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Help Clients Avoid a Big Life Insurance Mistake

We're focusing this article on one of the most common and chronic mistakes that estate planning attorneys are asked to fix after someone passes away.

To avoid this mistake, we encourage insurance agents and advisors not to allow a client to name the probate estate as the primary beneficiary of a life insurance policy. We see this happen consistently with financial professionals who are either new to the business or have been poorly trained. It is a particularly prevalent issue in the property and casualty industry.

In most states, life insurance proceeds can be passed to a beneficiary free of any creditor claims on the deceased's assets. This is one of the fantastic benefits of life insurance.

For example, a person who dies with a massive amount of debt can have beneficiaries receive life insurance free of creditor claims if the beneficiary form was filled out correctly or the life insurance is payable to certain kind of trust.

Real Life Story

To contrast this, we came across an incredible mistake made by an agent that cost a widow and her unborn child a fortune.

The husband was in his 40s and died while running on a treadmill at his gym. He had been a successful real estate developer, but in a real estate downturn he lost a lot of property. He filed for bankruptcy and owed about $20 million to creditors. He was in his second marriage, and his new wife was pregnant.

The husband bought $2 million dollars' worth of term insurance to make sure his wife and child would be protected financially. However, the life insurance agent made a terrible mistake. He made the husband's estate the primary beneficiary.

The Creditors Were Happy

And so, instead of the life insurance proceeds passing free of any creditors' claims to the wife and child, it went directly to the probate estate where creditors were thrilled to receive it. The attorney for the estate was able to negotiate some money for the wife and child, but the bulk was chewed up by creditors. It was a terrible outcome.

The creditors were satisfied, of course, but the wife and child received a modest amount in comparison to what they would have received if her husband's life insurance agent had recommended that he set up a trust for the widow and child.

Lawsuit against the Agent

The mistake surmounted into a great case of professional negligence that could have been brought against the life insurance agent. The widow chose not to bring a case because the agent was a family friend and because he was new to the business. The agent had told the husband that he didn't need to do any estate planning since there was no estate due to the pending bankruptcy. And yet, this is the same agent that sold him $2 million in term life insurance.

What's the Point?

If you are unsure of what to do as an agent, ask an attorney colleague. Or better yet, work with your attorney colleague and think through the planning consequences of any significant life insurance investment.

If you name the estate or the probate estate as the primary beneficiary of the policy, regardless of the situation, you're assuring that the creditors of the deceased can stand in line with the beneficiaries to receive the proceeds.

We hope this information is useful to you and helps your clients and their families. If you have a specific case or question, please don't hesitate to call our office.