Watch That Life Insurance Policy

By Robert D. Kaplow, Esq.

A life insurance policy is a valuable asset. Life insurance serves many purposes. Life insurance proceeds can protect your family upon death and make sure that your spouse and children are taken care of in the manner in which you choose, such as providing funds for ownership of a home, education of children, providing funds for starting a business, etc. In addition, for those clients who have substantial debts, life insurance can provide funding for those debts. Furthermore, life insurance can provide liquidity for an estate which owns hard-to-sell assets. Finally, for those clients who are lucky enough to have an estate tax liability, life insurance proceeds can provide funding to make sure that estate taxes do not burden their families.

We recently had a situation in which our client had set up an irrevocable trust to own a second-to-die life insurance policy to provide liquidity for his family upon the death of both the husband and wife. A second-to-die life insurance policy provides insurance proceeds after both of the insured parties have died. In this particular case, the policy was purchased by an irrevocable trust that was created in 2002 when the estate tax exemption was only $1,000,000 and not the current $11,700,000. The client expected to have a substantial estate tax liability. Therefore, the client purchased $5 million worth of whole life insurance. In a whole life policy, the premiums are substantial, but a cash value builds up in the policy. In fact, at the time of the death of the second of the insureds, the cash value of the policy exceeded the $5 million face amount of the policy.

Upon the death of the second of the insured, we submitted a death claim form to the insurance company, and the insurance company was very pleased to promptly send us payment of $5,280,000, which represented the cash value of the policy. While this was a substantial amount, it was **below** the death benefit amount that had been shown on the annual statements from the insurance company. In fact, the death benefit that was shown on the policy annual statements was $6,270,000, or approximately $1 million more than the amount received from the insurance company.

Our office negotiated with the insurance company to have them pay the full amount as shown on the annual statements. Eventually we were successful in having the insurance company pay the full amount of $6,270,000. Interestingly, upon further audit of the policy by the insurance company after payment of the $6,270,000, they determined that they had actually underpaid the policy by another $150,000, and this amount was also sent to our clients. (The insurance company also told us that they had searched their records regarding death benefit payments to other parties, and had found other payments that were underpaid.)

Therefore, the moral of the story is to make sure to retain the annual notices that are received from the insurance company showing the death benefits available under the policy. Do not automatically assume that the death benefit payment received from the insurance company is correct. Most insurance policies are very detailed and the computations of the death benefits are complicated. Therefore, it is best to have the insurance company audit their own policy death benefit determination in the event of death of the insured to make sure that they are paying the correct amount.

Please contact our estate planning group if you have any questions regarding the use of insurance in connection with your estate plan.