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# **LIFE INSURANCE:**

## **An Asset Class Needing a Second Look**

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After the stock market crash of September of 2008, *Business Week* published an article<sup>1</sup> describing what happened in the months that followed as the Panic of 2008.

As many Americans experienced—and read about—the economy’s ongoing turbulence and uncertainty, they seemed to begin assembling a list of targets of choice to hold responsible for their losses. Shortly after the country’s largest banking corporations came its investment brokers, financial advisors, and its retirement-fund managers. It was not long before anyone connected to the country’s financial-services industry at large was likely to be held in some suspicion for the entire economic debacle.

Two years later, it seems that a few new targets may be about to be added to that national “list” for filing legal suits: life-insurance companies and the trust professionals who manage trust-owned life-insurance policies.

A recent Indiana appeals-court decision, *In re Stuart Cochran Irrevocable Trust*<sup>2</sup>, concurred in a trial-court finding that KeyBank’s ILIT trustees had not breached their fiduciary responsibilities to the beneficiaries of Mr. Cochran’s life-insurance trust; neither, the court decreed, had those trustees acted imprudently when they replaced the Cochran Trust’s original life-insurance policies.

In a recent presentation to the American Banking Association, Steven Zeiger of XRAY YOUR LIFE INSURANCE said, “The Cochran case is a “*must read*” for any trust professional today.” The case background and legal arguments relate directly to the handling of insurance trusts as they exist today and as they seem likely to evolve in today’s turbulent economy.

*Cochran* case was the first nationally known settled case in which an insurance-trust beneficiary sued the trustee of the insurance trust for breach of fiduciary responsibility. And it would have required consideration of just a few more basic questions in this case for the decision to have come down entirely differently.

Briefly, after accepting responsibility for handling Mr. Cochran’s irrevocable trust in 1999, KeyBank’s ILIT trustee approved an exchange of the trust’s policies. That exchange increased the collective death benefit from \$4,753,539 to \$8,000,000.

Following the market losses of 2001 and ’02, however, KeyBank hired an independent insurance consultant in 2003 to review the Cochran trust’s replacement policies.

Based upon the existing policy values at the time, as well as the age of the insured (Stuart Cochran was just 51 years old in 2003), the consultant recommended continued close monitoring of the policies. Considering the economic conditions in 2003, however, it seemed possible, perhaps probable, that these policies could lapse before Mr. Cochran attained his normal life expectancy. Accordingly, his personal insurance advisor recommended purchasing a replacement policy guaranteed to age 100. It carried a guaranteed face value of \$2,787,524.

KeyBank’s consultant concurred and recommended replacing the existing policy. Accordingly, as trustee, KeyBank replaced the old policies with the recommended policy.

Mr. Cochran, the insured, however, never attained his “normal” life expectancy. Shortly after the new policy was purchased, he died at age 53. Quickly, his beneficiaries brought suit against KeyBank for breach of its fiduciary responsibilities, with the eventual result noted above.

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<sup>1</sup> “Stock Market Crash: Understanding the Panic,” Ben Steverman; *Business Week*, October 10, 2008.

<sup>2</sup> 901 N.E.2d 1128 (Indiana Court of Appeals, March 2, 2009).

We believe that result could have been entirely different had just a few more questions been presented for the court's consideration. For example, neither the plaintiffs nor their attorneys asked the court to consider the specific expenses associated with handling and monitoring the TOLI (Trust-Owned Life Insurance) policies as they compared one to another throughout the life of the trust.

Many policy holders assume the cost of a life-insurance policy to be the premiums paid. In fact, however, the actual cost of the policy is the monthly charges that are deducted from the policy's cash value.

In addition to the relative COIs (Cost of Insurance), there were the FAEs (Fixed Administration Expenses) and the M&Es (cash-value-based "wrap fees") that were never addressed during either court's examination of the presented evidence. Apparently, KeyBank's ILIT trustees never thought to measure such expenses, despite the fact that this component is critical to measuring the whole performance of any life-insurance policy.

Neither, apparently, did the beneficiaries-turned-plaintiffs ever think to ask for evidence the trustees might even have noted such comparisons. The actual comparison of the Cochran policy expenses is shown in an excellent table included in the August, 2009, issue of *Steve Leimberg's Estate Planning Email Newsletter*<sup>3</sup>.

*Note:* Based upon the tabular breakdown of the expenses for each of three policies held throughout the life of the trust, the *Total Cost per policy* ranges from **12.0¢** for the least costly policy to more than double that—**25.9¢—per \$1.00 of Death Benefit.**)

This was the first nationally known legal case to consider a plaintiff's claim of breach of fiduciary duty by ILIT trustees and can hardly be seen as constituting evolved case law<sup>4</sup>. It is there, however, to be considered by those most likely to feel its impact: trust beneficiaries; their ILIT trustees; and the beneficiaries of traditional and non-trust-owned policies as well.

There was a time in the world of financial services when life-insurance policies were idly kept in the "bottom drawer" of many larger financial plans—ready to provide some value should circumstances so dictate but hardly a significant part of a sophisticated financial plan. Today, that time is over. The life-insurance policy is a significant financial asset and needs to be monitored like any other financial asset.

Plaintiffs of the near future—disappointed trust beneficiaries and their attorneys—may want to examine the *In re Stuart Cochran Irrevocable Trust* decision as they prepare their respective cases before going to court. Certainly, it is essential that ILIT trustees examine the case just as carefully and see to the monitoring of their own policies as well as to the *educating of their clients*, the trust beneficiaries.

Detailed records of such educational efforts on their clients' behalf should be maintained in their client files to demonstrate that the trustee did, in fact, hold to his/her fiduciary responsibilities and consistently monitor all trust assets through a detailed and consistently prudent process. Steven Zeiger suggests that one of the most useful outcomes of the Cochran case was underlining the importance of "reliance on information provided by an independent entity with no policy to sell or any financial stake in the outcome." Many banks today use an insurance agent to compare policies. This may not be a prudent approach, however; since such agents can certainly have a financial stake in the transaction.

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<sup>3</sup> LISI Estate Planning Newsletter #1499 (August 5, 2009), Barry D. Flagg and Patti S. Spencer, @<http://www.leimbergservices.com/>

<sup>4</sup> LISI Estate Planning Newsletter #1486 (June 29, 2009), Patrick J. Lannon and Barry D. Flagg, @<http://www.leimbergservices.com/>

An article<sup>5</sup> in *The CPA Journal* suggests it is “crucial that trustees of ILITs have a documented review process and the help of appropriate experts to make sure the process is effective.

*Steve Leimberg’s Estate Planning Email Newsletter* of February, 2009<sup>6</sup>, describes the ongoing developments of today in this field as “the trust-owned (TOLI) life insurance paradigm shift from inadequate policy management to a service-based fiduciary model.”

With today’s ongoing vacillations in our stock markets and the current decline of short-term interest rates—both of which profoundly affect the performance of most life-insurance policies—it is possible we may see the further underperformance of some policies in the near future. That being the case, it seems equally possible we will see more lawsuits in the similarly near future to add to the evolved-law possibilities of *In re Stuart Cochran Irrevocable Trust*.

David Buckwald, CFP, CLU, ChFC  
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<sup>5</sup> *The CPA Journal*, October, 2008, “Trust-Owned Life Insurance: A Lawsuit Waiting to Happen?” Matthew Tuttle, Richard Urbealis, and Steven Zeiger, p. 59.

<sup>6</sup> LISI Estate Planning Newsletter #1425 (February 25, 2009), E. Randolph Whitelaw and Liz Colosimo, @<http://www.leimbergservices.com/>