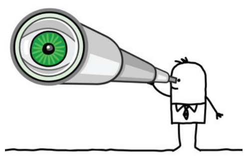
COMPLEXITY, continued[1]

Jack Davidson

THE UNINTENDED

Who is looking over your shoulder?



Thanks to the efforts of many who drafted the 2009 Vermont Trust Code, trustees may have a duty to notify and report to future beneficiaries when a trust becomes irrevocable. That obligation, put in place for good reason by draftsmen with long experience working with fiduciary law, may, however, have unintended consequences.

Do you want your trustee to report to your children after you are gone but while your spouse is still alive?

Are you comfortable having your trustee report to your grandchildren while your surviving spouse or children are still alive?

Do you mind if your trustee sends statements to a divorced spouse who requests statements and would be entitled to reports by virtue of being a parent of a grandchild who may become a beneficiary of your trust? (This last example is not hypothetical.)

Trusts set up before July 1, 2009, may or may not be exempt from these new rules. If your trust can be modified, then a well-drafted amendment to the instrument in this regard can eliminate unintended effects of the Trust Code's provisions, which are required, unless overridden by the trust's own language. [2]

If you have concerns, our best advice is for you to talk to your lawyer. Our second best advice is to ask your trust officer what he or she plans on doing when you are no longer in full control of your trust.

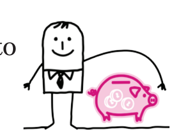
COMPLEXITY DESIGNED TO HIDE THE DOWNSIDE OF A PRODUCT OR A SERVICE?

Understanding Life Insurance ~ Why the wise and prudent favor life insurance, but at what price?

Life insurance is important, and basic life insurance, referred to as a term policy, is not complex. Just a few questions need to be answered. How much do I need and how much can I afford? How long will the premium stay the same and how long can I be insured before I have to have another physical? Will the insurance company be around when I die?

But other types of insurance in the agent's portfolio are in competition with the term policy and they gained traction over the years primarily because of two attributes: tax benefits and insurance for the long term.

There was one other attribute that parents tend to favor for their children: forced monthly savings.



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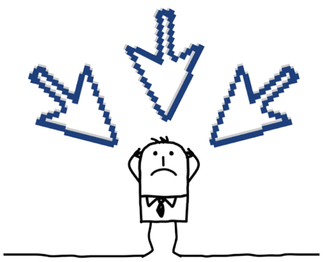
[1] Complexity - July 2013 newsletter

[2] Uniform Trust Code 2009 VT Laws No. 20

Unlike term, these products are complex: Whole-life, Universal, Variable life and Variable Universal life to name a few. They are all designed to charge higher premiums to pay for both the insurance and a fund to provide for the continuation of the insurance when the insurance becomes expensive later in life.



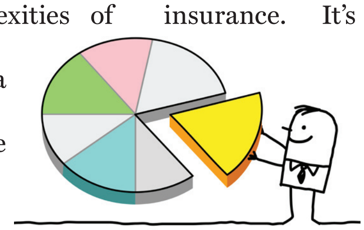
It's not easy being a life insurance salesperson. The life insurance business is highly competitive and commission driven. The first year's commission tends to be in the range of 80% of the first year's premium and term insurance is cheap in comparison to their other products such as whole-life insurance. Commissions can sometimes be as much as ten times greater selling a whole-life rather than a term policy with the same death benefit.

It's a tough world and getting tougher in part because the industry has taken at least three hits:

1. The Tax Benefits: The arrival of 401-k plans and IRAs started to change the landscape. If I buy a cheap term policy and save the difference between a whole-life and term policy by adding to my SEP or IRA instead, I now have the similar tax benefits offered by the whole-life in accumulating reserves in the policy tax deferred.
2. Insurance for the long term: In the past, you couldn't find term policies with level premiums for periods of more than 10 or 15 years. Now you can easily find 20- and 30-year term policies. If you don't need insurance after 30 years, whole-life or variable or whatever other product in the life insurance agent's arsenal is no longer competitive.
3. Estate Taxes: Now that the federal tax exemption is $5,340,000 and, with portability, $10,680,000, funding of Life Insurance Trusts designed to save estate taxes are slowing to a snail's pace.

Quoting CNN Money, when your agent offers a product other than term *" ... stick with term, and do your investing elsewhere".* Are there exceptions? Yes, but very few. One is estate taxes that might be due more than 30 years out. Another is the parental voice, sometimes thought but often not said, "the higher premium will force you to save for retirement".

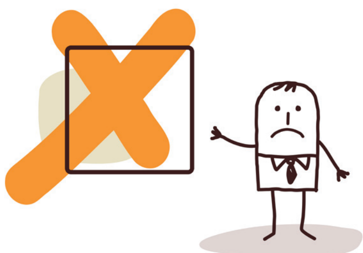
So if your insurance needs fall within the 30 year period, you can avoid the complexities of insurance. It's that simple. It's like buying a pizza. You can have the whole pizza at the cost of a slice:



Most agents who read this will probably disagree. Some strongly. If you need to tackle the complexities of insurance, the challenge is to find enough information to allow you to make an educated decision and you may encounter significant hurdles.

Your agent may be invested in a culture that uses software to illustrate the best possible outcome. I call this the "Quote". The Quote sells. The outcome, however, is determined by the insurance policy. I call this the "Contract" and this is controlled by the lawyers and others who are compelled to secure the best possible outcome for the insurance company.

Here is an extract of a "comfort" letter from the insurance company assuring the prospect that if he paid the premiums on time, he would only have to pay the premium for ten years. Tucked into the letter was: *".... If a difference exists between the Policy Form, the Quote and/or this letter, the Policy Form controls...."*



I was asked by my colleague to review this policy. I was reluctant. The contract was 54 pages long. I was still recovering from trying to figuring out health insurance. Then I remembered a past sin. Newly married, I bought a whole-life policy. I did not read the contract. Matter of fact I can't recall even being offered a contract. I was offered a quote. The quote looked good. A few years later with the umbrella of my employer's term policy, and compensation just above poverty-line, I cashed in the policy after consulting with my spouse. "Look Honey, see how much we'll get if I turn this in", while showing her the quote sheet with the cash surrender value. Well, the check was quite a bit less.

So, I checked the contract given to me by my colleague. It did not match the quote. In fact, it seemed to contradict the quote. The quote shows the premium ending after ten years, and the contract shows the premium for the life of the insurance (50 years).

Perhaps I missed something buried in this very complex document? I did not want to read it again. So I pulled out my trusty spreadsheet and ran the numbers. If the premium lasted for the life of the contract, then it would be possible to provide lifetime insurance well past 30 years honoring the promised 2% increase on the reserves. If the premium ended at ten years, the insurance company might not survive if they continue to sell policies like this one, which will lose money for them. I kind of think buying the Brooklyn Bridge might have been a better investment for them.

Your insurance agent may or may not know the probabilities of choosing the best case scenario. They use software that generates the quote. Many of them are optimists. They are inclined to see a bright future.

If you have a need for insurance past 30 years, you are facing a minefield of complexities. And you run a risk. This is what your brain might look like under the influence of trying to understanding insurance products: