New Standards for Managing Life Insurance as an Asset

Situation

- Life Insurance is often integral to planning …
  - Income Tax Free Death Benefit
  - Tax Deferred Growth of Cash Values
  - Non Taxable Withdrawals
  - Non-Taxable Loans

    Loans from inforce insurance policies that are not modified endowments, are received income tax free. IRC Sec. 72(e)(5)(A)(i).

Situation

- Life Insurance is often integral to planning,…but is the last, largest, most-neglected asset.
- Few know what they are being charged and that these costs vary as much as 80%.
- Few know what they are actually getting in performance.
- Actual results fallen short of client expectations.
- Product suitability based on “flavor of the day” marketing using hypothetical illustrations.

Product Suitability

Despite a confusing variety of products & terminology, the performance of ALL life insurance products is a function of:

$$\text{COIs} + \text{E} - \text{i\%}$$

New Guidance

FINRA
Financial Industry Regulatory Authority

3ethos

Office of the Comptroller of the Currency
U.S. Department of the Treasury

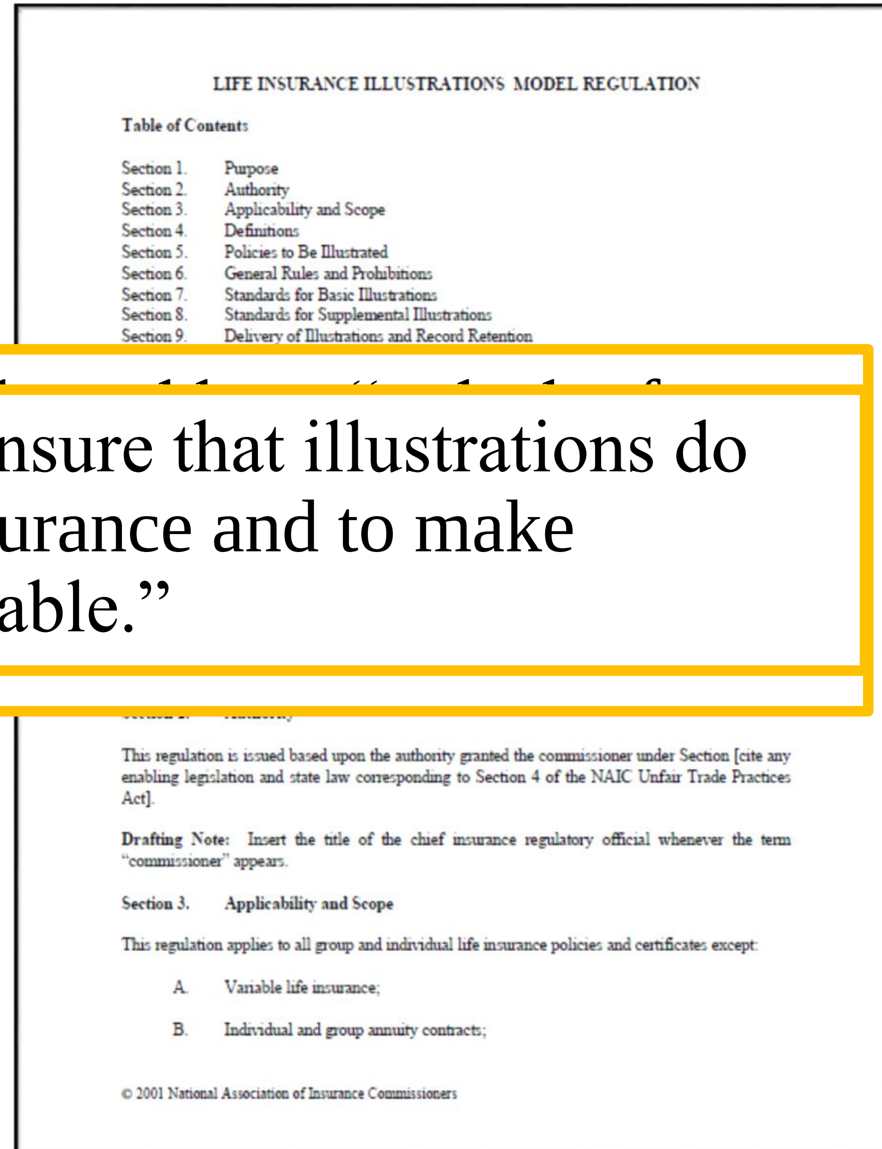
SOCIETY OF ACTUARIES
A.S.A. 1889
A.I.A. 1909
1949

ULC
Uniform Law Commission
The National Conference of Commissioners on Uniform State Laws

NAIC
National Association of Insurance Commissioners

Illustration Model Regulation

1993 - “The goals … are to ensure that illustrations do not mislead purchasers of insurance and to make illustrations more understandable.”



LIFE INSURANCE ILLUSTRATIONS MODEL REGULATION

Table of Contents

This regulation is issued based upon the authority granted the commissioner under Section [cite any enabling legislation and state law corresponding to Section 4 of the NAIC Unfair Trade Practices Act].

Drafting Note: Insert the title of the chief insurance regulatory official whenever the term “commissioner” appears.

Section 3. Applicability and Scope

This regulation applies to all group and individual life insurance policies and certificates except:

A. Variable life insurance;

B. Individual and group annuity contracts;

Illustration Model Regulation Proper Uses

- Help policyowners understand how a policy works.
- Calculate the sufficiency/adequacy of premiums.
- Establish a baseline for ongoing policy management.
- Incorporate in financial, estate, and/or cash flow planning.
- ~~Compare cost or illustrated performance of different policies?~~

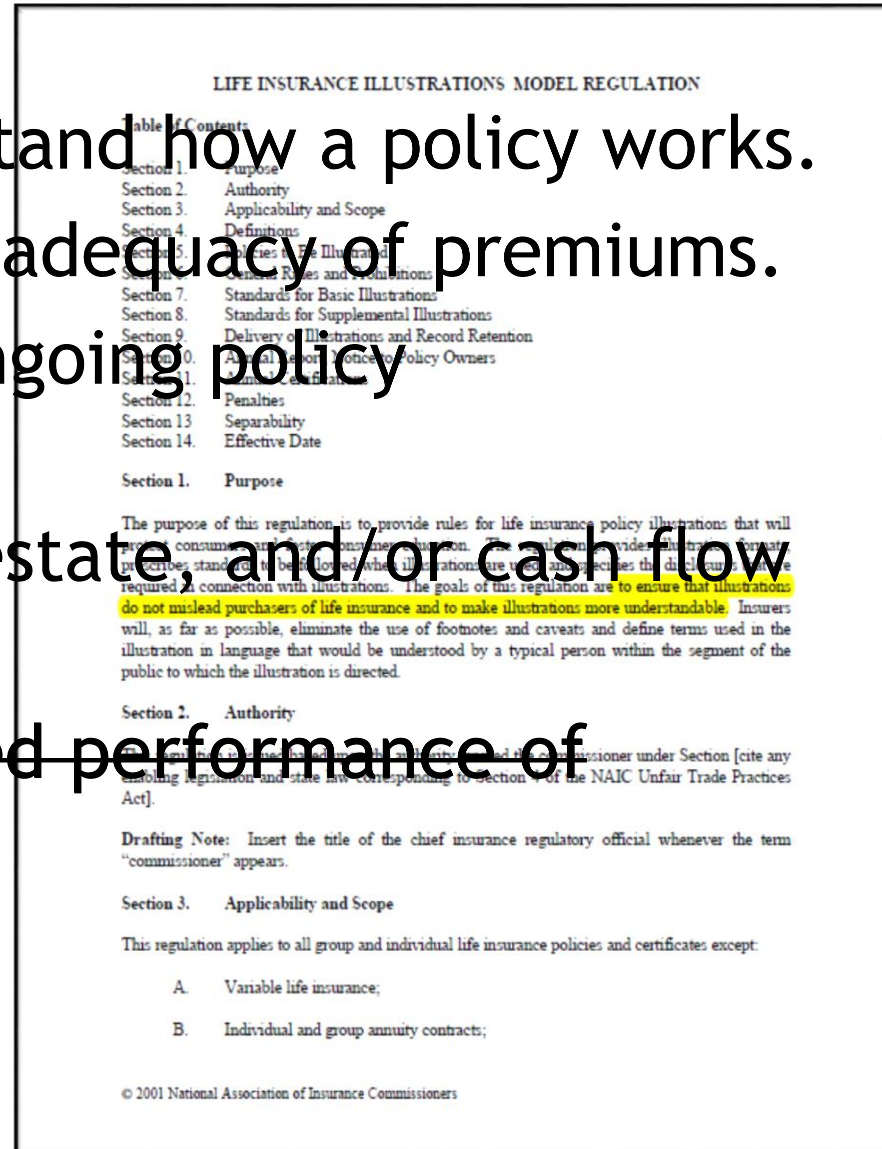

LIFE INSURANCE ILLUSTRATIONS MODEL REGULATION

Table of Contents

Section 1. Purpose

The purpose of this regulation is to provide rules for life insurance policy illustrations that will protect consumers and foster consumer education. The regulation provides illustration formats, prescribes standards to be followed when illustrations are used, and specifies the disclosures that are required in connection with illustrations. The goals of this regulation are to ensure that illustrations do not mislead purchasers of life insurance and to make illustrations more understandable. Insurers will, as far as possible, eliminate the use of footnotes and caveats and define terms used in the illustration in language that would be understood by a typical person within the segment of the public to which the illustration is directed.

Section 2. Authority

This regulation is issued based upon the authority granted the commissioner under Section [cite any enabling legislation and state law corresponding to Section 4 of the NAIC Unfair Trade Practices Act].

Drafting Note: Insert the title of the chief insurance regulatory official wherever the term "commissioner" appears.

Section 3. Applicability and Scope

This regulation applies to all group and individual life insurance policies and certificates except:

A. Variable life insurance;

B. Individual and group annuity contracts;

Uniform Prudent Investor Act (UPIA)

- Uniform Prudent Investor Act (UPIA) imposes new duties on life insurance fiduciaries:

Duty to Monitor. Subsections (a) through (d) apply both to investing and managing trust assets. "Managing" embraces monitoring, that is, the trustee's continuing responsibility for oversight of the suitability of investments already made as well as the trustee's decisions respecting new investments.

abrogating categoric restrictions. The Restatement says: "Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio." Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment f, at 24 (1992). The premise of subsection 2(e) is that trust beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives as prescribed in subsection 2(b) than in attempts to identify categories of investment that are per se prudent or imprudent.

The Act impliedly disavows the emphasis in older law on avoiding "speculative" or "risky" investments. Low levels of risk may be appropriate in

8

Uniform Prudent Investor Act (UPIA)

- Uniform Prudent Investor Act (UPIA) imposes new duties on life insurance fiduciaries:

When tax considerations affect beneficiaries differently, the trustee's duty of impartiality requires attention to the competing interests of each of them.

Subsection (c)(8), allowing the trustee to take into account any preferences of the beneficiaries respecting heirlooms or other prized assets, derives from the Illinois act, 760 ILCS § 5/5(a)(4) (1992).

Duty to investigate. Subsection (d) carries forward the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or the security of an investment.

for trusts, the long-term bond, has been discovered to import a level of risk and volatility – in this case, inflation risk – that had not been anticipated. Accordingly, section 2(e) of this Act follows Restatement of Trusts 3d: Prudent Investor Rule in abrogating categoric restrictions. The Restatement says: "Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio." Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment *f*, at 24 (1992). The premise of subsection 2(e) is that trust beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives as prescribed in subsection 2(b) than in attempts to identify categories of investment that are per se prudent or imprudent.

The Act impliedly disavows the emphasis in older law on avoiding "speculative" or "risky" investments. Low levels of risk may be appropriate in

8

Uniform Prudent Investor Act (UPIA)

- Uniform Prudent Investor Act (UPIA) imposes new duties on life insurance fiduciaries:

SECTION 7. INVESTMENT COSTS: "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."

The language of Section 6 derives from Restatement of Trusts 2d § 183 (1959); see also id., § 232. Multiple beneficiaries may be beneficiaries in succession (such as life and remainder interests) or beneficiaries with simultaneous interests (as when the income interest in a trust is being divided among several beneficiaries).

The trustee's duty of impartiality commonly affects the conduct of investment and management functions in the sphere of principal and income allocations. This Act prescribes no regime for allocating receipts and expenses. The details of such allocations are commonly handled under specialized legislation, such as the Revised Uniform Principal and Income Act (1962) (which is presently under study by the Uniform Law Commission with a view toward further revision).

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.

Comment

Wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs.

The language of Section 7 derives from Restatement of Trusts 2d § 188 (1959). The Restatement of Trusts 3d says: "Concerns over compensation and

14

Uniform Prudent Investor Act (UPIA)

- Uniform Prudent Investor Act (UPIA) imposes new duties on life insurance fiduciaries:

SECTION 2. RISK AND RETURN OBJECTIVES: "a trustee shall [have] an overall investment strategy [with] risk and return objectives reasonably suited to the trust" and "consider … the expected total return."

beneficiaries).

The trustee's duty of impartiality commonly affects the conduct of investment and management functions in the sphere of principal and income allocations. This Act prescribes no regime for allocating receipts and expenses. The details of such allocations are commonly handled under specialized legislation, such as the Revised Uniform Principal and Income Act (1962) (which is presently under study by the Uniform Law Commission with a view toward further revision).

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.

Comment

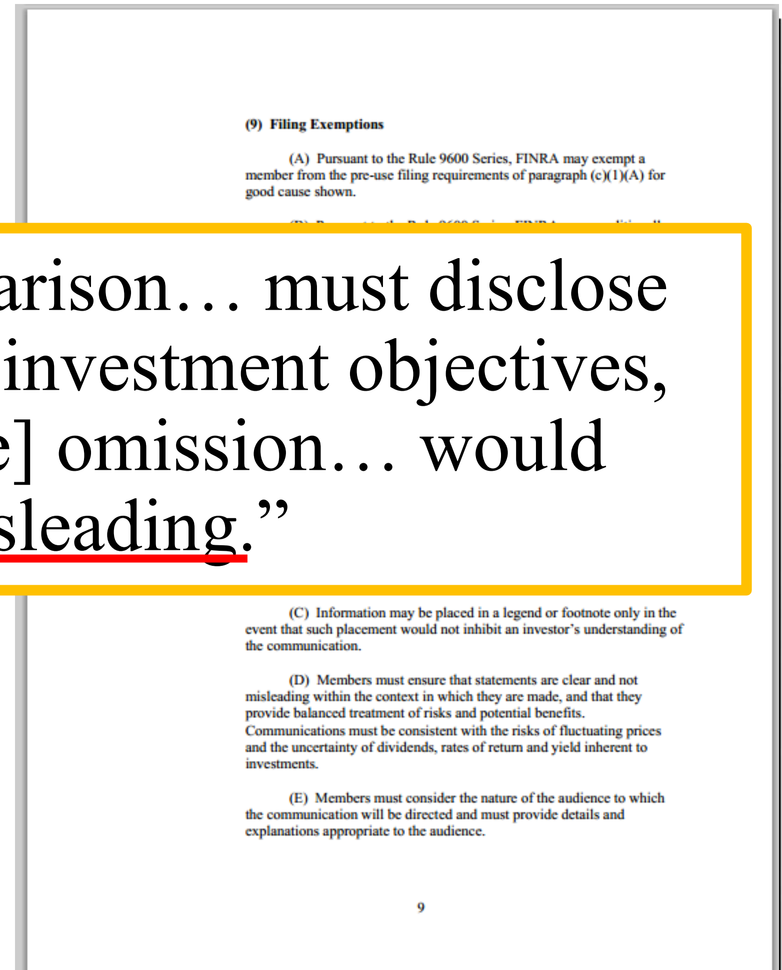
Wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs.

The language of Section 7 derives from Restatement of Trusts 2d § 188 (1959). The Restatement of Trusts 3d says: "Concerns over compensation and

14

Regulatory Guidance

- New guidance: illustration comparisons are “misleading” …



(9) **Filing Exemptions**

(A) Pursuant to the Rule 9600 Series, FINRA may exempt a member from the pre-use filing requirements of paragraph (c)(1)(A) for good cause shown.

(C) Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

(D) Members must ensure that statements are clear and not misleading within the context in which they are made, and that they provide balanced treatment of risks and potential benefits. Communications must be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield inherent to investments.

(E) Members must consider the nature of the audience to which the communication will be directed and must provide details and explanations appropriate to the audience.

9

FINRA Rule 2210(d): “Any comparison… must disclose all material differences…including investment objectives, costs and expenses, [etc]…[because] omission… would cause the communications to be misleading.”

Regulatory Guidance

- New guidance: illustration comparisons “misleading”, “fundamentally inappropriate”…

TRANSACTIONS OF SOCIETY OF ACTUARIES
1991-92 REPORTS

FINAL REPORT* OF THE TASK FORCE†
FOR RESEARCH ON LIFE INSURANCE SALES ILLUSTRATIONS
UNDER THE AUSPICES OF THE
COMMITTEE FOR RESEARCH ON SOCIAL CONCERNS

EXECUTIVE SUMMARY

Purpose

FINAL REPORT OF THE TASK FORCE FOR RESEARCH ON LIFE INSURANCE SALES ILLUSTRATIONS: “Illustrations should not be used for comparative policy performance purposes” because doing so “is fundamentally inappropriate.”

rable enough for this to be meaningful.

Illustrations handle Type A requirements well, especially if several illustrations are used to show different scenarios. Illustrations inherently do not

*Opinions expressed herein are those of the Task Force for Research on Life Insurance Sales Illustrations and of the Committee for Research on Social Concerns. This report does not purport to represent the views of the Society of Actuaries or of its Board of Governors.

†Judy A. Faucett (Chairperson), Benjamin J. Bock, Bruce E. Booker, John W. Keller, John R. Skar, Linden N. Cole, Staff Liaison, W. Steven Prince, CIA Liaison, and Michael J. Roscoe, AAA Liaison.

Regulatory Guidance

- New guidance: illustration comparisons "misleading", "fundamentally inappropriate", and unreliable…

policy. Independent of these reviews, a fiduciary bank must have risk management systems and reviews that address the following.

- **Sufficiency of premiums**: The bank fiduciary must determine whether current premiums are sufficient to maintain the policy to maturity or to meet the insured's life expectancy.
- **Suitability of the insurance policy**: Consider replacing an insurance policy if the bank fiduciary identifies concerns with the condition of the insurance provider or if that provider does not meet the needs of the grantor or beneficiaries. Also assess any tax changes that could affect the suitability of the policy.
- **Carrier selection**: The bank fiduciary needs to evaluate the carrier's financial condition. To the extent insurance carrier ratings are available, they generally lag corporate and market events, and should be used principally as indicators of a firm's creditworthiness.
- **Appropriateness of investment strategy**: The bank fiduciary must evaluate the appropriateness of investments of any segregated account to support

OCC Handbook:"This policy illustration is subject to a high degree of fluctuation."

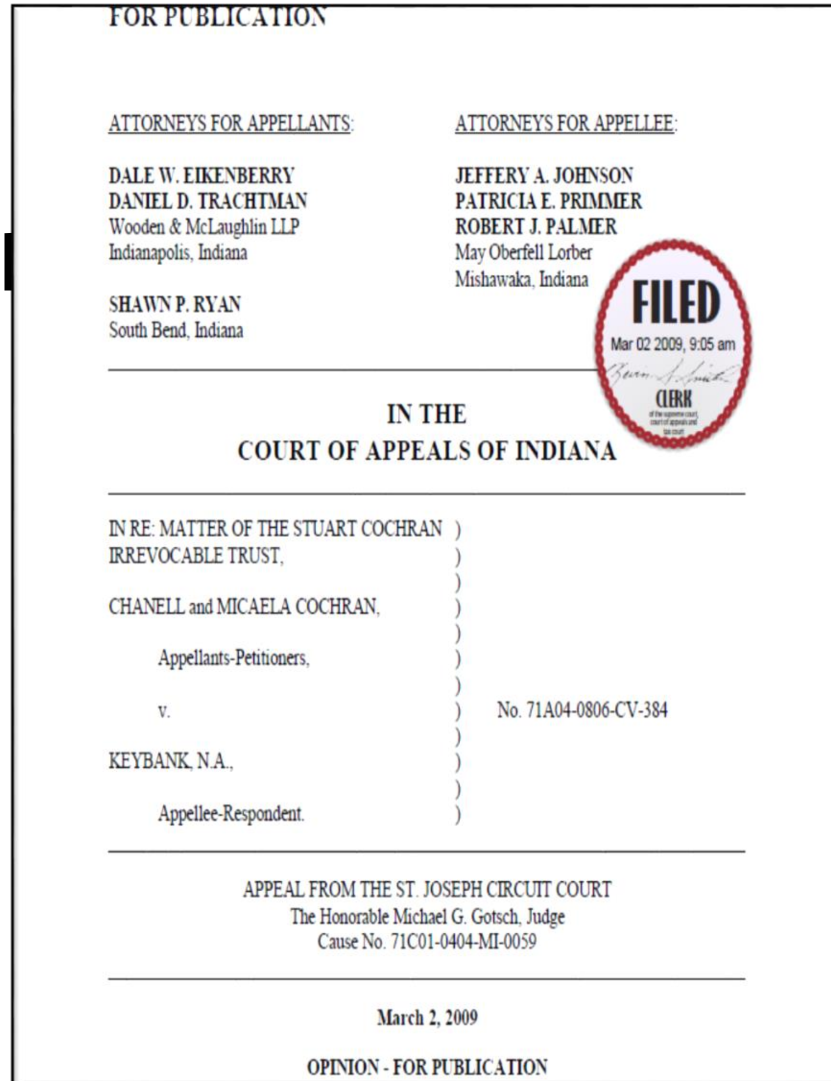
assists the trustee in monitoring the economics of the policy.

Generally, while insurance companies are regulated by the state and maintain a mandatory level of reserves, specific assets are not identified to support an insurer's promise to pay on a policy. Policyholders are subject to the creditworthiness and liquidity constraints of the company. It is important that a bank fiduciary perform due diligence on an insurance company issuing a policy to ensure that it is sound, viable and able to meet future obligations.

Cash value on permanent life insurance policies may be included as part of the account's assets if the bank has done a thorough review of the insurance

Case Law

- Litigation involving life insurance on the rise.
  - Cochran v. ILIT Trustee
  - French v. ILIT Trustee
  - Larry King v. Insurance
  - Micale v. ILIT Trustee
  - Schneider v. Attorney
  - Vagelos v. Stockbroker



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
CLERK

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. 71A04-0806-CV-384

APPEAL FROM THE ST. JOSEPH CIRCUIT COURT
The Honorable Michael G. Gotsch, Judge
Cause No. 71C01-0404-MI-0059

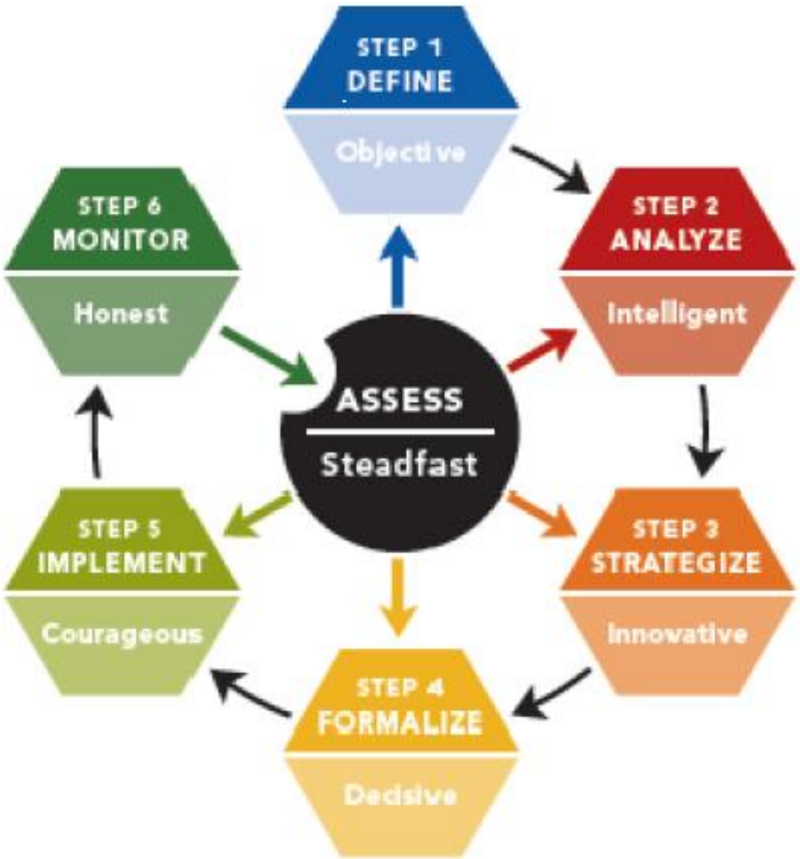
March 2, 2009

OPINION - FOR PUBLICATION

Best Practice Standards

- Financial Planning Association (FPA) formed in 2011 a task force to define prudent selection and proper management of life insurance.
- Best Practices Standards finalized at West Point in 2013 by representatives of most professions who have clients who own life insurance.
- Applies the same universal decision-making framework to life insurance that is already widely-accepted in the investment business.

Best Practice Standards



Best Practice Standards

1. Define Roles
   - Define Roles & Responsibilities of Each Decision Maker
   - Confirms Each Decision Maker Understands their Roles and Responsibilities
   - Addresses Perceived Conflicts of Interest

Best Practice Standards

STEP 2 ANALYZE Intelligent

2. Analyze Situation

- State Goals and Objectives
- Defines Decision-Making [illegible]work
- Confers Tax Strategy wi[illegible]Advisor
- Confers Legal Structure with Legal Advisor
- Confirms Insurability
- Confirms capacity to comply with Standards or Prudently Delegate

STEP 2 ANALYZE Intelligent

Best Practice Standards

3. Strategize
   - **R** - Risk Tolerances of Client
   - **A** - Assets & Asset Class Preferences
   - **T** - Time Horizons
   - **E** - Expected Outcomes

Best Practice Standards

4. Formalize Solutions
   - Define Consistent with RATE
   - Not constrained by compensation model, distribution channel, proprietary products, prevailing marketing practices, etc.
   - Is consistent with prevailing industry best-practices (i.e., avoids questionable practices).
   - Life Insurance St Statement (LISS)

Best Practice Standards

5. Impleme

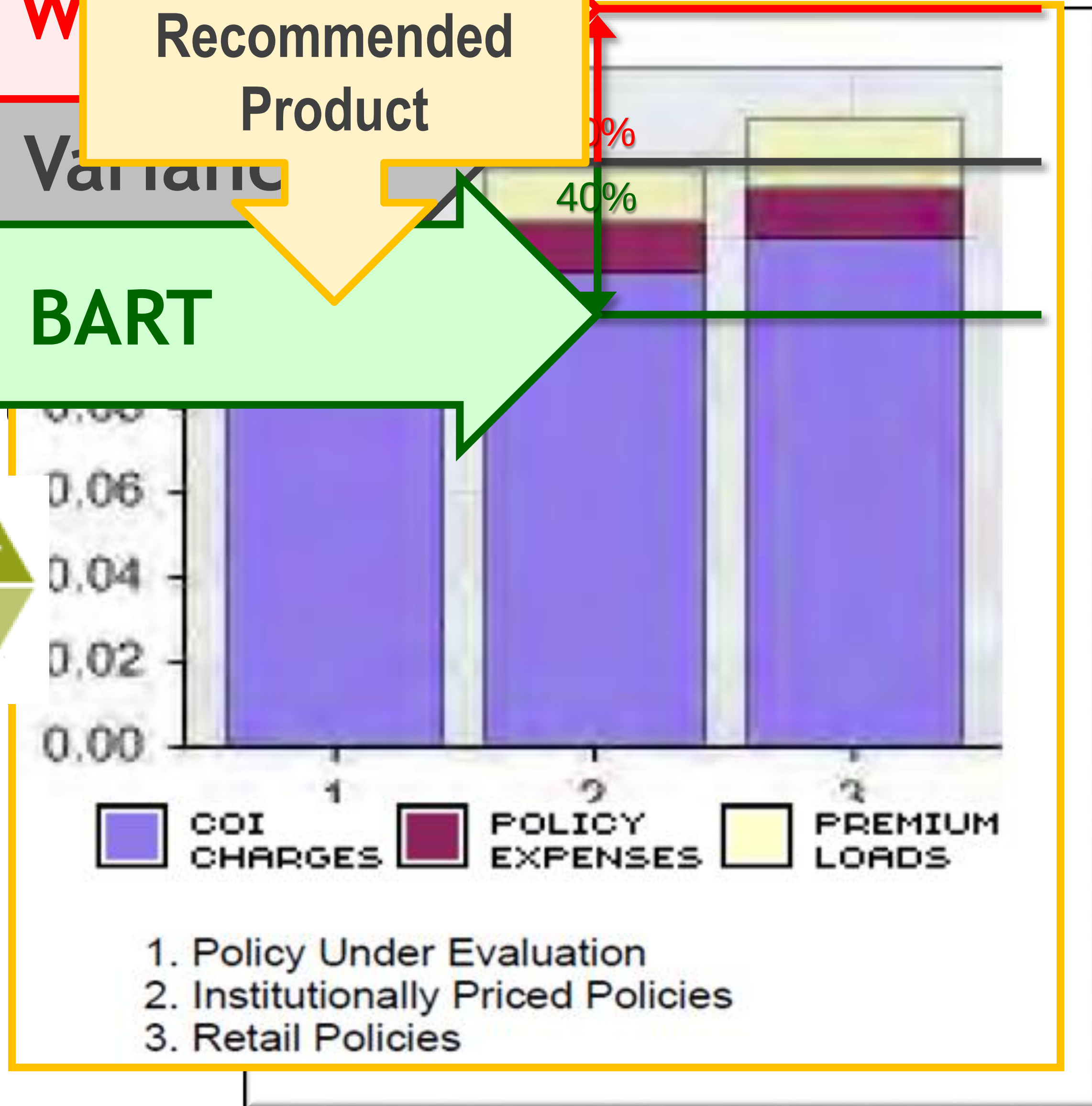
- Defi
  - Fi
  - Cost (
  - Pricing Stabili
  - Cash Va
  - Historic
    Underly

W

80% Cost Varianc

Inforce Policy or Recommended Product

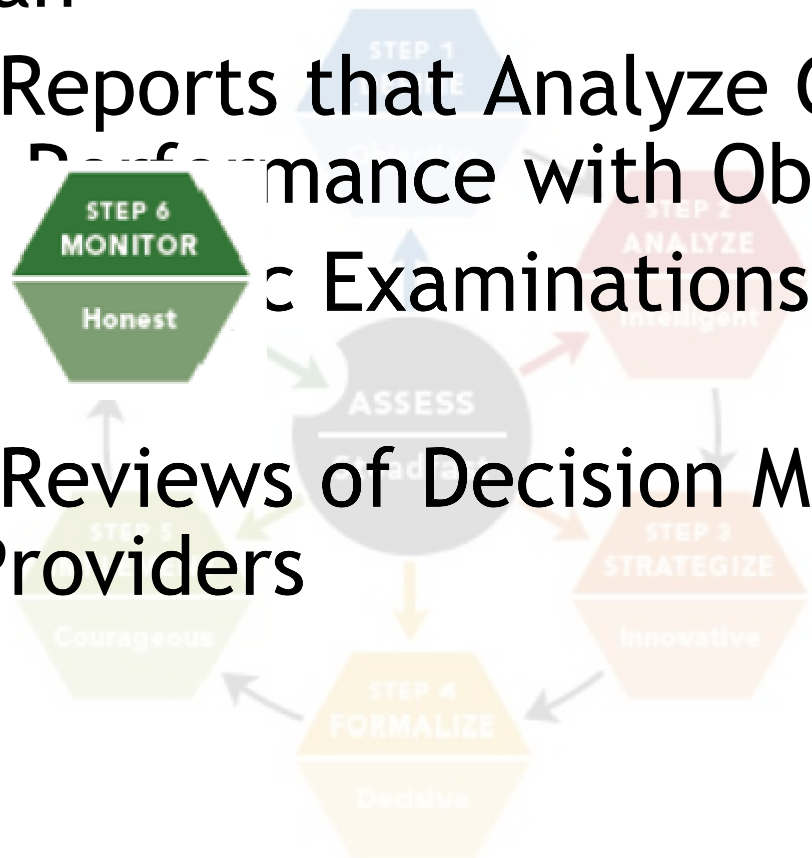
BART



Best Practice Standards

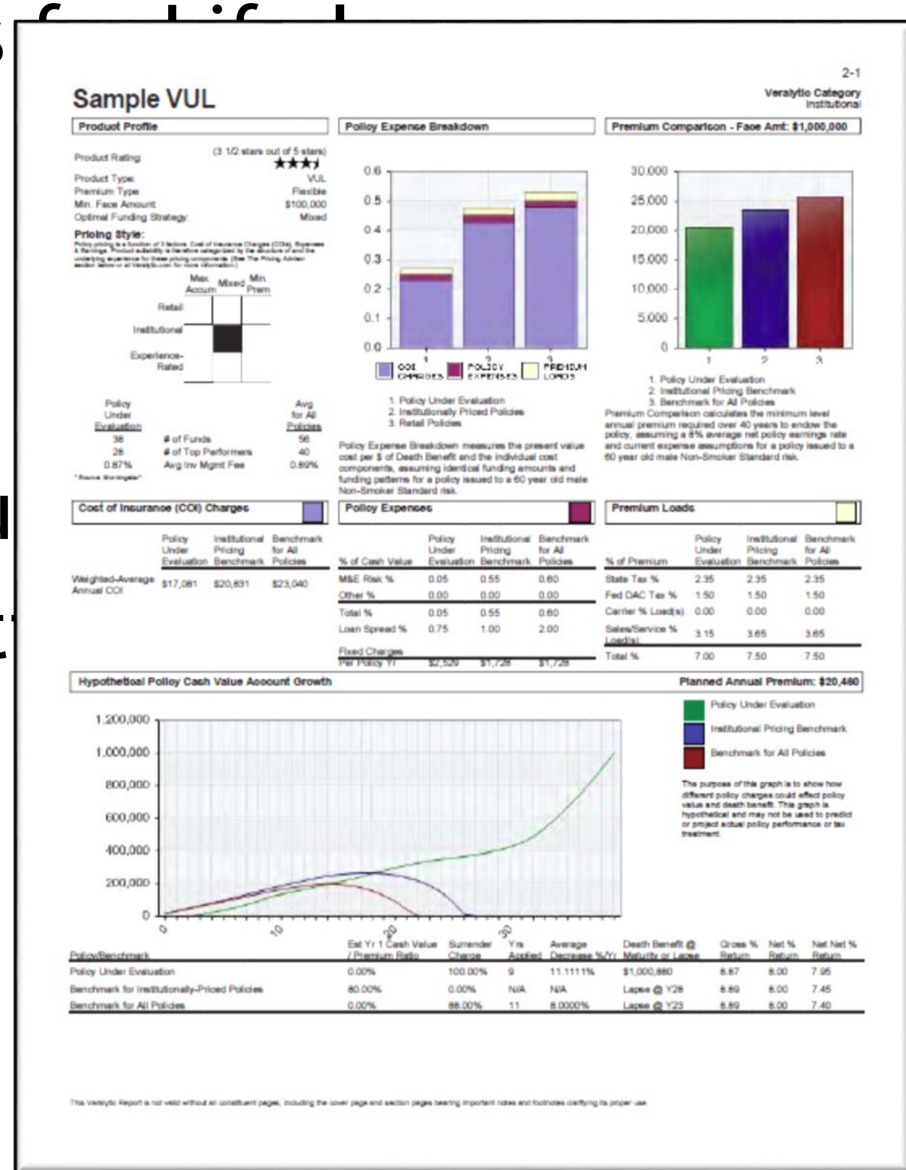
6. Monitor Plan

- Periodic Reports that Analyze Costs and Compare Performance with Objectives
- Perform [illegible]c Examinations for Conflicts of Intere[illegible]
- Periodic Reviews of Decision Makers and Service Providers



Take-Aways

- Best Practice Standards
  Stewardship
- TRUSTS & ESTATES
  A Shot Across The Bow
- 3 Questions to Ask abou
- Complementary Veralyt



Conclusions

- Life Insurance increasingly considered and/or promoted as an asset.
- Following new guidance avoids “misleading”, “inappropriate”, and unreliable insurance industry practices.
- Following new Best Practice Standards increases likelihood of meeting client expectations.

Contact Us

Veralytic

Text VERALYTIC to 22828 to join our e-newsletter or find us on social media

Barry Flagg

@Veralytic

Veralytic

Barry D. Flagg, CFP®, CLU, ChFC, GFS™

bflagg@veralytic.com

888-908-8242

www.veralytic.com

Q&A

Veralytic

Veralytic is an independent life insurance research company based in Tampa, Florida. Veralytic provides objective, innovative research solutions to help reduce costs and risk, improve consistency, and document due diligence processes against possible lawsuits and regulatory requirements. Our research reports are based upon a patented "five star" rating system that benchmark suitability against an ever growing database. Veralytic has been endorsed by the New York Bankers Association (NYBA), accepted by the Financial Planning Association (FPA), reviewed by the chief regulatory body of the financial services industry, and trusted by financial advisors, brokers, and fiduciaries across the United States.

For more information:

Barry D. Flagg, CFP®, CLU, ChFC, GFS™

bflagg@veralytic.com

888-908-8242