A New Take on Prudence: The Role of Trustees in Life Insurance in a Changing Environment

By Matthew L. Severs and Philip E. Harriman

Matthew L. Severs and Philip E. Harriman analyze how a trustee's duty of due diligence under the Uniform Prudent Investor Act is being impacted by the current economic turmoil and the need for a risk assessment that goes beyond mere reliance on insurance company rating agencies.

What defines a prudent investor? It is a question that every trustee or advisor should be able to answer, but one which surprisingly few truly understand. In an era of rapid change, the insurance industry needs prudence now more than ever, but the ideal of prudence has changed along with the industry. As struggling insurers stir up distrust among insurance buyers, carrier selection has become an evermore imperative metric increasing the need for not only prudent investors but prudent advisors. The foremost doctrine of prudence today is the Uniform Prudent Investor Act (UPIA), created and approved by the National Conference of Commissioners of Uniform State Laws in 1994, and since adopted by nearly every state. The UPIA requires trustees, acting as fiduciaries on behalf of the beneficiaries of the trust, to show a process for diversification of trust assets, and for the evaluation of risks associated with those assets.[1] Those who do not do this are undoubtedly leaving themselves open to litigation. As an example, it is common practice for trustees and advisors to rely solely on the opinions of rating agencies to demonstrate risk evaluation of a life insurance carrier. This method has proven to be particularly questionable in the insurance industry, where examples of highly rated companies failing seemingly overnight abound. Life insurance contracts are unique investments in that they are often designed to last a lifetime. As such, life insurance policies and carriers demand special attention and forward-looking evaluation of risk. Prudence in the current era of change requires concerted effort to disseminate financial strength information and identify forward-looking metrics to evaluate carrier risk. Advisors who know and understand this can offer considerably more to trustees and clients in a time of uncertainty.

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Origins of Today's Prudent Investing

The ideal of prudent investing has stood at the center of fiduciary responsibility for hundreds of years, but in that time the legal duties of trustees have undergone significant change. The duties of trustees today were born out of the "Prudent Man Rule," taken from the 1830 *Harvard College v. Armory* case and first codified by the American Bankers Association in 1942. The emphasis of this early definition was placed on conservative investing and preservation of capital, thus, for many years in the field of financial and estate planning prudence could be shown through conservative investing and a focus on preservation of capital alone.[2] However, there is an easily identifiable flaw with this early definition. That is, conservative investing and preservation of capital may not fit the needs of every investor or the objectives of every trust. For example, young clients with a long investment horizon and high risk tolerance would be disserved by this older ideal of prudent investing. In fact, trustees have frequently been found imprudent in recent court cases by the new standards of prudence even though the original principal of the trust was maintained.[3] The Restatement (Third) of Trusts: Prudent Investor Rule (1992) and the more recent Uniform Prudent Investor Act of 1994 (UPIA) took this and other factors into consideration when identifying the responsibilities of trustees today. Both the Third Restatement of Trusts and UPIA identify five guiding principles for trustees to follow: 1) The suitability and prudence of trust assets will be determined as a whole, not on an individual basis, 2) the evaluation of risks associated with trust assets and their correlation to expected returns, is the trustees' central consideration, 3) there are no longer restrictions on acceptable investments for trustees, 4) a trustee must diversify the assets of the trust, and 5) it is acceptable for trustees to delegate investment and management functions to experts in those fields.[4] By the older prudent man standard, the UPIA adopted risk and return and diversification ideals from modern portfolio theory. By doing so, it has opened the available investment options for trustees, but paired this freedom with a responsibility to evaluate risk and diversify assets. It follows that under the UPIA, trustees will not be liable for unfavorable returns so long as they have developed and documented a process that follows the standard of care and diversification guidelines required under the act. Trustees are required to use their documented process for the purposes of careful decision making based on the facts associated with the trust and its beneficiaries.[5] The new Act requires trustees to be active in the selection and evaluation of trust assets, be skillful when making investment decisions and in correlating the needs of the beneficiaries with the asset selection, and be involved in the ongoing management of trust assets.

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The UPIA and Irrevocable Life Insurance Trusts (ILITs)

The heart of the UPIA and its predecessor the Restatement (Third) of Trusts, is to show a process for evaluating risk and in selecting assets that meet the objectives of the trust. In Irrevocable Life Insurance Trusts (ILITs), the asset(s) held in trust will be life insurance policies. So what determines the riskiness of a life insurance contract? Part of the answer lies in the type of insurance. When buying variable life insurance, the net premiums (after expenses) are placed in an account which is separate from the general account of the insurer. The investment allocation options in this account are typically restricted by the carrier, but it is the trustee's duty to evaluate the risk associated with the investment accounts chosen by the owner of the policy. Non-variable universal life represents a larger share of the insurance market than variable. In the case of non-variable universal life insurance, the net premiums are placed into the general account of the insurer and credited a current non-fixed crediting rate. Therefore, for non-variable life insurance contracts the risk lies in part with the financial strength of the insurer itself. It follows that the duty of the trustee is to evaluate the strength of the life insurance carrier to determine the riskiness of the contract. It is all too common, however for trustees to neglect this duty or give it very little effort. Most tend to rely on the opinions of third party rating agencies for information on the strength of carriers. There are two problems with this approach: First, these trustees lack a documented risk evaluation process, and second, the accuracy of ratings given by the rating agencies is now being questioned by analysts and lawmakers alike.

Failure of the Rating Agencies: An Introduction

The economic turmoil of 2008 made few things more apparent than the need for change in the way we analyze risk and advise clients and investors. The financial troubles of insurers like American International Group (AIG) and Genworth pointed out the need for better financial strength information in the industry and reinforced the idea that guarantees, in life insurance products, are only as good as the guarantor. Most of all, the economic turbulence brought to light the failures of a broken risk rating system—one championed by the big four rating agencies; Fitch, Moody's, A.M. Best's, and Standard & Poor's. These are the companies that have, over the past century positioned themselves as impartial authorities on risk; a position that has them open for criticism. In fact, the troubles of the mortgage-backed securities markets, corporate risk management programs, and U.S. lending institutions are all thought to have been exacerbated by the shortfalls of the big four. In the last half of the year, the SEC and many analysts began publicly berating the agencies with accusations of improperly aligned interests, inadequate resources, and overly generous ratings. The actions of companies like Moody's Corporation do little in disallowing the accusations. Mark Weil of Bloomberg recently noted that in a September, 2008 lawsuit, a Moody's shareholder asserted that the company's claims of independence in the rating process were false. Moody's counter to that claim was that 'generalizations regarding integrity, independence and risk management amount to no more than puffery.'[6] A clearly detrimental statement to what should be the company's core tenets of operation.

On December 3, 2008, the Securities and Exchange Commission (SEC) approved a new set of control measures to be put in place which are designed to try to alleviate some of the most glaring shortfalls of the rating agencies. Transparency and accuracy of future ratings will be the main focus of the SECs new measures, but the Commission also hopes to reposition the rating agencies, making them just one piece of a proper risk assessment, not the only piece; counterintuitive to the way that many advisors in the insurance industry were using the ratings. In fact, many investors and advisors were using the big four as a sole source of risk information when evaluating securities and institutions like insurance carriers, magnifying the problems of the rating agencies and highlighting the need for independent analysis in the new era of estate planning. This era will likely produce a race to fundamentals and exceptional proof of performance and integrity. Those who spend some time and effort independently analyzing the companies they do business with will be the best prepared for the new insurance environment. The new insurance professional will employ a new tool set to analyze insurers and the forward-looking risks they may present clients. Forward-looking risks like troubled assets, business line concentration, variable and indexed annuity exposure, and cost of insurance (COI) exposure to stranger originated life insurance (STOLI), are left out of a typical rating agency analysis, but are essential in determining the long-term viability of life insurance carriers. Qualitative characteristics like underwriting risk, issuing process, and policyholder service should also be added to a complete carrier analysis. Even stock price movements can be used to signal when more in-depth analysis should be conducted.

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Shortfalls of the Rating Agencies

There are several reasons rating agencies may have missed the boat. On the surface, the environment in which they operate allows them very little freedom and very little room for error. They are in the public eye, their moves are watched and put under scrutiny, and for many, taken as the last word on the risks certain assets or companies present. Rating agencies have recently had, by necessity, to walk a thin line between waiting to take action on financially shaky institutions and adding to the blight of suffering world markets by issuing downgrades. The notion that rating agencies are neutral, dispassionate, third party mavens has proven to be misguided. Here is why.

Looking a little deeper at the organization of the rating agencies shows that disturbing weaknesses have developed in the rating business model. Rating agencies now, and it was not always like this, receive a good deal of their funding through the issuers of securities and corporations that they rate.[7] In its July 2008 report, The SEC's office of compliance inspections and examinations referred to this "Issuer Pays Conflict." The report went on to say "The conflict of interest inherent in this model is that rating agencies have an interest in generating business from the firms that seek the rating, which could conflict with providing ratings of integrity." In essence these debt issuers and corporate entities pay rating agencies to rate and publicize their financial strength. Further, it is not uncommon for rating agencies to advise issuers on how to improve ratings then rate the securities and collect fees for both services.[8] It is not hard to see why these companies are looking for positive reviews, or how harsh ratings could severely stifle business for the raters. In a July, 2008 deposition to the SEC former Moody's executive, Jerome Fons stated, "originators of structured securities typically chose the agency with the lowest standards, engendering a race to the bottom in terms of rating quality. While the methods used to rate structured securities have rightly come under fire, in my opinion, the business model prevented analysts from putting investor interests first."[9]

Rating agencies also for some time have come under scrutiny for not having the knowledge, skill, or resources to accurately price some of today's most complex securities.[10] They have been stretched to their limit in terms of resource utilization. The study conducted by the SEC office of Compliance Inspections and Examinations last July cited from an internal e-mail within an unnamed rating agency that employees were working more than 60 hours a week, the agency was beginning to see resignations occurring, and expected to see more on the horizon[11]. Exacerbating the problem, rating agencies are being overrun by a rapidly expanding structured securities market, one in which they are compensated more heavily. Thus, they are motivated to put themselves further out on a limb to rate these more complex instruments. In 2006, for example, nearly half (46.8 percent) of Moody's Investors Service revenues came from structured finance related services.[12] The rating agencies' apparent technical dearth in understanding and rating today's most complex instruments has been an issue for some time. In the same July report mentioned earlier, the SEC's office of compliance inspections and examinations noted, "there was a substantial increase in the number and in the complexity of residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDO) deals since 2002, and some rating agencies appeared to struggle with the growth." The July report also stated that "internal documents at two of the rating agencies appear to reflect struggles to adapt to the increase in the volume and complexity of the deals."[13]

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Of all those who invest in insurance companies, the policyowners of general account products are arguably the most exposed to carrier insolvency, and yet they are often the least educated and least informed about the long-term solvency of their carrier. A real concern for holders of general account permanent insurance contracts should be what can happen to the premiums, cash values, and death

Table 1. Failure of Insurers: Impact on Policyholders

Event	General Account Values	Contractual features/ secondary guarantees	Separate Account Values
Sale or Merger	NO IMPACT New owner assumes contract	NO IMPACT New owner assumes contract	NO IMPACT New owner assumes contract
State Conservator/ Receivership	CV and DB Guarantees up to $ amount State Law	?	NO IMPACT
Past Industry Practice in Receivership	Full Death Benefit Paid CV preserved at lower rate w/ surrender charges Higher COI	Contracts reformed with Exec Life, Confederation and Mutual Benefit	NO IMPACT

Permanent life insurance contracts and annuities are designed to last a lifetime. Purchasers of permanent insurance policies are often making a lifelong decision which can be difficult or costly to change.

benefits should an insurer get bought or go into receivership. Because most universal life contracts are what are known as general account products (excluding variable universal life), the premiums are kept in the general account of the insurer and these policies are credited based on current rates derived from the insurer's investment experience. In the event of a sale or merger, contracts will be assumed by the purchaser or standing entity, and the values and guarantees of in-force contracts will be preserved. The real trouble for policyholders potentially arises when an insurer fails. When the Insurance Commissioner determines that an insurer is in danger of defaulting on its contracts, he or she can take control of the insurer and direct an orderly reorganization or merger to protect policyholders. This is known as receivership. While no policyowner has failed to receive benefits as a result of receivership, changes to interest crediting rates, policy charges, and premium amounts may be made by the acquiring company. With the failure of insurers like Executive Life and Confederation Life, for example, even guaranteed contracts were reformed and premiums needed to maintain guarantees were increased. In the case of Confederation Life, the relatively high dividend rates on outstanding whole life policies were lowered to match the universal life crediting rates at the time. Because of risks like these, insurance carrier failure has become an increasingly important issue to address with clients in today's marketplace where exposure to overvalued assets and capital constraints have strained even the largest insurers.

The New Insurance Environment

The actions of the SEC are likely to bring about change in three ways. First, accuracy and transparency problems will be further regulated. Second, rating agencies will be repositioned as one piece of a proper risk evaluation, as they were originally intentioned. Lastly, a shift of reliance from rating agencies toward independent analysis on the part of advisors will result. This independent analysis should be considered part of the duties and responsibilities of a trustee managing a life insurance trust. Section Two of the UPIA delineates the standard of care requirements, and the risks that must be evaluated by trustees. According to the language of the act, this is a nonexclusive list that includes environmental factors, and in the case of life insurance, should certainly include factors relating to the strength of the life insurer.[14] It is important to note that section two of the UPIA also states that "a trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets."[15] Among those facts should be measures of financial strength regarding the carrier, as well as the use of the life insurance. Life insurance contracts perform different functions depending upon the needs of the insured and/or the owner. For estate planning, the contract may be needed to create tax-free death benefits. Therefore, assuring that the insurer is capable of paying the claim may be the most important evaluation criteria. In a business setting, the same policy may be used to deliver deferred compensation payments to a key employee. In this instance, assuring that the insurer has sound underwriting principles to minimize the potential increases in cost of insurance (COI) and other expense charges in the future, which will significantly impact the equity value of the policy needed to pay after-tax benefits to a retired employee. In yet another scenario, the policy may be structured to "morph" the term insurance portion of the contract into permanent insurance as dividends on a whole life policy are declared. The purpose of the policy should influence of the focus of the due diligence.

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Forward-Looking Measures: A new dimension of evaluation

The shortfalls of the rating agencies and the requirements of the UPIA have made it clear to the most diligent trustees and advisors that more must be done in the way of carrier evaluation. The new insurance environment will demand better analyses as more and more cases of improper trust management and improper planning come out. As was mentioned in short earlier, some of the forward looking business risks that should be considered are exposure to troubled assets, business line concentration, variable and indexed annuity exposure, and COI exposure to STOLI.

Exposure to Troubled Assets

The cash value credited, and the expenses taken from general account universal life policies, are directly influenced by the investment results of the writing company. While there are restrictions on the investments available to insurers, the types and amount of risk taken can vary dramatically among life insurers. Fitch released a report in October, 2008 that examined the ten U.S. insurance carriers with the largest exposure to non-prime residential mortgage backed securities (RMBS). The report found that even among these carriers, the percentage of RMBS exposure to statutory capital ranged from 227 percent to 16 percent.[16] Thus, when evaluating carrier exposure to troubled assets, both the riskiness of the assets and the amount of exposure must be considered. The results of the recent economic downturn reinforced the notion that those assets that are the most complex and least liquid often present the greatest risk. Carriers with the largest exposures to these types of assets also bring more risk to investors and policyowners.

Business Line Concentration

It is important to diversify risk not only among invested assets, but among business lines as well. Carriers whose income is concentrated in one or two lines could be negatively impacted by a change in regulation, poor performance or market forces, whereas a well diversified portfolio of quality product lines may allow a carrier to supplement struggling business units. Annuity focused insurers have been some of the most significantly impacted recently, and those with diversified operations will be the best prepared to weather the storm.

Variable and Indexed Annuity Exposure

In down markets, writers of variable annuities can be exposed to a double hit on earnings.[17] Large market losses result in lower asset values for the annuity contracts, meaning less mortality and expenses income for insurers. The reduced mortality and expense income then results an accelerated write-down or "unlocking" of an asset called deferred acquisition cost (DAC). Deferred acquisition costs are placed on the books of variable annuity writers in order to spread the up-front costs of selling the annuity over the life of the contract. Insurers are allowed to amortize DAC write-downs based on current and projected income calculations. In declining markets projected earnings decrease and DAC must be reduced to reflect the new assumptions, thus reducing an asset on the carrier's books more rapidly than expected.

Indexed Annuity contracts pose another problem for insurers. Indexed annuities are likely to become securities through legislation in the near future. With this new classification only properly licensed individuals will be able to sell Indexed annuities and the costs of selling and following compliance procedures will increase for carriers. Carriers will likely experience decreased equity indexed annuity profits as a result.

Cost of Insurance (COI) Exposure to Stranger Originated Life Insurance (STOLI)

Stranger Originated Life Insurance (STOLI) is a very controversial (and in some states, illegal) arrangement in which an investor induces an elderly individual to apply for life insurance and exchange the death benefit proceeds for an up front fee. The investor pays the policy premiums and gains at the death of the insured. STOLI negatively impacts life insurers in the following way: In order for the investor to profit, they must select individuals they feel are going to die in a short period of time. These individuals may not have the money to fund insurance themselves as premium rates may be very high. Investor funding thereby induces a form of adverse selection and can cause improper diversification of risks in the carrier's book of business. To compound the problem, STOLI policies are less likely to be lapsed than traditionally owned life insurance policies. This adversely affects the carriers expected losses. Carriers exposed to large amounts of STOLI business may have to raise cost of insurance charges to make up for lost earnings.

Stock Analyst Measures

Stock analyst measures can be used to add a comprehensive and forward-looking analysis to any insurance carrier review. Stock analysts are individuals who research the financial well-being of companies and provide investment advice regarding a company's stock or debt. Many of the ratios and tools that analysts use focus on the long-term financial strength of insurers: an especially important metric in an industry where business commitments can last a lifetime. The recommendations and opinions of analysts should be taken into consideration for a number of reasons. First and foremost, analysts live or die on the quality of the advice they give. Analysts' interests are aligned with providing information and advice that will help investors profit, and they receive daily feedback from the market by way of investors who use their dollars to vote on the long-term confidence in a company's direction. In addition, analysts have much greater resources than the rating agencies in terms of funding, people, and knowledge. They also have the pull to ask hard questions and get answers from publicly traded companies. Perhaps the best single analyst measure is price to book value. It provides a relative measure of strength by comparing current stock price to the book value of carrier assets. Stock price analysis can be very useful as well. Stock prices react quickly to news, can easily be tracked for long periods of time, and incorporate the research and expectations of investors and analysts into one data point. Because of these characteristics, stock price can in many cases be used as an early-warning sign for troubled stock insurance carriers, especially if the stock price is falling in comparison to the sector or its normal range. Anomalies like these may be an indication that the company is not innovating relative to its peers or it has troubled assets, exposure to risks or liberal contract wording compared to the industry, bloated overhead, or any number of factors that would expose the shareholder to risks that do not have a high reward correlation in the life insurance and annuity sector of financial services. The following two examples provide some evidence of how stock price can be used in the evaluation of insurance carriers.

The AIG Example

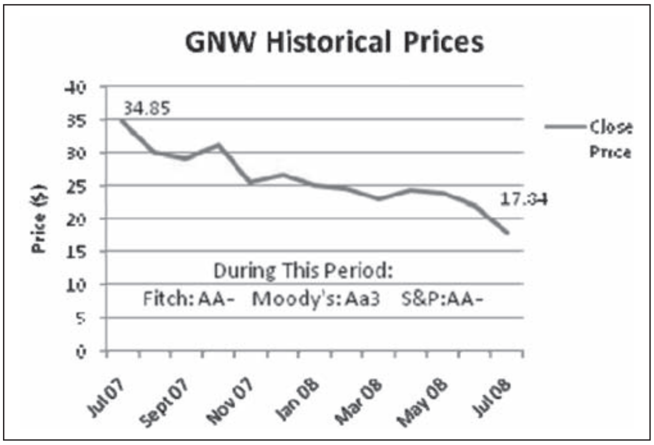
AIG's stock price fell by about 20 percent from the beginning of February, 2008 through market close on May 8, 2008, just before the company's first quarter earnings call, and fell another 13 percent in the four days thereafter.[18] On May 8, AIG announced a $7.8 billion first quarter loss, spurred on by a deteriorating U.S. housing market coupled with its huge exposure to non-prime residential mortgage backed securities, and a pre-tax net realized capital loss of $9.11 billion attributable to its credit default swap portfolio (AIG Financial Products Corp. super senior credit default swap portfolio). The first of the ratings agencies to act were Standard & Poor's and Fitch who each downgraded AIG one level on May 12. Moody's put the insurer on watch for most of the month of May and eventually made an official downgrade on the 23rd of the month. These downgrades all occurred after AIG announced its capital losses and at least three months after the company's stock started its rapid decline. Most notable about AIG's stock price decline from February to May, was that it was much higher than the industry average over the same time period. Take I-Shares Dow Jones U.S. Insurance Index (IAK), for example. From Feb. 1 through May 8, 2008, the index fell about 8.5 percent, and this return was made worse due to the fact that at the time, AIG was IAK's largest holding, representing 10 percent of the portfolio. From May 8–12, IAK fell less than one percent.[19]

The 2008 stock decline would have warned those watching closely of AIG's impending failure, but the problems at AIG had been present and pointed out by analysts long before 2008. A December 2008 Washington Post article noted that in 2002, AIG was fined for creating "sham" securities designed to hide $762M in PNC Financial Services Group underperforming assets.[20] The same article delineated the 2005 investigation of AIG by New York Attorney General, Elliot Spitzer. AIG was accused of selling finite insurance policies that essentially were not insurance at all, but simply ways to improve the appearance of the buyer's and seller's financial statements. The Post article also pointed out that the collapse of the housing market in 2007 proved disastrous for AIG and its credit default swap exposure. To validate this point, the company's stock price steadily declined from its high around $72 in the summer of 2007, never reaching that mark again.[21] While investors, life insurance purchasers, and brokers relying solely on the rating agencies during this time may not have thought twice about AIG's financial situation or creditworthiness, a stock price analyst may have had second thoughts.

The Genworth Example

Genworth is another case in which stock price would have sent warning signs to investors and insurance professionals long before the worst of the company's news hit, and long before rating agencies took any action with regard to the company. Most of the concern about the carrier originated from its crippled mortgage insurance subsidiary. Genworth (GNW) stock lost almost 95 percent of its value in the two month period from the middle of September to the middle of November, 2008. But the carrier's stock price had been performing poorly since the summer of 2007. In July, 2007 Genworth's stock price was in the $34 to $35 range, but one year later in July, 2008 GNW stock had dropped nearly 50 percent.[22] During this time the rating agencies Fitch, Moody's, and S &P, took no action to downgrade or even watch the insurer.

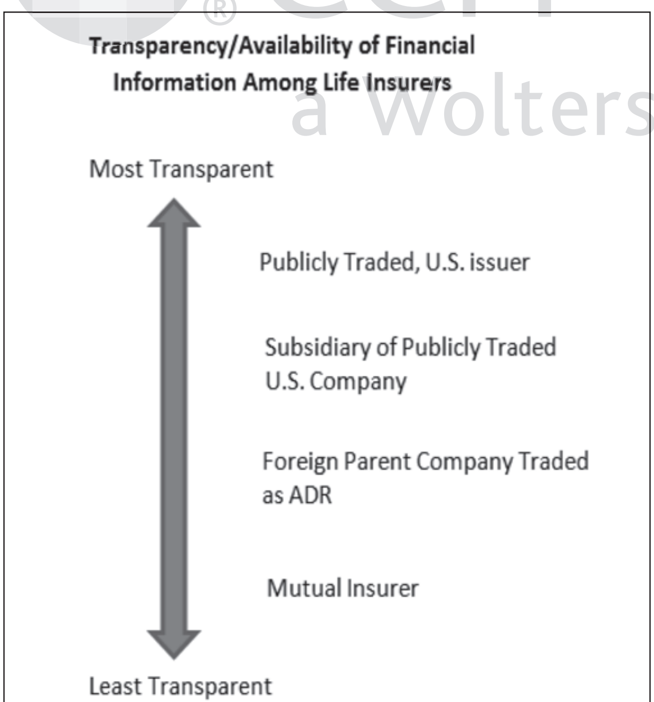
Figure 1.



The Limitations of Analyst Tools

Stock price and other measurement tools, including traditional rating services, have their limitations. Stock prices are very volatile and can be influenced, sometimes unjustly, by investor emotions. A large short decrease in stock price may not always signal long-term trouble for a carrier, meaning there is a

Figure 2.



not always a direct correlation between decreasing stock prices and a troubled carrier. There are times in fact when a decrease in stock price may be good for policyholders. Consider these examples: Met and Hancock both issued several billion dollars of additional equity in the fourth quarter of 2008. This action is beneficial for policyholders because the companies were able to secure additional liquidity, but it also diluted earnings for existing shareholders. Another example, in 2008, Lincoln Financial cut its stock dividend in half. Because the company will pay less out to shareholders the action is good for policyholders, but bad for shareholders. Stock price as a metric should ideally be used to signal when more in-depth analysis is warranted.

Other analyst tools and the forward-looking risks discussed above all suffer from informational limitations as well. Publicly filed information may reflect the status of a parent organization, not necessarily the issuing company. The company issuing insurance policies may be financially unrelated to the parent. Information given by companies like Prudential (PRU) and Lincoln National Corp. (LNC) have the most direct correlation. In this case, policies are issued by the entity supplying the information. They are also U.S. listed companies, so the data for these organizations is the most transparent available. Stocks of insurers like MetLife (MET), Protective (PL) and AIG (AIG) tell you what is going on at the parent, but still leave a degree of uncertainty as to what will happen in the subsidiaries, who are the entities issuing policies. Stocks that are American Deposit Receipts (ADRs) like AXA Equitable (AXA-ADR), ING (ING), and AEGON (AEG) have still more uncertainty because they are held to less stringent reporting in order to list on U.S. exchanges, and in most cases downstream U.S. Subsidiaries are the issuing entities. Companies that are not publicly traded like Mutual Insurance companies provide perhaps the least in terms of data availability.

Prudent Advising in Practice

After scores of cases, experience demonstrates to us the compelling need for trustees to take a fresh assessment of the life insurance they are managing. The matrix of possibilities between policy performance on a "guaranteed" and "current" projections proves that what the trustee and grantor assume are occurring and what is actually happening are likely to be very different. Here is why. Especially over the last five years there have been remarkable decreases in short term interest rates, and steep, rapid declines in equities and bonds, which have likely significantly impacted future policy performance. Indeed many trustees will discover that without proper policy management the policy may lapse before the insured passes away. But this result is avoidable!

Another aspect of life insurance policy costs is mortality charges, which have continued to decrease. The single most important factor that affects the price of life insurance is obtaining the best medical and avocation underwriting decision. With the impressive advances in medicine and pharmacology, combined with health lifestyle changes, many people are now eligible for good and prime rates where once they were offered standard or rated premiums.

Surely, there are many circumstances where a through review of the policy enables the trustee with guidance from a life insurance professional to keep the policy in force. As a fiduciary, the trustee needs to document that she/he has delivered due care of the policy for the beneficiary(s). Two recent cases come to mind that demonstrate the wisdom of making comprehensive policy review and management prudent.

First, a couple in their 70s is insured by a Whole Life policy. The policy has substantial cash value which the trustee doesn't need, rather seeking the highest death benefit possible for estate liquidity. After overcoming some insurability obstacles the couple qualified for prime rates. The policy premium remained the same, but remarkably the death benefit tripled; and the contract is guaranteed to age 100, issued by a premiere insurer.

Another case involved a couple insured by a combination of Whole Life and Term. The Term portion was to decrease in proportion to increases in death benefits in the Whole Life component. Because Whole Life dividends declined over the years, the policy fell considerably from projections. In the meantime, one of the insureds died leaving gift tax exclusion limitations for the surviving donor. Favorable underwriting and changing policy design resulted in the same death benefit and a lower guaranteed premium to age 105, which also fit into the gift tax exclusion. In a final example, a policy covering a male in his mid 60s, built on a Universal Life platform was performing as planned. However, the insured has been diagnosed with Parkinson's disease resulting in an abrupt and dramatic change in his lifestyle and living expenses. After obtaining current life expectancy analysis it was determined that the insured/grantor could stop paying premiums now and let the existing policy values cover expense and mortality charges for his new life expectancy.

Concluding Thoughts

Unlike most other financial tools, life insurance and annuities can be likened to planting acorns so that huge oak trees will grow. These unique tools are meant to last a lifetime, often 50 years or more, which requires a current and forward looking analysis of the issuer in the context of how the policy is to be used by the owner. Recent events have proven that rating agencies alone are no longer suitable in determining which insurer has the highest potential to deliver on the policyowners expectations. History has proven that life insurers can withstand depressions, world wars, plagues and still deliver on the promises made in their contracts. Yet, today markets move with the click of a computer mouse, affecting the world wide economy. This makes it vital for financial advisors to delve deeper into the values and principles each insurer brings to the product they offer, including underwriting classification, COI and expense charges, and exposure to Stranger Originated Life Insurance, to name a few. Financial advisors should look at the long term purpose of the policy in conjunction with life insurance companies' track record at delivering policyholder results, stock analysis, and rating agency ratings. Advisors must look deeper into underwriting practices, policyholder services and other lines of business the insurer may be engaged in that could affect the policy in the future. Transparency and availability of information among life insurers is going to be more important than ever before because policyholders will eventually become uninsurable at prime rates, thereby locking the policyowner into a company. In the new insurance environment, only a combination of sound data and varied financial analyses will allow purchasers of life insurance to plant an acorn with a solid company and foster the kind of benefits that will be used to impact families and businesses for generations to come.

Endnotes

1 Uniform Prudent Investor Act of 1994, §11.

2 *Harvard College v. Armory,* 26 Mass. (9 Pick.) 446 (1830).

3 Dominic J. Campisi, *The Perils of Prosperity:What Goes Up Will Likely Result*

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[9] *Testimony of Jerome S. Fons Before the Committee on Oversight and Government Reform*, United States House of Representatives. October 22, 2008, available online at *http://oversight.house.gov/documents/20081022102726.pdf*.

[10] *See supra* note 6.

[11] *See supra* note 5.

[12] Moody's Corporation, Form 10-k. March 1, 2007.

[13] See supra note 5.

[14] *See supra* note 1, §2.

[15] *See supra* note 1, §2.

[16] *Analysis of Non-Prime RMBS Exposure Disclosure for 10 Large U.S. Life Insurers,* Fitch Ratings. October 14, 2008, available online at *www.fitchratings.com*.

[17] *DAC in a Volatile Equity Return World,* SOA 2004 Valuation Actuary Symposium (24PD).

[18] Source: Yahoo! Finance, available online at *http://finance.yahoo.com/echarts?s=AIG#symbol=AIG;range=1y*.

[19] Source: Yahoo! Finance, available online at *http://finance.yahoo.com/echarts?s=IAK#symbol=IAK;range=1y*.

[20] Brady Dennis and Robert O'Harrow Jr., *A Crack in the System*. The Washington Post. Tuesday, December 30, 2008, Page A01, (second of three parts).

[21] Robert O'Harrow Jr. and Brady Dennis, *Downgrades and Downfall*. The Washington Post. Tuesday, December 30, 2008, Page A01, (third of three parts).

[22] Source: Yahoo! Finance, available online at *http://finance.yahoo.com/echarts?s=GNW#chart1:symbol=gnw;range=2y*.