Munich RE

The challenge of minor beneficiaries

Life insurance companies seek to adjudicate and pay claims as quickly as possible, delivering on the promise made when the policy was issued. Unfortunately, situations outside the insurer's control may either lengthen the process or prevent it from occurring. A life insurance claim where a minor child is the primary policy beneficiary can be one of these situations.

Life insurance is often purchased to ensure the needs of dependent children are taken care of in the event of their parent's death. Unfortunately, if the beneficiary designation on the policy is not well thought out or executed, these good intentions may not work out as planned. This is especially true when an insured dies while a child is still a minor and named as the primary beneficiary of a life insurance policy (or is named as a contingent beneficiary and the primary beneficiary predeceased the insured or died simultaneously).

Designating a minor as primary beneficiary

Designating a minor as primary beneficiary is rarely, if ever, part of proper financial planning; however, often a policyowner lacks an understanding of the potential consequences of this decision. Even when a policyowner does understand the need to appoint a legal guardian to handle the minor's financial affairs in the event of the insured's untimely death before the child reaches the age of majority (usually between 18 and 21), circumstances leading to a minor being the primary beneficiary may be the result of other events, including a divorce or predeceased spouse (or other beneficiary), where the policyowner needs additional time to contemplate the situation.

Alternatives to naming a minor as a primary beneficiary may require an investment of significantly more time and expense, such as creating a trust or legally appointing a guardian in advance. In addition, caring for a child is not to be taken lightly, causing parents to understandably struggle to determine the most appropriate guardian in the event of their premature demise, someone who is capable of making medical, educational and financial decisions for the minor. This is especially true when the insured is a single parent, as grandparents or other relatives may no longer be physically able or equipped to manage the affairs of a minor. Once decided, the naming of a legal guardian can cost thousands of dollars in expenses and may take several months to complete in some jurisdictions.

Considering these facts, a policyowner may still name a child as a primary beneficiary accepting the risk that they will live until other financial planning arrangements are completed or until the child reaches the age of majority. The latter is even more likely when the child is a teenager at the time the insurance policy is applied for or the beneficiary designation is made. Naming a minor as beneficiary is easy, quick, and inexpensive. Unfortunately, the quick and easy solution may have unintended consequences that significantly affect a surviving child's future.

Making policy proceeds immediately available for the minor's care[1]

After determining that a life insurance benefit is payable, the insurance company first looks to pay the proceeds directly to the named beneficiary according to the policyowner's instructions. Unfortunately, life insurance companies cannot make payments directly to a minor; thus, a minor beneficiary is problematic to the insurance provider's desire to pay the claim expeditiously and in accordance to the policyowner's instructions. In addition, it is often critical for the benefits to be immediately available for the minor's care. Unfortunately, without the policyowner's proper planning and execution of the beneficiary designation prior to the insured's death, there are only a few payment options that accomplish these goals.

Guardianship

It is important to understand the distinction between the guardian of a person and the guardian of a person's estate. A natural parent or other individual may be the guardian of a minor child as a person, but unless specifically named as guardian of the minor's estate, they are not automatically the guardian of that minor child's financial assets. This includes a surviving natural parent who can make certain financial, educational and health care decisions, yet unless they are appointed legal guardian over the financial affairs of the child, they are likely not able to receive or utilize a life insurance benefit on behalf of the child. When discussing a "guardian" or guardianship as it applies in this article, we are referring to the guardian, or often called a "custodian," of the financial affairs.

A guardian of the minor can control the funds for the benefit of a minor until the child reaches the age of majority at which time the minor, assuming they are mentally competent, can legally take control of their own financial assets. If a guardian has not already been appointed, the next of kin or any other individual seeking guardianship may be appointed by a court to receive and administer funds on behalf of the minor at the time of the life insurance claim. Appointing a guardian is a legal proceeding that takes place in the probate court and may require a bond be posted.

Once proper documentation of the appointed guardianship is received, the insurance company is able to pay the minor's proceeds directly to the appointed guardian, who is then responsible for ensuring the funds are used for the minor's benefit until they reach the age of majority.

Uniform Transfers to Minors Act (UTMA)

If there is no plan to have a legal guardian appointed, the Uniform Transfers to Minors Act (UTMA) is the simplest and most common manner for insurance companies to pay proceeds from a life insurance policy to a minor beneficiary when the proceeds are relatively small. Under UTMA, an adult seeking to be the financial guardian is able to establish a custodial account at a life insurance company, bank, or other financial institution without the expense of creating a legal trust or guardianship. The custodian controls and manages the assets until the minor reaches the age of majority as defined under the UTMA statute for that particular state. At the age of majority, the assets are turned over to the beneficiary, who can use the assets in any way he or she chooses. While the UTMA was intended to be uniform in all states, most states have modified the rules, including the amount that can be paid under the UTMA.

An insurance company must verify the laws for each state prior to issuing payments under the UTMA to ensure it is in compliance with the statutes. Currently, UTMA is in effect in all but two states as South Carolina and Vermont have not yet adopted the UTMA. Instead they adopted the Uniform Gifts to Minors Act (UGMA), which may be used in those states. The UGMA is also available in most other states, yet it is generally more complex related to payment of life insurance benefits compared to the UTMA.

Uniform Custodial Trust Act (UCTA)

Although not as well known, the UCTA is similar to the UTMA as it permits a one-time payment on behalf of a minor up to a specified amount (usually $10,000 or $20,000) to an adult member of the beneficiary's family. As of January 2016, the UTCA has been adopted by 18 states and the U.S. Virgin Islands.

If the amount of proceeds owed to the minor exceeds the specified amount, generally, no payment may be made under the UCTA. UCTA transfers in excess of the specified limit can be made with court approval in some states. As an example, the UCTA for the state of Colorado[2] defines "member of the beneficiary's family" as: "a beneficiary's spouse, descendent, stepchild, parent, stepparent, grandparent, brother, sister, uncle or aunt, whether by whole or half blood or by adoption."

Before payment is made, the UCTA requires written and signed acknowledgment of delivery that the custodian will receive the proceeds on behalf of the beneficiary.

Payment methods of last resort

Guardianships, the UTMA, and the UCTA may be the best options for an insurance company to pay small amounts to a minor beneficiary as both options make the funds available to a guardian for the child's immediate needs as intended by the policyowner. If the insurance company is unable to pay the proceeds through one of these methods, the insurance company may have no alternative other than to handle the proceeds in a manner that will safeguard them until the minor reaches the age of majority; thus, limiting the use of the funds for the care of the minor. Of course, if a guardian is appointed after implementation of one of these safeguarding methods, the insurance company can proceed with payment to the guardian. Alternative methods for dealing with policy proceeds owed to a minor beneficiary include:

Supplemental contract or Retained Asset Account

Many insurance companies utilize a supplemental contract or Retained Asset Account (RAA) to hold the proceeds until the minor reaches the age of majority. A supplemental contract is simply a contract, outside of the life insurance contract, that provides protection of the proceeds in an interest bearing account with the insurer until the minor reaches the age of majority and takes control of the funds or a legal guardian over the minor's estate as appointed by the court. An RAA is an interest bearing account that provides a temporary repository of funds created by the insurance company with a separate financial institution, generally a bank.

Using a supplemental contract or RAA establishes the claim as paid and creates an account to maintain the policy proceeds in the name of the minor beneficiary while accruing interest. Generally, the supplemental contract provides interest at the insurance companies "money on deposit" rate; however a RAA may provide a different rate of interest.

Insurance companies usually request a certified death certificate for the deceased insured and a copy of the minor's birth certificate to establish a Supplemental Contract or Retained Asset Account.

Maintain funds within the claims department

Life insurance companies that do not utilize supplemental contracts or RAAs, usually simply maintain the death benefits that cannot yet be paid, due to the beneficiary's status as a minor, as a pending claim within their claim department. Insurance companies may choose this option for various reasons, including when it is expected that a guardian will be appointed in the near future or the minor is only a relatively short time period from reaching the age of majority (usually six months or less). Utilizing this method is not preferred as the aging pending claim may increase the administrative burden of the claims department, including maintaining current contact information and compliance with state mandates for ongoing communication with the beneficiary, often as frequently as every 30 days. This burden may be ongoing for more than 18 – 21 years in some circumstances.

Escheatment of funds

When unable to pay a death benefit directly to a minor beneficiary or using any of the methods above, a few companies have considered whether or not they are obligated to escheat the funds, on behalf of the minor beneficiary, as unclaimed property to the state where the minor beneficiary resides. The funds then reside with the state and the minor or their legal representative may make their claim to the proceeds to the state. While escheatment of unclaimed life insurance benefits is common for adult beneficiaries, there are currently no companies known to use this method for minor beneficiaries and it is not a recommended practice. In addition, escheatment of benefits payable to a minor may cause the benefits to be difficult for the minor beneficiary or guardian to retrieve from the state and, for very young beneficiaries, knowledge of these funds may be lost to the minor and never recovered when the age of majority is reached. For this reason, some states have reportedly declined to accept life insurance benefits escheated for a minor beneficiary.

Whose responsibility is it anyway?

It is in the best interest of agents and insurance companies to educate the policy owner regarding proper planning and executing the beneficiary designation (many do provide instructions and educational pamphlets); however, the designation that is ultimately made is solely the policyowner's responsibility. If a policyowner insists on naming a minor as a beneficiary without establishing a trust, naming a guardian, or otherwise providing for an adult custodian to safeguard and utilize the funds for the benefit of the child, then the insurance company has no alternative than to accept the beneficiary designation as presented.

Summary

Policyowners must give significant thought and care when making beneficiary designations involving minor children. One of the biggest mistakes of life insurance policyowners is making a beneficiary designation that results in a minor being the primary beneficiary without putting an adult in charge of the funds. If the insured dies, this scenario is problematic for both the insurance company and the minor; the insurance company is unable to pay the death benefits as designated, while the minor beneficiary may not have access to the benefits for their daily, health, and educational needs. While insurance companies may provide educational material, making the proper beneficiary designation is ultimately the responsibility of the policyowner. When policyowners fail in this responsibility, determining the best method of payment becomes the insurance company's responsibility, and those options are limited. It is in everyone's best interest to ensure the beneficiary designation is proper before the insured's death.

References

[1] If the insurance company is aware a minor beneficiary is a special needs child, it may be advisable to suggest the prospective guardian seek legal advice before the death benefits is paid as inherited funds, including life insurance benefits, may disrupt any government care or support programs the special needs child depends upon for their daily and put future care in jeopardy.

[2] http://www.leg.state.co.us/preclics/1999/sbills99/sb220.htm

If you have questions or would like to discuss this article further, please email the Munich Re, U.S. (Life) claims team—clm@munichre.com.