



Fiduciary Risk: Trust-Owned Life Insurance

There is an old proverb that says, “If everything is going well, you may not know everything that’s going on.”

Many life insurance policies are not funded with adequate premiums to keep coverage in force until death. In recent years, the risk of underperformance for many policies has been shifted from the life-insurance carrier to the policy owner and the trustee as a fiduciary.

Investment returns and non-guaranteed expenses are typically explained by insurance carriers on annual policy statements, but they can be hard to find and even harder to decipher. This is particularly a problem for trust-owned life insurance where the trustee is under a fiduciary duty to manage risks and monitor the performance of the trust policies.

Trustees of trust-owned life insurance policies are guided by the Prudent Investor Act. This act requires anyone with control over another person’s assets to acquire investments or manage existing funds in such a way that the holdings will be exposed only to risks that a reasonably intelligent and cautious person would consider worthwhile. In other words, their actions must have a low probability of permanent or long-term losses.

A fiduciary who breaches the Prudent Investor Act can be held responsible for damages. They are also often responsible for the recovery of losses incurred by inadequate life insurance acquisition processes, ineffective ongoing management, or inappropriate investment strategies. Additionally, if a policy lapses before the insured person’s death, the trustee may be held responsible for not properly reviewing and managing the policies.

For trusts that own policies, annual life insurance reviews are essential. These should include in-force

illustrations and appropriate benchmarking. The trustee should follow appropriate guidelines and procedures for managing the policies, including keeping detailed records, illustrations, notes, and summaries of actions taken at review meetings.

Financial advisors who have expertise in managing life insurance can assist with providing a comprehensive review. Insurance carriers do not provide comprehensive reviews or advice.

Without professional management, the policy owner may be required to pay substantially higher future premiums. They may also be at increased risk of the policy lapsing before the insured person's death. A life insurance portfolio review can identify policies that are underperforming and that may lapse or require dramatically higher premiums in the future.

In many cases, existing policies can be edited and improved. Alternatively, improvements can be achieved by comparing existing coverage to policies offered by other insurance carriers. Comparison shopping can result in lower premiums for the same amount of coverage, more coverage for the same premiums, or more predictable premiums with less risk.

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