CAPTRUST

Fiduciary Risk: Trust-Owned Life Insurance

Many life insurance policies may not be 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 fiduciary.

Investment returns and non-guaranteed expenses are often not clear from the annual policy statements provided by the insurance carrier. This is particularly a problem for trust-owned life insurance where the professional or amateur trustee is under a fiduciary duty to manage the risks and monitor the performance of the trust policies.

Trustees of trust-owned life insurance policies are guided by the Prudent Investor Act, which requires those who have control over another's assets to acquire investments or manage the funds in such a way that the holdings are only exposed to risks that a reasonably intelligent and cautious person would consider worthwhile. They must, in other words, have a low probability of permanent or long-term loss.

A fiduciary that breaches the Prudent Investor Act can be held responsible for damages and recovery of losses incurred by inadequate life insurance acquisition processes, ineffective ongoing management, or inappropriate investment strategies. If a policy lapses before the insured's death, the trustee may be held responsible for, among other things, not properly reviewing and managing the policies.

For trusts that own policies, annual life insurance reviews that include in-force illustrations and appropriate benchmarking are essential. The trustee should follow appropriate guidelines and procedures for managing the policies, including keeping detailed records, illustrations, notes, and 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 and may be at increased risk of the policy lapsing prior to the insured’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, improvements can be made to an existing policy. Alternatively, improvements may be achieved by comparing to policies offered by the other insurance carriers. This can result in lower premiums for the same amount of coverage, more coverage for the same premium, or more predictable premiums with less risk.