



Liability Awaits the Irrevocable Life Insurance Trust Trustee

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Grantors of irrevocable life insurance trusts (ILIT) often give far too little thought to their choice of trustee. Additionally, they frequently do not fully grasp the obligations and responsibilities they thrust upon their choice for trustee. The responsibilities of the ILIT trustee have historically been viewed as twofold. The trustee must:

- (1) send notification of the beneficiary's right to withdraw (Crummey notices) upon receipt of a gift from the grantor(s); and
- (2) after lapse of the withdrawal right, pay the life insurance premium.

However, a recent Indiana Court of Appeals case provides significant clarification of the ILIT trustee's duties and guides us as to the potential liability for their failure to honor those duties.

In 1999, KeyBank approved an exchange of life insurance policies as trustee of Stuart Cochran's ILIT whereby the collective death benefit was increased from \$4.7 million to \$8.0 million. The new policies were variable universal life contracts. In 2003, due to considerable market losses, KeyBank hired an insurance consultant to review the performance of the variable universal life policies. At the time of the review, Mr. Cochran was 52 years old. The review, performed at various rate-of-return assumptions, revealed that the policies were likely to lapse when Mr. Cochran was between 58 and 71 years old. On the assumption that Mr. Cochran's life expectancy was well past 71 years of age, KeyBank approved a 1035 exchange of the cash value in the variable policies into a universal life policy with a guaranteed death benefit of \$2.5 million, to Mr. Cochran's age 100, and no further premium payments due. Mr. Cochran died at the age of 53.

The ILIT beneficiaries, Mr. Cochran's two adult daughters, sued KeyBank alleging breach of fiduciary duty. The Court of Appeals ruled that it was prudent

for KeyBank to move the trust assets from insurance policies with significant risk of lapse into an insurance policy with a smaller but guaranteed death benefit. The Court further determined that KeyBank's process (though not perfect) was sufficient.

The ruling in *Cochran* provides a roadmap for future litigation against ILIT trustees and, as a result, the prudent trustee should understand the lessons of the case and take reasonable precautions to limit their risk of fiduciary liability. Those precautions include adoption of (1) an investment policy statement as required by the Uniform Prudent Investor Rule (UPIA), (2) a process to periodically review performance of the insurance policy and the issuing carrier, and (3) a process to review suitability of the insurance in light of the purposes of the trust.

A well written investment policy statement is designed to protect the parties of an ILIT. It clarifies and documents trust objectives, product suitability, purpose of the insurance, needs of the beneficiaries and time frame for the insurance need. It further assures that reasonable expectations are documented at the outset so that the trustee(s), grantor(s) and beneficiaries are on the same page. The investment policy statement should also be reviewed by the parties on an annual basis to ensure the trust and its insurance policies continue to meet the parties' stated objectives.

The Court's ruling in *Cochran* clearly identifies the ILIT trustee's duty to (1) analyze the performance of the life insurance policies owned by the trust and (2) consider alternative investments to meet the trust's objectives. Many trustees do not have ready access to expert services that can perform these duties. However, BUI's Performance Evaluation process is specifically designed to accomplish these goals in a systematic manner whereby the performance of the life insurance policy is evaluated and alternative products in today's marketplace are considered based on the insured's current health status. A BUI Performance Evaluation of trust owned policies commonly leads to increasing death benefit for the same premium, preventing a policy

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from lapsing, extending guarantees, confirming life insurance carrier stability or adjusting coverage based on trust objectives. Documenting these results and changing trust investments when necessary helps the trustee minimize the risk of future litigation.

The Court in *Cochran* taught us that suitability is an important issue with respect to the insurance and it must always be considered when reviewing the performance of the contracts in the trust. An annual meeting among the parties of the trust is essential to evaluate trust objectives. By reviewing trust objectives with the grantor(s) and beneficiaries and ensuring the life insurance coverage meets those objectives, the trustee involves all parties in the process. As a result, the trustee's relationship with the grantor and beneficiaries is enhanced while the likelihood of a dispute or lawsuit is minimized.

While many suits have been filed and settled out of court, *Cochran* is the first known case involving breach of fiduciary duty against an ILIT trustee to proceed to the Court of Appeals. ILIT trustees can take some comfort in the fact that in this instance, the Court ruled in favor of the trustee. However, it is clear that trustees must adopt a process to minimize their risk of fiduciary liability. Those ILIT trustees who are family members or friends of the insured generally are not well-informed as to the personal liability when undertaking their role as trustee. Advisors can perform a valuable service for their clients and their clients' trustees by introducing them to BUI's Performance Evaluation process.

For more details on BUI's Performance Evaluation process, please contact BUI's advanced marketing specialists at (314) 392-2841 or visit BUI's website at www.brokerageunlimited.com.

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