



# WRMarketplace

An AALU Washington Report

The *WRMarketplace* is created exclusively for AALU members by experts at Greenberg Traurig and the AALU staff, led **by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca Manicone.** *WRMarketplace #17-09* was written by Greenberg Traurig Shareholder **Karen D. Yardley.**

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**TOPIC: Forget Something? Make Sure to Change Life Insurance Beneficiaries Post-Divorce.**

**MARKET TREND:** It is very commonplace for life insurance beneficiary designations to be overlooked or even forgotten. Proper legacy management requires updating life insurance beneficiary designations following divorce.

**SYNOPSIS:** Typically, after divorce, individuals no longer want their former spouses to receive life insurance death benefits. In many cases, the terms of the policy and/or applicable state laws will automatically revoke the designation of a former spouse as a life insurance beneficiary, but this is not always the case.

Further, the divorce decree may require that a former spouse or children from the marriage be named as beneficiaries of an individual's life insurance policy. Accordingly, reviewing and updating beneficiary designations post-divorce is critical to ensure payment of policy proceeds to the required or desired beneficiaries.

**TAKE AWAY:** Potentially conflicting state and federal laws impact how a beneficiary designation in favor of a former spouse will be treated following a divorce. Best practices dictate filing new beneficiary designations for all policies either before filing for divorce or immediately after the divorce is finalized. Failure to update beneficiary designations after a divorce can result in disruption of the insured's legacy plan.

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One of the key practical issues that must be addressed when a couple gets divorced is updating life insurance beneficiary designations to account for the couple's changed circumstances. When a spouse is named as the primary policy beneficiary, a divorce may or may not automatically revoke this designation, depending upon the terms of the policy and applicable state and federal laws. Failure to update beneficiary designations on a timely basis following a divorce can lead to unintended consequences.

### ***BASIC RULE: BENEFICIARY DESIGNATION CONTROLS***

As a basic rule, the beneficiary designation on file with the insurance company or employer controls the payment of the policy proceeds, based on the general assumption that if the policy owner/insured ("**owner**")<sup>1</sup> wanted to change the designation, he could have done so at any time. Unfortunately, after divorce, individuals frequently delay or forget to update their beneficiary designations.

*Example:* Hal and Wendy filed for divorce after 10 years of marriage. During the marriage, Hal named Wendy as the primary beneficiary of a \$5 million policy insuring his life. The divorce decree gave the policy to Hal. Hal subsequently married Nancy and passed away in an accident 5 years later. Following his death, Nancy discovered that Hal never changed the beneficiary designation on the policy. Pursuant to the basic rule, the \$5 million death benefit passes to Hal's former spouse, Wendy, who refuses to waive her right to the proceeds.

## ***POSSIBLE EXCEPTIONS***

While the basic rule is that a policy's beneficiary designation controls the payment of the policy proceeds, this rule does not always apply in the event of a divorce. In these cases, the beneficiary designation may be revoked by the terms of the policy contract, the divorce decree, applicable state law, or even federal law.

**Policy Terms.** Sometimes the policy contract itself will provide for automatic revocation of a spousal beneficiary designation in the event of divorce. While helpful in some cases, this type of provision can cause issues if the owner's divorce decree requires the owner to name the former spouse as the beneficiary or if the owner and the former spouse are on good terms and the owner intends that the proceeds pass to the former spouse. Accordingly, in cases of divorce, the owner should review his policy for this type of provision and will need to submit a new beneficiary designation to ensure the proceeds pass to the former spouse, if required or desired.

**Divorce Decree.** Divorce decrees often address the disposition of a couple's life insurance policies. The owner must carefully review the decree to determine his rights and obligations and ensure that the policy beneficiary designations comply with the order. For example:

- The divorce decree may require that the owner maintain the policy for the former spouse's benefit for the period that spousal or child support payments are made. If the policy provisions or state law (discussed below) automatically nullify a beneficiary designation in favor of the former spouse, the owner will have violated the terms of the decree, and the spouse will have a claim against the owner's estate for the proceeds, resulting in costly and prolonged litigation.
- Alternatively, the divorce decree may give the policy to the owner without any obligations, allowing the owner to name any beneficiary desired. If neither the terms of the policy or applicable state law provide for the automatic revocation of a spousal beneficiary designation post-divorce, the former spouse will still receive the proceeds if the beneficiary designation is not changed.

**State Law.** Regardless of whether the divorce decree addresses the disposition of the life insurance policy, the owner should file new beneficiary designations after the divorce to prevent unintended consequences under state law. A number of states have enacted statutes that, post-divorce, automatically nullify a pre-divorce beneficiary designation in favor of a former spouse. Other states nullify the beneficiary designation unless the divorce decree requires the former spouse be named as the beneficiary or other conditions apply.

*Example:* Jack and Mary, residents of Texas, divorced after 15 years of marriage. At the time of the divorce, Jack owned a \$10 million policy insuring his life and naming Mary as the primary beneficiary. Texas law provides that a pre-divorce designation of a former spouse will not be effective post-divorce unless (i) the divorce decree designates the former spouse as the beneficiary, (ii) the insured re-designates the former spouse as the beneficiary after the divorce decree, or (iii) the former spouse is designated to receive the proceeds in trust for the benefit of a child or dependent of the owner or the former spouse. Unless one of the exceptions applies, after the divorce, Mary's designation as policy beneficiary will be nullified.<sup>2</sup>

**Federal Preemption.** Beneficiary designations for employer-sponsored life insurance benefits also must be addressed post-divorce, ***since the original beneficiary designation may still control even if state law provides otherwise.***

***Federal Employee Group Life Insurance (FEGLI).*** FEGLI benefits are governed by federal laws which direct that, unless the divorce decree expressly addresses the designation of a former spouse as a beneficiary, the filed FEGLI beneficiary designation form controls the disposition of the proceeds and preempts state law to the contrary. These laws will result in payment of FEGLI benefits to a former spouse if the beneficiary designation is not changed post-divorce.<sup>3</sup>

***Employment Retirement Income Security Act (ERISA).*** Federal ERISA laws, which govern most employer-sponsored life insurance benefits, also may preempt state laws automatically revoking spousal beneficiary designations post-divorce.

ERISA’s preemption section states that ERISA “shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan” covered by ERISA<sup>4</sup>. The U.S. Supreme Court has held that life insurance benefits under an ERISA-governed, employer-sponsored plan had to be paid to a former spouse pursuant to the beneficiary designation on file, preempting a state law that would have invalidated the designation.<sup>5</sup>

***PUTTING IT ALL TOGETHER***

To illustrate how divorce can impact beneficiary designations, assume a married couple, Howard (H) and Wilma (W). H has \$5 million of life insurance coverage on his life, with W named as the primary beneficiary (no secondary beneficiary is named). H and W divorce and H remarries, but dies five years later without changing the beneficiary designation. The following chart illustrates how the insurance death benefits would be distributed under the various rules.

<b>Payment of Death Benefits under Applicable Rules</b>					
<b>Disposition of H’s Coverage Under Divorce Decree</b>	<b>Basic Rule: Designation Controls</b>	<b>Policy: Revokes Designation</b>	<b>State Law: Revokes Designation</b>	<b>State Law: Revokes Designation Subject to Decree</b>	<b>Federal Law: Enforces Designation Subject to Divorce Decree</b>
<b>To H with No Conditions</b>	To W	To H’s estate	To H’s estate	To H’s estate	To W
<b>To H but W Must Remain Beneficiary for 10 Years</b>	To W	To H’s estate, subject to W’s claim under divorce decree	To H’s estate, subject to W’s claim under divorce decree	To W	To W

## **BEST PRACTICES**

**For Owners.** For owner spouses, best practices dictate that the owner ***submit new beneficiary designations for all insurance policies as soon as possible after the divorce is finalized*** to avoid unintended consequences under the policy contract or state or federal law. Changing beneficiary designations also ensures coordination with the owner's legacy plan and the avoidance of probate, neither of which occurs if the payment of benefits simply defaults to the owner's estate. The owner should also be advised that ***changing his will does not revoke a beneficiary designation*** - beneficiary designations supersede the provisions in a will.

In addition, advisors and their clients should:

- Carefully review the terms of the divorce decree and ensure the new beneficiary designations comply with the decree.
- Name an alternate (or secondary) beneficiary on all beneficiary designations to avoid potential payment to the owner's estate if the primary designation is automatically revoked for any reason.
- Update beneficiary designations again once the terms of the divorce decree no longer apply.

**For Former Spouses.** If the divorce decree provides for payment of policy proceeds to the former spouse, best practices dictate that new beneficiary designations be submitted to comply with the decree and that the former spouse be provided with evidence that the new designations are on file with the insurance company or the insured's employer. In addition:

- The former spouse will need to establish a mechanism to ensure premiums are timely paid.
  - Consider including provisions in the divorce decree requiring that: (i) the premium is to be paid annually, (ii) the former spouse is to receive annual statements from the insurance company, and (iii) the former spouse is to be notified by the insurance company if a premium is not paid.
  - Also consider providing in the divorce decree that policy ownership goes to the former spouse with the former owner spouse (the insured) obligated to pay the premiums.

- The former spouse also could consider requiring that the policy be transferred to an irrevocable life insurance trust (“**ILIT**”) for the benefit of the former spouse and/or the couple’s children.
- If the beneficiary designation does not comply with the divorce decree, the former spouse should notify the insurance company and provide the company with a copy of the decree as soon as possible after the insured’s death to enforce the decree and prevent the proceeds from being paid out to a new spouse or other beneficiaries.

### ***TIMING IS EVERYTHING***

The best time to change life insurance beneficiary designations *may be before* the petition for divorce is filed. Once a petition is filed, automatic temporary restraining orders (“**TROs**”) are imposed on both parties to maintain the financial status quo and protect the rights of each spouse. TROs restrict the ability of the insured to revoke or change beneficiary designations without notice to, or the consent of, the insured’s spouse or securing a court order. TROs generally remain in place until the divorce is final (or the petition is dismissed) and new beneficiary designations executed while a TRO is in place will be invalidated. For example, in *First Metlife Invs. Ins. Co. v Filippino*<sup>6</sup>, after divorce proceedings were initiated and while a TRO was in place, the husband executed a new beneficiary designation for his \$750,000 policy, which removed his wife as the beneficiary and named his son instead. The husband died while the proceedings were pending. The court held that the new beneficiary designation violated the TRO and awarded all the insurance proceeds to the wife<sup>7</sup>.

- ✓ *Practice Points:* If the insured lives in a community property state (like California or Texas), then absent a pre- or post-marital agreement that provides otherwise, the spouse may have a community property interest in the life insurance policy. Execution of a new beneficiary designation before initiating divorce proceedings will not eliminate the spouse’s community property interest in the policy. The spouse will still own a one-half community property interest in the policy proceeds to which the new beneficiary designation will not apply unless she consents to the change. State elective share rights also may prevent a new beneficiary designation from disinheritting the spouse until divorce proceedings are finalized as the proceeds could be included in determining the amount of the insured’s estate and the spouse’s elective share.

## **FORMER SPOUSE AS BENEFICIARY OF AN ILIT**

Insureds frequently establish an ILIT for the benefit of the insured's spouse and descendants. A well-drafted ILIT may provide for the automatic removal of the spouse as an ILIT beneficiary in the event of a separation or divorce. Absent such provisions, the former spouse will continue as an ILIT beneficiary post-divorce. If the former spouse is not automatically removed, and if there are no ongoing obligations under the divorce decree, there are several options that can be considered to remove the former spouse as an ILIT beneficiary:

- The former spouse can disclaim or waive any rights or interest that he or she may have in the ILIT as part of the divorce settlement.
- The life insurance policy could be sold or decanted to a new trust of which the former spouse is not a beneficiary (note, however, that ILIT trustees have fiduciary duties to all ILIT beneficiaries, including a former spouse, so trustees may be reluctant to take actions that will remove the spouse as a trust beneficiary due to fiduciary liability concerns).
- If the individual is still insurable the existing policy could be allowed to lapse and a new policy acquired through a new ILIT.

## **TAKE AWAY**

Potentially conflicting state and federal laws impact how a beneficiary designation in favor of a former spouse will be treated following a divorce. Best practices dictate filing new beneficiary designations for all policies either before filing for divorce or immediately after the divorce is finalized. Failure to update beneficiary designations after a divorce can result in disruption of the insured's legacy plan.

## **NOTES**

## DISCLAIMER

**This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.**

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<sup>1</sup> For purposes of this report, it is assumed that the insured is the owner of the policy unless otherwise specified.

<sup>2</sup> See also *Hertzske v. Snyder*, 2017 UT 4 (2017), discussed in *WRNewswire* #17.01.24, in which the Utah Supreme Court held that, absent specific language in a divorce decree, the presumption under Utah Law is that divorce revokes a life insurance policy naming the former spouse as the beneficiary.

<sup>3</sup> See *Vassil v. Office of Personnel Management*, 2017 WL 431686 (January 31, 2017), discussed in *WRNewswire* #17.02.07, in which the decedent submitted a beneficiary designation during his marriage naming his wife a the majority beneficiary of his FEGLI. The decedent and his wife divorced in 2003. The divorce decree made no mention of the disposition of the FEGLI. The decedent subsequently died in 2016, a resident of Pennsylvania, without changing the beneficiary designation. Pennsylvania law revokes a beneficiary designation in favor of a spouse following divorce, treating the spouse as predeceasing the insured. The court in *Vassil*, however, held that federal law preempts state law and upheld the beneficiary designation, noting that in the absence of a divorce decree that expressly provides otherwise, upon the death of a participant, FEGLI benefits must be paid to the beneficiary or beneficiaries designated by the employee in a signed and witnessed writing received by the employing office before the participant's death. See also, *Hillman v. Maretta*, 133 S.Ct. 1943 (2013), where the U.S. Supreme Court applied federal preemption doctrine to enforce a beneficiary designation in favor of a former spouse where the insured failed to change the designation following the divorce despite state law to the contrary.

<sup>4</sup> See 29 U.S. C. § 1144(a).

<sup>5</sup> See *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001).

<sup>6</sup> See *First Metlife Invs. Ins. Co. v. Filippino*, 2017 NY Slip Op 50092(U), January 25, 2017.

<sup>7</sup> See also *Minnesota Life Insurance Co. v. Birney*, 2017 WL 106902, January 11, 2017, discussed in *WRNewswire* #17.01.17 (U.S. District Court in the S.D. of Ohio refused to fully honor a husband's beneficiary designation made in violation of a TRO).