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Estate Planning & Elder Law

The Life Insurance Checkup

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Life insurance is a key component of an estate plan. It is critically important that the attorney makes sure that the estate plan is regularly reviewed. In this context it is imperative that the client's life insurance policies are reviewed periodically to make certain that they still achieve the client's objectives. Further, to the extent that the policies are owned in life insurance trusts, the trustees have an obligation to make sure the policies are reviewed at regular intervals.

Life insurance is an amazing tool from an estate planning perspective. It can be owned by an irrevocable life insurance trust and payable to the trust and remain outside of the insured/grantor's taxable estate. This is a very common tax planning technique. However, in meeting with clients year after year it has become clear that in most cases, trustees of these insurance trusts are not sensitive to their responsibilities in the operation of the trusts during the grantor's life.

The responsibilities of trustees should go beyond paying premiums out of a trust account and sending crummy letters advising beneficiaries as to their withdrawal rights under the trust. Trustees have a fiduciary duty to manage trust assets in a way that is in the trust beneficiaries' best interests, even if trust assets are limited to life insurance policies.

Typically, an insurance policy remains in a trust with no regular review as to whether the policy is appropriate. Further, attorneys rarely remind their clients to engage in such a review. Trustees should be asking questions to include the following:

1**. Is the insurance policy still performing as expected on initial illustrations?** Interest rates, economic factors and poor policy performance could result in the policy not performing as expected. It may be appropriate for a trustee to determine whether to continue to pay premiums on a policy, or to consider alternatives. As a separate matter, a policy may have built up so much cash surrender value that no additional contributions to the trust by the grantor are necessary and the policy can sustain itself.

2. **Have circumstances changed so that a replacement policy is appropriate?** There are many reasons why a new policy may make sense as an alternative. For example, the insured's health may have improved since the policy was purchased. If a lengthy period of time has passed since a health incident, the cost of insurance could have gone down, with a better rating available to the insured. Another example where a new policy may be appropriate is if changes in interest rates, economic factors or actuarial tables result in the cost of insurance diminishing. In those circumstances, the trustee should evaluate if he or she can purchase more insurance with the same premium or can purchase the same amount of death benefit with less premium costs.

3. **Do new insurance products have superior features?** New forms of policies or features on existing policies should be considered where the insured's health and age do not render him or her uninsurable or increase the costs of new insurance exponentially. For example, some policies are designed to terminate when the insured reaches a certain age. If that is the case, the trustees should evaluate whether a policy with a longer term is available to better protect trust beneficiaries. Many policies issued 10 or 20 years ago were designed to endow at age 100, which means the cash value would equal the death benefit. Today there are new policies that do not endow. Clients who are purchasing insurance only for its death benefit and not as an investment could pay less in premiums with a newer policy.

4. **Is the insurance carrier financially secure despite shaky economic conditions?** This issue can create substantial liability risk on the part of the trustee. The trustee should request a financial report for the company that issued the current policy and ensure that the insurance investment is sound.

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5. **Have the insured's goals for the insurance changed?** It may be that a policy was purchased to pay off a mortgage on a home which has long since been repaid. A policy may have been purchased to provide income replacement to a spouse in case the primary bread winner dies prematurely and this policy has not been revisited even though the bread winner has long since retired. Or a policy is purchased to cover the costs of children's college expenses and the children are through college and married with children. It is important to insure that the owner's need for the insurance is still high and that a change in goals does not justify a change in the insurance investment.

6. **What is the insured's estate tax exposure?** If the initial need for insurance is not present, is there a new need for insurance due to the insured's estate tax exposure?

7. **Did the trustee evaluate options before exchanging or terminating a policy?** If an old policy is to be eliminated and a new policy purchased, the trustee may contemplate exchanging a policy for a new one under Internal Revenue Service Code Section 1035(a) to transfer the old policy's basis without recognizing any gain on the transaction. However, other options should be considered as well. For example, the old policy could be surrendered for its cash surrender value (with any tax recognized) and a new policy purchased, and the proceeds could be used to offset the cost of third-party financing to fund the new policy.

In summary, it is an important role for the estate planning attorney to make sure that the client has a regular review of his/her life insurance policies to make sure they are still achieving the client's purpose for having the policies. Further, the trustees of life insurance trusts have an obligation to the beneficiaries to make sure there is a regular review of the life insurance coverage. ■