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Life Insurance: Is It a Shortfall or a Windfall?

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Life insurance has become an integral part of our society. Due to the heavy financial responsibilities many are undertaking, life insurance assists the surviving spouse in meeting the financial obligations to which a couple has committed. But with that responsibility comes many obstacles which are often overlooked.

Our divorce statute specifically provides under Pa.C.S. 23 Section 3502(d) that, "the court may direct the continued maintenance and beneficiary designations of existing policies ... and where it is necessary to protect the interest of a party, the court may also direct the purchase of, and beneficiary designation on, a policy insuring the life ... of either party."

In divorce, life insurance can become part of the settlement to guarantee financial obligations which are promised to be paid in the future are actually paid. Those obligations include payment of child support, alimony, college expenses and the mortgage. But if you are drafting an agreement, you must be aware of all of the necessary elements to make sure the life insurance provision does what the parties really intended it to do.

For example, if you purchase life insurance to pay a support obligation, the total obligation will decrease each year the support obligation is paid. The agreement should reflect a decrease after each year so that the beneficiary of the policy doesn't receive a windfall should the insured pass away before the obligation has been paid in full. There should be some language in the agreement which confirms the amount of the obligation paid each year and confirms the life insurance benefit is decreased by only the amount that had been paid the prior year. Additional language might include an exchange of information each year to confirm the actual support paid and the decrease in life insurance.

Compliance with a life insurance clause is sometimes difficult to achieve and sometimes impossible to comply. In a recent case, an agreement required the spouse to provide life insurance for the divorced spouse. There was no termination clause, there was no cutoff if the premiums were too high to pay and basically there were no protections in the agreement for the insured spouse.

Unfortunately, the insured spouse just became too old to comply with the agreement and did not have the money to pay the premiums. Surely, the divorced spouse had outlived all of the obligations under the agreement, but failed to have a termination clause which would permit the policy to be canceled. The results were financially devastating to the insured.

The parties to the agreement failed to recognize the financial effects of keeping in place a life insurance policy, decades after the underlying obligations had ceased. Was it really necessary for an ex-spouse to receive a substantial death benefit after all prior financial obligations had been met? Regardless, a strict reading of the underlying agreement required the policyholder to comply and directed the policy to remain in effect even though the premiums were cost prohibitive.

Alternatively, we also hear of the cases where life insurance is required, but the insured fails to pay the policy premiums and no one is notified until the insured is deceased. In this scenario, there may very well be outstanding financial obligations which have not been satisfied and the life insurance policy no longer exists. This may then result in a claim against the estate with the hope the financial obligations can be met.

Most of the problems outlined above can be remedied with a life insurance trust in place. Property settlement agreements should obligate the parties to create a life insurance trust. Although this might take a little more time and money to set up in the long run, the life insurance trust can clearly outline the obligations of both parties such as, paying the annual premiums, a built in compliance clause and express the clear intent of the parties.

The life insurance trust can name the ex-spouse as the owner of the policy. This way, the ex-spouse will receive the premium notices and will know immediately if the bill is paid. The beneficiary of the life insurance should be the trust. Once the insured dies, the monies will go into trust and will be paid to named beneficiaries of the trust.

There are many benefits of this arrangement. First of all, if the purpose of the life insurance was to pay child support, by naming the trust the beneficiary, the trustee can pay the monies to the beneficiaries on a monthly basis. Secondly, it keeps the ex-spouse from using the monies solely for his or her benefit and not the children. Especially in situations where college expenses might be due, the trustee can make the payments directly to the school. Finally, the deceased can name a trustee who will meet the necessary financial obligations and for which there will be annual accountability.

The life insurance trust should be carefully crafted in compliance with the terms of the parties' property settlement agreement. In turn, the agreement should identify the purpose of the life insurance trust. The purpose might be "to fund all obligations due the children under the agreement including child support and college tuition," or "to fund the husband's alimony obligation as outlined in the agreement." With the obligation specifically enumerated the intent of the parties can be identified at a later date if there is an issue of contempt.

The parties will also want to address termination clauses. The trust shall terminate when "the youngest child is age 18 and has graduated from high school or no later than when the youngest child has obtained the age of 19" or "upon the final payment of the alimony provision or December 31, 2020, whichever is later." The insured should also purchase term insurance which would be in effect for the length of the obligation and remain at a fixed yearly premium so the insured will know what to expect by way of expense over a long period of time.

Certainly the trust document should reference the parties' property settlement agreement and of course should specifically make reference to the life insurance policy which is currently in effect including the death benefit, owner of the policy, the beneficiary and payment of the premiums. A qualified estate lawyer should be able to aid you in this task.

A life insurance trust is a valuable tool for any divorce attorney. The terms of the trust protect the intent of the parties as well as the spouse who negotiates a settlement which is paid out over many years. Life insurance alone is usually not enough to cover the obligations because of the risk of failure to perform. Certainly with the proper language, both parties will benefit. •

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