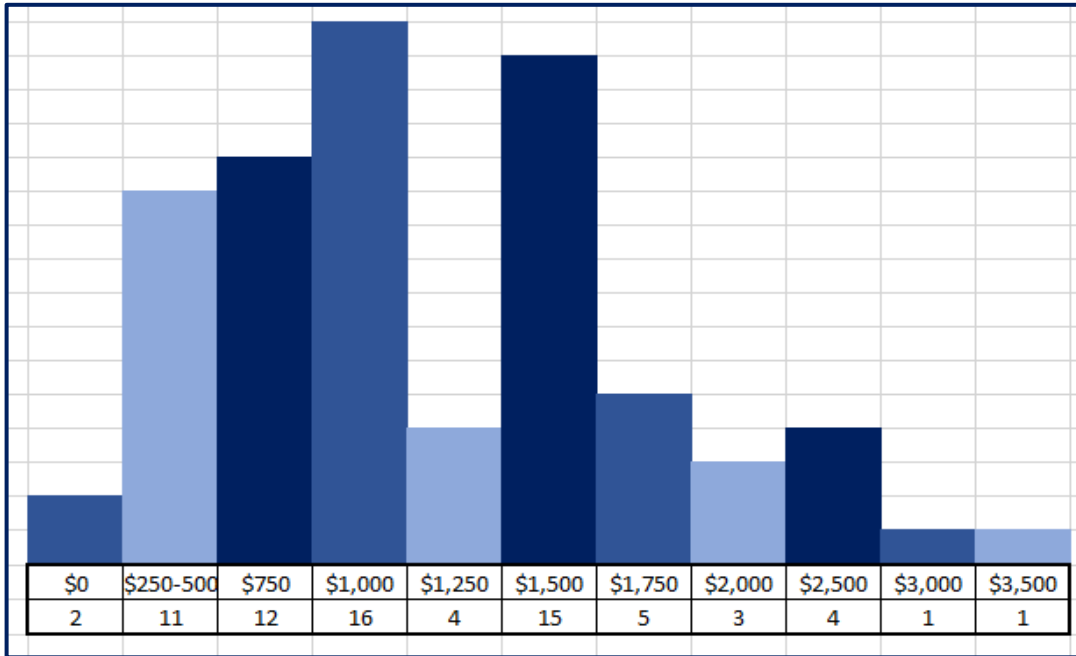
**TOLI**

**Portfolio Trust**

**Size**



**What are your peers charging?**



*Survey with 74 responses*

**Are you factoring all costs into your pricing?**

- Administration and Administrators
- Insurance Expert(s)
- Legal Counsel
- Office Manager(s)
- Insurance
- Liability
- Lost Production

**Do You Want To Be In This**

**Business?**



**Mistake #3: Failing to Understand the Trust Document  
and Policy When Taking in a Trust**

**ILIT Trust Document Review**

## **Determine whether the ILIT is a grantor trust for income tax purposes.**

### **Common powers in a trust document that would cause grantor trust status:**

#1) Trust income can be used to pay premiums on an insurance policy on the life of the grantor or the grantor's spouse without the consent of an adverse party.

#2) The power to spray income among the trust beneficiaries is held by the grantor, grantor's spouse, majority of trustees who are related to the grantor, or majority of subordinate parties who are subservient to the wishes of the grantor.

#3) A power to pay trust income to the grantor's spouse exercised at the direction of a non-adverse party or without the consent of an adverse party.

#4) The power to add beneficiaries (except after-born or adopted children) unless held by an adverse party.

#5) A power exercisable by the grantor or a non-adverse party enabling the grantor to borrow from the trust without adequate interest or without adequate security. There is an exception if the trust provides a general lending power to make loans to any person without adequate interest or security. (In order to prevent estate tax

inclusion, the trust should require adequate interest, but allow inadequate security – not requiring adequate interest could cause the value of the entire trust to be includible in the grantor's taxable estate.)

#6) A power exercisable by the grantor or a non-adverse party (and without the consent of an adverse party) enabling the grantor to reacquire trust assets by substituting assets of equivalent value.

#7) The grantor retains the power to remove and replace the trustees.



### **Other items that should be reviewed when reviewing a document (*not all inclusive*)**

- Are there outside advisors? If so, what is division of responsibilities? Who is responsible for Variable policy asset allocation?
- Does document confer fiduciary responsibilities on trust advisor?
- Does the trust contain provisions regarding trustee resignation?



- Does the trust contain provisions regarding trustee removal?
- Does the trust contain provisions regarding who may appoint a successor trustee?
- Does the trust contain provisions regarding trustee compensation?
- Does the trust contain Crummey withdrawal provisions? What is the Crummey withdrawal period? Are there any restrictions on the amounts that can be withdrawn? Does the trust provide different levels of priority of withdrawal rights? If the Crummey withdrawal is not exercised, what amount/percentage lapses? Does the trust contain hanging powers? Does the trust contain language regarding what means may be used to satisfy a Crummey withdrawal demand?
- Does the trust contain language regarding distribution of income or principal during the life of the grantors?
- Do the trustee powers contain language regarding the trustee's power to hire and compensate advisors/agents?
- What state law governs the trust?

### **On Boarding an ILIT – *General Sample Checklist, etc.***

- Trust Tax ID:** Best source: IRS SS-4/Notice of EIN. Otherwise verify from the policy application
- Trust Name and Date:** Review trust doc for correct trust name
- Is this a New Trust or Successor Trust?**
  - If this is new trust, obtain a new EIN from <https://sa2.www4.irs.gov/modiein/individual/index.jsp>
- Grantor(s)** – make sure all people listed are grantor(s) per trust doc review and trust doc – Salutation (Dr., Mrs. Judge, etc.), name, address, contact info if possible, gender, DOB, DOD (if applicable) SSN (can get from the policy or other correspondence, but not a necessity)
- Trust Type:** Gift Exclusion (withdrawal rights) or Other (Irrev. Trust w/o withdrawal rights and “other” trusts)
- Trust Withdrawal Beneficiaries:** Salutation, name, address, other contact info if possible, gender, relationship to grantor, DOB, minor, Guardian (Guardian must be someone other than the grantor(s))
- Withdrawal Provisions?** Make notes in regards to the withdrawal period, limitations on withdrawals, levels of priority, donor right to modify/restrict withdrawals, or any other issues.
- Trust Income/Principal Beneficiaries:** Beneficiaries of the trust that do NOT have withdrawal rights need to be identified as such

**Please Note: While this list and all items to follow may seem exhaustive, it is general in nature and other items will be included, depending on the situation.**

- Does the trust appoint an external trust advisor regarding selection, review, exchange, etc., investment or other issues concerning life insurance policies?
- Is any life insurance policy subject to split dollar agreement?
- Is Trust a grantor trust for income tax purposes?

**Grantors/Beneficiary info gathered:**

- Name
- Gender
- Title (Mr., Ms., Dr., Judge, etc.)
- Address
- Alternate Mailing Address
- Preferred method of communication
- Phone
- Cell Phone
- Date of Birth
- Date of Death, if applicable
- Social Security Number

***For Beneficiaries, add:***

- Relationship to Grantors
- Withdrawal percentage

**Documents needed:**

- Copy of Fully Executed Trust Agreement
- Copy of Amendments
- Prior appointments, resignations or removals
- Applicable Court Documents
- Non-Judicial Settlement Agreements
- Copies of any available prior Withdrawal (Crummey) Notices
- Copy of Current Fee Agreement / Schedule
- Copy of any other pertinent trust information or documentation (e.g., divorce decree, death certificates of grantors or beneficiaries, power of attorney, intentions for the trust, etc.)

**In addition, for the policy:**

- Policy Application
- Copy of the Life Insurance Policy
- Policy Amendments
- As-Sold Illustration for Policy
- Most Recent Illustration
- Most Recent Annual Statement
- Most Recent Premium Due Notice
- Copy of Fully Executed Split Dollar
- Copy of any Pertinent Policy Information including intentions for the policy

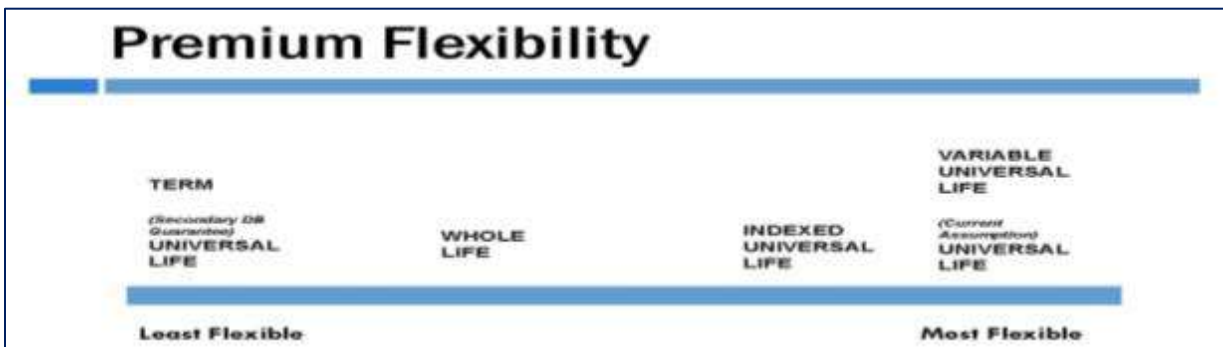
**NOTE: If a successor trust, make sure there is a bright yellow line on “takeover date”. Also, make sure policy is in good shape and that policy premium is paid during the transition period.**

**Policy Review: You need to understand the policy at least enough to know whether it is appropriate.**

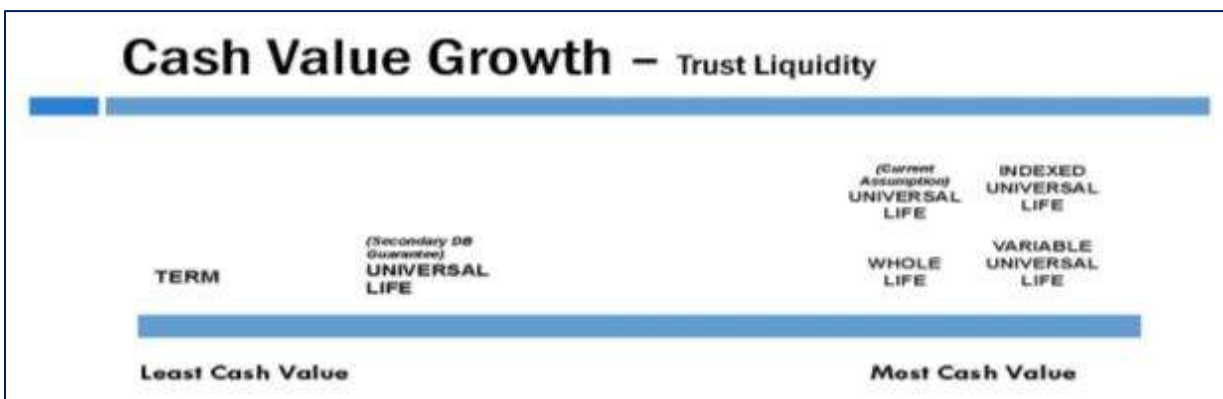
- Premium flexibility
- Cash value growth
- Investment risk
- Guarantee of death benefit
- Years to pay
- Level or increasing death benefit
- Control over investment decisions

**Typically you are not part of the “sales process” which can be an issue.**

### Policy “Choices”



- Does client need premium flexibility?
- Are you comfortable you will get gifts each and every year?
- Are there changes that could affect client cash flow?



- Is liquidity important?
- Is it possible that policy will be “traded up” or surrendered in the future?

# Investment Risk

(Secondary DB  
Guarantee)  
UNIVERSAL  
LIFE

WHOLE  
LIFE

(Current  
Assumption)  
UNIVERSAL  
LIFE

INDEXED  
UNIVERSAL  
LIFE

VARIABLE  
UNIVERSAL  
LIFE

Least Investment Risk

Most Investment Risk

- Are you “managing” the policy? Attempting to “lower” premium costs by increasing returns?
- Is client comfortable with risk?

## Documenting a Policy

- **Agent Form**
  - Spells out Agent responsibilities
  - Provides caveats to Agent to approve policy
- **“Statement of Understanding” to Grantor**
  - Spells out parameters, responsibilities
  - Provides caveats to policy acceptance
  - Liability disclaimer for trustee

## Mistake #4: Failing to Adequately Document a Prudent Process

From The ITM Blog <http://blog.youritm.com/>

### ***“The Outcome Cannot Always Be (Completely) Controlled, But The Process Can”***

- The risk of investors not meeting their goals and objectives decreases proportionally by the number of additional prudent practices employed. *Fiduciary Ethos, Living in a Fiduciary World, Volume One: Investment Management, by Don Trone*
- In any situation where liability is being reviewed, the focus is not as much on the outcome as on the process employed by the trustee. Many things outside of your control can affect an outcome, but if you are being accused of not living up to your TOLI duty you had better be prepared to show the prudent practices that you employed.

## Documenting Prudent Practices Throughout the LifeCycle of a Trust/Policy

- **Bringing a Trust/Policy in**
  - Trust document review process

- Policy review process, including some sort of statement of understanding
- **Policy Administration**
  - A Procedure Handbook
  - An Escalation or Trust Committee
- **Ongoing Legal Direction**
- **Dealing with Issues on Policy**
  - Have you reviewed all options on policy?
  - Have you shred with all people that need to know?
  - Have you documented this?
- **Dealing with Changes to Policy**
  - Who is made aware?
  - Have you documented?

#### **STEPS TO BUILDING A DEFENSIBLE FILE**

1. Focus on the Beneficiary as client.
2. Review the Trust Document thoroughly.
3. Understand the policy.
  - Policy type – advantages, disadvantages, caveats, issues
  - Policy “numbers”
4. Develop a systematic Review program for annual policy reviews.
5. Provide Grantor with Review or Statement of Understanding periodically.
6. If changes or issues arise, develop a secondary program to deal with them.
  - More in depth policy Review, with Options outlined *simply*.
7. If any changes occur to the policy, make sure that Beneficiaries are made aware.
8. Create a central depository for all trust information.

***You cannot always be right, but you can always be prudent.***

***And you always have to show that you are prudent.***

### **Mistake #5: Failing to Adequately Communicate with Both Grantor and Beneficiary**

If communication is not good you can create numerous issues:

- Policy issues
- Fee issues
- Additional costs to you
- Liability to you
- Negative outcome

#### Developing good communication:

- Understand trust goals
- Understand any back stories
- Rhythmic communication, especially about policy
- Know Beneficiaries, not just grantor
- Who are Advisors and what are their roles? Document them.

Is the contact information that you have on file up to date?

Please verify the information listed below and provide us with any additions or corrections:

Grantor(s):  
[[GRANTOR.GrantorListAllInfo]]

Beneficiary(ies):  
[[BENE.ListAllInfo]]

*Information Update Request Added to All Notices*

#### Dealing with the Non-Responsive Grantor

##### Levels of Non-responsiveness

- Not going to pay anymore, but you can reach
- Not going to deal with anymore
- Impossible to get in touch with

##### Reasons for Non-responsiveness

- Financial
- Divorce, other family issues
- Criminal charges
- Drugs, alcohol abuse
- Changes in relationship with beneficiary
- Lose interest

- General Protocol
- Contact procedures
- Document non-responsive nature
- Reach out to Beneficiaries
- Reach out to Advisors
- Review all policy options
- Build a prudent file

What if Grantor is no longer paying?

- Are there other assets to pay with? Do you take cash value?
- Can the Beneficiaries contribute?
- If “stuck” with policy how do you get most value for Beneficiaries?
- What are legal options?

## Developing a Prudent Communication Model

- Document policy parameters, possible policy outcomes, including guaranteed, non-guaranteed elements with grantor.
- Provide annual reviews/updates on policy to grantor.
- Develop relationship with Advisors on policy/trust, if available.
- If possible, develop relationship with beneficiary. Can provide information about policy condition to beneficiary, but always contact beneficiary if there are any changes to policy value.
- Document any changes to policy with beneficiary.

**Make sure any changes to policy value is communicated to the Beneficiary and documented.**

**Follow our webinar schedule at  
<http://www.youritm.com>**

**Follow the ITM Blog at  
<http://youritm.wordpress.com>**

