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White Paper

Divorce and Risk Management

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Divorce and Risk Management

What is risk management and how is it relevant to divorce?

Risk may be defined as the possibility of harm, injury, loss, danger, or destruction. One option to help manage risk is to purchase sufficient insurance to pay for losses. Risk management is an important topic for separated or divorcing couples. When a divorce occurs, the selection of life and health insurance beneficiaries may have to be revised and, in some cases, insurance coverage may terminate. Because it's common for one spouse to maintain health insurance for the family, for example, the breakup of a marriage can have serious consequences for the nonworking spouse. Therefore, it's important to revisit the issue of risk management when a divorce seems likely.

How will a divorce affect your health insurance coverage?

Often, one spouse participates in a group health insurance plan at work; typically, this plan will provide coverage for both spouses. When a divorce occurs, coverage for the nonemployee spouse may eventually end (unless the divorce decree requires a spouse to continue carrying coverage on the ex-spouse).

However, temporary protection may be provided by the Consolidated Omnibus Reconciliation Act of 1986, COBRA. This federal law was designed to protect employees of larger companies (20 or more workers) and their dependents from losing group insurance coverage as a result of job loss or divorce. If your former spouse maintained family health coverage through work, you may (at your own expense) continue this group coverage for up to 36 months after the divorce or legal separation. This COBRA coverage will terminate sooner than 36 months, if you remarry or obtain coverage under another group health plan.

Caution: Bear in mind that COBRA doesn't apply to a group health plan if the employer maintaining the plan normally employs fewer than 20 employees on a typical business day. Also, certain governmental plans and church-sponsored plans are exempted from the act. For more information, see COBRA.

Caution: Several states have enacted laws that preserve a spouse's eligibility for health insurance after separation and divorce. These laws may provide a former spouse with more generous rights than those provided under COBRA.

- Health insurance for you--When analyzing the issue of health insurance during divorce proceedings, you should consider whether it's cheaper to continue COBRA coverage, to purchase individual coverage, or to seek coverage from your own employer (if you're employed). For young homemakers with children and older homemakers who sacrificed career opportunities for domestic concerns, COBRA coverage and purchasing individual policies may be

the only choices available. Keep the cost of insurance in mind. Individual policies are often more expensive than group policies, so COBRA coverage is certainly attractive. If you decide to exercise your COBRA rights, note that your cost of continuing COBRA coverage can't exceed 102 percent of the cost to the plan for providing identical benefits to an active participant. Additionally, be aware that you have the right to pay the premiums in monthly installments. For older persons, it may be wise to purchase individual health insurance or to insist, in the divorce agreement, that the working spouse maintain health coverage for you. Otherwise, when the COBRA coverage terminates after 36 months, you may find that poor health in your later years presents an insurability problem or that the cost of your insurance is exorbitant. Nevertheless, federal law may provide certain protection regarding pre-existing conditions. For more information, see Health Insurance Portability and Accountability Act of 1996.

- Health insurance for your children--When there are children born of the marriage, the child support section of the divorce agreement should address the issue of health insurance for the children--you need to assign responsibility for providing health insurance. A federal law, the Omnibus Reconciliation Act of 1993, provides some protection to those spouses who have custody of the children. This act provides for the existence of a court order that secures your children's continued health insurance coverage. This court order is called a Qualified Medical Child Support Order (QMCSO). In accordance with this order, custodial parents have the right to obtain health insurance coverage for the children through the noncustodial parent's group health plan (if any). The children can't be denied coverage by the noncustodial parent, that parent's employer, or that parent's insurance company based on any of the following reasons:
 - The child doesn't live with the noncustodial parent
 - The child isn't claimed as a dependent on the noncustodial parent's federal income tax return, or
 - The child lives outside of the plan's service area

Along with covering an employee's child under an employer-sponsored health care plan, a QMCSO can require the following:

- Deducting the premium out of the employee's paycheck
- Making insurance reimbursements directly to the nonemployee parent (if that parent pays the provider), and
- Giving the nonemployee parent information requested regarding the health care plan and reimbursements

To qualify as a QMCSO, the court order must:

- Create the child's right to receive benefits under the group plan
- Specify the employed parent's name and last known mailing address and the names of each child covered by the plan
- Specify each plan and time frame to which the order applies, and
- Not require the plan to provide any additional benefits not actually provided in the plan

How will a divorce affect your life insurance coverage?

When you get a divorce, you need to reconsider whom to name as the beneficiary of your life insurance policies. Perhaps you might wish to name your children as sole beneficiaries. If so, be aware that if your children are under age 18 when you die, the probate court will require that a guardian be appointed to manage the insurance proceeds until your children reach age 18.

You might also consider naming your ex-spouse as beneficiary of your life insurance policy. Although this may not be your preference, it may be required as part of your divorce agreement. Because alimony terminates on the death of the payer, for example, life insurance may be used as a tool to guarantee a stream of income if the alimony-paying spouse passes away. This is equally important to ensure that child-support money will continue to be available. Often the parties will stipulate in the divorce decree that life insurance will be carried on the life of the payer to replace alimony and/or child support in the event of death.

In such cases, the recipient-spouse should either own the life insurance policy or be an irrevocable beneficiary in order to ensure payment of the premiums (and to create favorable tax treatment for the payer of the premiums, if alimony is involved).

Example(s): Assume Liz was receiving \$300 per month in alimony from her ex-husband, Frank. The court had ordered Frank to carry life insurance on his life (payable to Liz) for as long as alimony was required. After five years, Frank stopped paying his insurance premiums and the policy lapsed. When Frank died of a heart attack the next month, alimony payments ceased and Liz learned (for the first time) that there would be no life insurance proceeds forthcoming.

Tip: If your divorce agreement stipulates that a new insurance policy will be purchased on the life of the working spouse (to secure alimony or child support), make sure that the working spouse applies for the policy before the divorce is final. That way, if he or she can't pass the physical exam and is uninsurable, there's still time to modify the final property settlement to make up for this problem.

Should disability insurance be considered?

Another risk to your income is that you may become disabled or your ex-spouse (who is paying your support) may become disabled. During the discovery process of divorce, your attorney should uncover information about any disability plans at your spouse's place of employment.

While a former spouse can't own a disability policy on their ex-spouse, the former spouse can pay the premiums on the policy to ensure that it stays in force. Disability insurance is important and is a topic you may wish to address in your divorce agreement.

Example(s): Assume Ken agreed to pay his ex-wife \$2,000-per-month alimony, based on his \$7,000-per-month salary. After the divorce was finalized, Ken suffered an accident and became

disabled. If he has no disability insurance and no salary, he can go back to court to get his alimony obligation modified. If Ken has disability insurance, he might receive \$5,000 per month tax-free and could probably continue paying the same amount of alimony.

What about property insurance?

Real and personal property must be insured by the actual owner of the property. Therefore, applicable insurance policies must be modified or rewritten to reflect the proper owner as the insured. With respect to married homeowners, for example, the title is usually held by both spouses as joint tenants or as tenants by the entirety. In such cases, the death of one spouse will automatically vest the title to the other spouse. At the time of a divorce, a new deed should be drawn up to reflect the new arrangement and the homeowner's policy should be updated. For more information, see Property and Casualty and Liability Insurance.

Divorce negotiations provide you with a number of choices regarding the house. For instance, the house can be sold immediately and the proceeds divided. Or, both spouses can continue to own the house jointly (with a view toward a future sale). Alternatively, one spouse can keep the house and buy out the other's interest. Finally, one spouse can be awarded the house without trading other assets in return.

Again, it's the divorce agreement that should address the issue of the title to assets and property insurance. In cases involving an older homemaker or a younger spouse who has custody of children, it's not uncommon for a judge to award the entire house to such a party and to order that the other spouse pay the mortgage, property taxes, and subsidize the homeowner's insurance.

Disclosures

This material does not constitute the rendering of investment, legal, tax or insurance advice or services. It is intended for informational use only and is not a substitute for investment, legal, tax, and insurance advice.

State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

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