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Life Insurance Planning in Connection with Divorce

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It is estimated that there are over a million divorces in the United States each year.[1] This reflects a tremendous need for life insurance planning in relation to alimony, child support and property settlement agreements.

First, with regard to alimony and child support, it is a common practice to require that the supporting spouse carry a life insurance policy to make certain that the supported spouse and/or children will be provided for should the supporting spouse die prematurely. This of course raises the question of how long such coverage should be maintained. In that respect, if the coverage is intended to protect the children it can be terminated when they all reach the age of majority and that can be accomplished with a term policy of the appropriate duration. Better yet, a decreasing term policy may make the most sense since the death benefit can be matched to the declining obligation to the children. Similarly, if the insurance is needed to guarantee alimony payments to the former spouse it should be maintained for as long as those payments are required and if they are to run for that person's life permanent insurance is indicated. In any case, the rule of thumb is that term insurance is preferred where the coverage period is 10 years or less with permanent insurance indicated for periods of 15 years or more. In between periods typically require more study to tailor the insurance to the particular situation.[2]

Where the insurance may be required to last for many years the parties should consider more than just the lowest price of the policy when selecting a company. That's because differences in premium charges may reflect differences in the financial ratings of the companies in question. Consequently, the divorce agreement or decree should set minimum standards for the quality of the insurance company chosen to issue the policy.

A further significant question is who should be the owner of the policy since that individual will have the right to name the beneficiary of the coverage. In that regard, a good way to

[1] Steve Leimberg's Estate Planning Email Newsletter, Archive Message #1470, 28-May-09.
[2] Life Insurance and Divorce, GP/Solo Law Trends & News, Martin M. Shenkman and Richard M. Weber, September 2005, Volume 2, Number 1.

be sure that the policy and related beneficiary designation will be maintained as needed is to name the custodial parent as the owner of the contract. Alternatively, if that parent is not to be the owner the divorce decree or property settlement agreement might dictate that the custodial parent be given notice of any changes in the policy such as a change of beneficiary, the lapse of the policy, or loans taken against the cash value. On the other hand, from the perspective of the supporting parent, there is a need to be sure that the policy's cash value and death proceeds will be used for the benefit of the children and not dissipated by the former spouse. That may be achieved by putting the policy into a trust managed by an independent trustee.

In any case, a good preliminary step to all of the above planning is to have the proposed insured go through the underwriting process prior to signing the settlement agreement. That's because the desired coverage may not even be available due to health issues or the premiums may be prohibitively expensive.

Another consideration is that when looking at existing permanent life insurance in connection with a property settlement agreement it should be understood that such coverage may have financial significance beyond its cash surrender value. That is particularly true with respect to an insured that has terminal health problems or is over the age of 70 since they may be able to sell the policy for more than its cash value. Further, this may even be true with respect for a term policy when the insured's life expectancy is less than the remaining duration of the policy.

Lastly, while many states have laws that automatically revoke beneficiary designations upon divorce, ERISA preempts those laws when it comes to beneficiary designations for coverage under pension and welfare benefit pans.[3] That means a plan administrator will still pay the death benefit to a divorced spouse when that divorced spouse is the beneficiary on the plan's records. An exception to that rule may exist when that beneficiary has made an explicit and voluntary waiver of their rights as a beneficiary under a consent divorce decree.[4] The bottom line, however, is that when a divorce occurs the parties should make the proper changes in their beneficiary designations on the plan records.

[3] Englehoff v Englehoff, 532 US 141; 121S Ct 1322; 149 L Ed 2d 264 (2001)
[4] Estate of Rowley v MacInnes, Mic. Ct. Akpp., 94-177969-DO (1/8/04)