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Message From The Chair

Lee Harris

Use of the Insurance Section listserv (bulletin board) has exploded in the last few months. If you haven't signed up through the ATLA web site you are missing out on a great opportunity to get valuable information and to help colleagues with similar problems from around the country. In just the past several days notes have been posted on the following topics.

1. Allstate: Comparative Bad Faith Attack
2. Allstate's Attack on Plaintiff's Counsel
3. Attorney Disqualification
4. State Farm agent-application change on back up of sewers and drains
5. Economic damages required for emotional distress—bad faith
6. stone street capital
7. Provident-UNUM merger
8. Monarch Life-Chronic Fatigue

These are just a few of the topics that have gone back and forth over the last several months. There have been information and questions about most major carriers on most major coverage areas. In order to protect confidentiality ATLA has instituted updated access rules for the listserv. Access is now limited to Regular, Sustaining, Life, President's Club members and Paralegal affiliates sponsored by a Regular member. Members must also belong to at least one Section. Associate members, law professors, military, and government members are not in the access group. All members who gain access must agree to abide by ATLA rules posted at the ATLA site. There was considerable discussion at the most recent Section Leaders' Council meeting about law student members. It was agreed that there is no reasonable way to determine whether a law student supports the plaintiff or defense bar. Therefore, the Council voted to maintain the prohibition of law student access of Section listservs.

EVEN WITH THESE NEW PROTECTIONS THERE CAN BE NO CERTAINTY THAT POSTINGS ON THE INSURANCE SECTION LISTSERV WILL ONLY BE SEEN BY ATTORNEYS REPRESENTING PLAINTIFFS. Discretion is strongly advised. If an attorney has confidential information that he wishes to share, whether in question or answer, this should be done in private e-mail or through traditional phone, fax, or "snail" mail. This doesn't mean that a general topic or interest area or even a specific question shouldn't be posted. But, be careful to protect client names and other confidential information when making the posting.

Another very important point. YOU KNOW WHERE YOU ARE FROM BUT THE PEOPLE READING THE NOTE DON'T

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What's Inside

Federal Class Certification Decisions Are Now Immediately Appealable

A new amendment to Fed.R.Civ.P. 23. Rule 23(f) effective December 1, 1999, permits an appeal within ten days of a district court's decision on class certification. It is then within the discretion of the court of appeals to grant or deny permission to appeal. This changes the prior practice which disallowed any opportunity to appeal a class certification order unless counsel could obtain a 28 U.S.C. Sec. 1292(b) certification. The appeal does not stay the lower court proceedings unless there is an order to that effect.

Observations On Life Insurance Trusts And The Prudent Investor Rule

By Patrick Collins

A growing number of states have adopted "Prudent Investor" legislation based on the Restatement (Third) of the Law of Trusts. Restatement (Third) of the Law: Trusts (Prudent Investor Rule), The American Law Institute, St. Paul, Minn. (1992). Although some states provide trustees of insurance trusts a statutory exemption from some of the "principles of prudence" promulgated by the Restatement (See, e.g., Maryland Annotated Code §15-116 Estates and Trusts), most jurisdictions apply the Prudent Investor standard to all assets within the trust estate.

The application of Prudent Investor standards to the Irrevocable Life Insurance Trust (ILIT) poses an interesting challenge to the trustee who seeks to mitigate fiduciary liability. The trustee is faced with the task of successfully integrating:

- the new regulatory environment governing trust administration,
- the academic rationale that underlies the Third Restatement and that provides the means necessary to document the prudence of the decision making process, and
- the marketplace of insurance carriers and other product and administrative service vendors.

Current standards of practice in the Estate Planning and Trust community seem inadequate to this task. Most "due diligence" standards have either been created by the insurance industry itself or fail when judged according to the generally acceptable standards of quantitative and statistical analysis that form the intellectual basis of modern portfolio theory. See, e.g., Patrick J. Collins, *Myths and Realities Regarding Life Insurance Advice* California Trusts and Estates Quarterly pp.5-10, (Fall, 1998). By analogy, it is like the tobacco industry hiring faith healers to host seminars on the evaluation of cigarette health risks. The perspective is biased and the science is suspect.

At the end of the day, many trustees fail to document prudent decision making because they exhibit a mere passive acquiescence to the recommendations of the insurance vendor. Trustee and estate planning attorney files are crammed with:

- agent-supplied insurance illustrations run at various interest rates (despite the fact that the National Association of Insurance Commissioners [NAIC] states that illustrations cannot be used as a basis for determining future performance),
- internal rate of return calculations designed to measure the value of projected benefits (despite the fact that the NAIC states that use of death benefit internal rate of return measures is inherently misleading),
- computer-generated financial ratios purporting to demonstrate the financial strength of the carrier (despite the fact that such ratios are neither serially nor cross-sectionally consistent and despite the fact that use of unadjusted ratios violates the standards of practice of such financial organizations as the Association for Investment Management and Research).

From the perspective of the litigator, the thicker the file of agent-supplied information, the greater the probability that the trustee will be unable to demonstrate the independent exercise of reasonable care, skill, and caution.

The trustee of an insurance trust must apply the same standards of portfolio evaluation (defensible criteria for asset selection, monitoring, and retention) that are commonly employed in investment oriented trusts. See, e.g., Patrick J. Collins, *Is it Prudent and Suitable? Estimating the Value of a Trust-Owned Life Insurance Contract*, California Trusts and Estates Quarterly pp. 4-15, (Winter, 1998). Beyond a consideration of a carrier's future solvency or of a policy illustration's credibility, the Prudent Investor standards will require the trustee to address other areas crucial to ILIT administration. Documentation of a sound decision making process is an indispensable tool for mitigating fiduciary liability for ILIT design, implementation and administration. The following is a brief checklist of areas that should be of concern to both plaintiff and defense attorneys under the new regulatory environment:

- Duty of diversification: What was the rationale for placing all coverage with one company?
- Duty to avoid unreasonable or inappropriate costs: Did the trustee consider both load and no-load insurance products?
- Duty to manage assets as part of an overall investment strategy having risk and return objectives reasonably suited to the trust: What analysis was performed to determine the statistically expected value of the insurance contract and the probability that acquisition of the policy will subtract rather than add value to the estate should the insured live beyond average life expectancy?
- Duty of monitoring and surveillance in order to determine if trust assets continue to be prudent and suitable: What protocols have been established for periodic review of trust assets, grantor health changes, changes in financial objectives and circumstances, and so forth?
- Duty to supervise agents: What background information on agent business practices, professional training, contract limitations, and so forth was obtained by the trustee? Were commissions, shared trustee fees or quid pro quo arrangements disclosed?

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Many of these duties are non-delegable, and the fact that the agent was a trusted friend or relative of the grantor does not constitute a credible defense under the Prudent Investor Standards. Hoisington, W. L., & Anderson, R. L., "Practical Applications of the Prudent Investor Standard," Proceedings of New York University 56th Institute On Federal Taxation (Matthew Bender & Co., 1998), pp. 29-17 to 29-18. As time unfolds, ILIT trustees may require a written Investment Policy Statement comparable to those currently employed by trustees of investment trusts and endowments. Written documentation of sound policy offers the trustee:

- A legally defensible position that documents the prudence of the decision making process
- A mathematically reasonable position that enables interested parties to make informed decisions, and,
- An administratively convenient system through which a myriad of apparently contradictory vendor claims can be intelligently evaluated.

Patrick J. Collins & Kristor J. Lawson, *Managing Attorney and Trustee Liability for Life Insurance Contracts*, Journal of Asset Protection pp. 47-57, (September/October, 1996).

Absent tangible evidence of the trustee's use of care, skill and caution, the trustee is vulnerable to legal attacks following a variety of future events. Such occurrences include insurance programs that do not perform according to their original projections, disgruntled remaindermen who point to the long term "opportunity costs" of forsaking investment in alternative financial instruments (e.g. mutual funds), economic detriments of policy replacement and/or IRC§1035 exchanges, and, of course, policies that lapse without value prior to the death of the insured.

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Note: Look for this Section newsletter on ATLA NET at http://www.atlanet.org/cgi-bin/groups/grpmain.pl?group=insurance. Back issues are also available at this site.

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