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July 10, 2006

CPAs as Trustees for Trust Owned Life Insurance: The Need for Periodic Reviews

With life settlement transactions increasingly evolving from trust owned life insurance (TOLI), CPAs serving as fiduciaries will find it prudent to establish evaluation procedures for policies under management.

Authored by Marlene Frith

With a significant percentage of life settlement transactions evolving from trust owned life insurance (TOLI), CPAs serving as fiduciaries for Irrevocable Life Insurance Trusts (ILITs) will find it prudent to establish evaluation procedures for policies under management.

According to one major insurance carrier, trusts now own more than \$1 trillion of life insurance, and nearly 20 percent of the universal life and variable universal life policies sold to trusts are now on the verge of lapsing. A survey conducted several years ago by Trusts & Estates Magazine revealed that nearly 84 percent of the respondents who were acting as trustees indicated they did not have stated guidelines and procedures for handling performance reviews for trust owned life insurance policies.



Marlene Frith

An Industry Bellwether

An examination of our internal statistics in terms of policy ownership indicates that trust owned life insurance comprises 45 percent of the life settlement transactions routinely conducted by our firm. If this statistic is representative of the industry as a whole, it is a bellwether that many policies held in trusts are indeed susceptible to lapse. Trustees have the duty to investigate the value of all assets in the trust — including life insurance — and CPAs serving as trustees should be mindful of the need for periodic reviews and be on the lookout for ILIT policies that may be at risk of lapsing.

A Trustee Stops the Bleeding

A case in point involved a 75 year old male who owned a \$3 million life insurance policy with a cash surrender value of \$116,912. The trustee for the policy was an attorney who had a relationship with the insurance agent who had originally sold the policy to the client. The agent and the attorney worked together to review the policy's performance and discovered a problem. Since the insured had lost interest in

maintaining the policy and no longer wished to make gifts to the trust for premium payments, the cash surrender value was rapidly depleting as premiums were being deducted from the cash value. As trustee for the policy, the attorney decided to "stop the bleeding" and conducted an estate planning review to determine whether the policy should be surrendered or whether a life settlement would be more advantageous to the client's estate. They decided to proceed with the life settlement and the policy was purchased for \$328,000 — nearly three times the cash surrender value. The settlement proceeds were used to maximize cash in the trust.

CPAs and Life Settlements

A professional hallmark of CPAs is their commitment to lifelong learning and continuing professional education. That said, it is likely that most CPAs today have at least heard about the rapidly growing life settlement marketplace, even if they have not personally participated in a transaction. More and more seniors over the age of 70 are now aware that they have a right to resell an unwanted or underperforming life insurance policy, and many of those seniors are approaching their CPAs and other advisors requesting assistance in determining whether the product is right for them.

A CPA's Responsibility to the Client

Once the decision is made to pursue a life settlement, the CPA has a responsibility to guide their client in obtaining the highest possible value for this asset. Working with an established life settlement broker whose core competency is negotiating the highest possible market value for the senior's policy should be the CPAs next step.

The Fiduciary Risk of Accepting One Offer

Some might ask why the CPA or financial advisor should not approach a provider (an organization that purchases life settlement policies) directly to obtain an offer. The answer to that question is simply that approaching one provider will result in one offer. CPAs should not make the mistake of assuming that an offer from a provider, irrespective of the provider's reputation in the industry, represents the fair economic value of the policy.

Life Settlement Brokers — A Responsibility to the Policyholder, not to the Provider

The primary objective of a life settlement broker is an obligation to the policyholder which involves creating an auction-like environment where multiple providers present competitive offers for the same policy. Similar to the manner in which retail competition helps establish fair prices for consumers, multiple funding sources that operate on the secondary market for life insurance create an environment where the economics of competitive pricing establish the policy's true economic value. As we point out in our [article](#) published in the July 2006 issue of the Journal of Structured Finance, the "settlement broker" represents the policy seller in pursuit of the best possible offer, while the "provider" represents the interests of investors to purchase policies at the greatest possible discount.

CPAs As Problem Solvers

In an article entitled "Turn Unneeded Policies into Cash" which appeared in the September 2005 issue of the [Journal of Accountancy](#), author James Warring points out the following: "Life insurance planning isn't always about making sure someone has enough coverage. It's also about finding solutions for people who have too much."