



## TOLI Product Suitability

Product suitability is a TOLI trustee's most important policy acceptance and annual policy risk management decision in documenting a prudent process that maximizes the probability of a favorable outcome to the trust estate.

The prudent investor rule instructs a trustee to design and carry out a reasoned investment strategy that will fit within the trust's unique purposes and the beneficiaries' expectations to make the trust property productive. To fulfill this duty, a trustee must first establish product suitability criteria and distinguish product suitability from policy suitability.

- A trustee has the duty to make product suitability determinations based upon initial grantor guidance, the TOLI Investment Policy Statement (TIPS) and annual policy performance reviews with trust beneficiaries. TIPS confirms the expected death benefit proceeds "return" and acceptable level of premium adequacy "risk", if any. Based on TIPS criteria, suitable policy sales proposals can be evaluated.
- Product suitability criteria determine initial and ongoing policy suitability. Lacking product suitability criteria, life insurance producers may make sales proposals for products that expose the trust to unexpected premium and death benefit risks.

### Guaranteed versus Non-Guaranteed Death Benefit Products

Life insurance is ideally suited for risk management. For example, a trustee can transfer all premium adequacy and policy performance risk to the underwriting carrier by accepting a guaranteed death benefit policy and paying scheduled premiums timely. Alternatively, a trustee can contractually retain these risks by accepting an indeterminate premium non-guaranteed death benefit policy and actively managing policy values (see Policy Suitability Matrix on page 2).

Flexible premium non-guaranteed adjustable life, universal life, and variable universal life were the TOLI product-of-choice from 1980 through 2000, and represent approximately 40% of in-force TOLI policies. These policies do not have a "premium" in the conventional sense, and carrier illustrations do not evaluate premium adequacy risk. As a result, TOLI policy acceptance, management, and restructure determinations should be based on actuarially defensible premium adequacy evaluation; hence, most trustees outsource the annual monitoring function.

### Annual TOLI Policy Risk Management

A product suitability determination is implicit with each premium payment, and this determination has become increasingly problematic for trustees. Approximately 25% of in-force flexible premium TOLI policies are predicted to lapse during the insured's lifetime, and a lapsed TOLI policy usually documents trustee negligence and quantifies damages. A "wait-and-see" procrastination decision will rarely correct a mispriced policy or mistaken reliance on carrier illustrations for predictive performance decisions.

The annual policy performance review and suitability determination should be based upon (1) dispute defensible policy performance evaluation, (2) the trust's current objectives and premium payment capacity, and (3) the needs and risk tolerance of trust beneficiaries. These factors should be considered along with the following:

- If the annual premium payment needs to be increased, will the grantor increase the annual gift to the trust to sustain the original death benefit objective or should the death benefit be reduced to keep the policy in-force?
- Is the policy suitable for the trust purpose and risk tolerance of the beneficiaries? If trust objectives have changed, should a policy exchange or a life settlement be considered?
- Is a variable universal life policy's current asset allocation strategy appropriate? Are the investment subaccounts performing competitive with relevant asset class benchmarks? Is the annual premium adequacy evaluation volatility tested?

## Policy Restructure

A TOLI trustee is expected to review trust policies and, if necessary, formulate a plan for restructuring the portfolio to achieve a suitable level of risk and expected return. Since an insurance trust may span a 10 to 50 year time horizon, restructure should be expected as family situations, trust objectives, tax laws, and life insurance policies change. Restructure recommendations should include credible third-party policy analysis as most trustees and trust parties lack life insurance expertise.

## Product Suitability Options

Life insurance carriers offer a broad range of death benefit and cash accumulation products, and continually introduce new products or product enhancements in response to consumer demand. Recognizing that **all products are not the same**, an impartial fee-based life insurance consultant with the demonstrated product expertise can assist trust parties with the initial policy selection and subsequent restructure determinations.

The following matrix sets out a TOLI trustee's primary policy acceptance and annual management considerations, and the annual performance verification expected by beneficiaries.

Trustee Acceptance Considerations Policy Management Features	Guaranteed Products				Non-Guaranteed Products			
	Whole Life	No Lapse Guarantee Universal Life	Level Premium Term	Yearly Renewable Term	Adjustable and Universal Life	Indexed Universal Life	Variable Universal Life* and ILI**	Variable Life
Premium Schedule	Fixed	Fixed	Fixed Period	Increasing	Flexible	Flexible	Flexible	Fixed
Specified Death Amount	Fixed	Fixed	Fixed	Fixed	Flexible	Flexible	Flexible	Fixed
Account Value Management	Carrier	Carrier	None	None	Trustee	Trustee	Trustee	Trustee
Asset Allocation Required	N/A	N/A	N/A	N/A	No	Yes	Yes	Yes
Illustration Credibility	Yes	Yes	Yes	Yes	No	No	No	No
Actuarial Evaluation	N/A	N/A	N/A	N/A	Yes	Yes	Yes	Yes
Volatility Simulation	N/A	N/A	N/A	N/A	Yes	Yes	Yes	Yes

Trustee Management Requirements								
Investment Policy Statement	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
TOLI – Specific Procedures	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Product Suitability	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Premium Adequacy Risk	No	No	No	No	Yes	Yes	Yes	Yes
Premium Adequacy Monitoring Cycle	N/A	N/A	N/A	N/A	Annual	Annual	Annual	Annual
Carrier Solvency Risk	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Carrier Suitability Monitoring Cycle	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing	Ongoing
Asset Allocation Review	N/A	N/A	N/A	N/A	N/A	N/A	Annual	Annual
Conversion Review	N/A	N/A	As Directed	As Directed	N/A	N/A	N/A	N/A
Rating and Rider Review	Annual	Annual	Annual	Annual	Annual	Annual	Annual	Annual
Regulatory Review (Institutional)	Annual	Annual	Annual	Annual	Annual	Annual	Annual	Annual

Professional Advisor Annual Verification								
Product Suitability	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Premium Adequacy	N/A	N/A	N/A	N/A	100%	100%	100%	100%
Death Benefit Adequacy	N/A	N/A	N/A	N/A	Yes	Yes	Yes	Yes
Carrier Suitability and Solvency	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Investment Performance Rebalancing	N/A	N/A	N/A	N/A	N/A	Yes	Yes	Yes
Term Conversion	N/A	N/A	As Directed	As Directed	N/A	N/A	N/A	N/A

\* Including Private Placement Life Insurance (PPLI) – Accredited investors have access to PPLI which wraps investments similar to VUL but also includes options such as hedge funds, private equity and complex derivatives.

\*\*Institutional Life Insurance