ifpas

INSURANCE AND FINANCIAL PRACTITIONERS ASSOCIATION OF SINGAPORE

TUESDAY TIMES ISSUE # 84

EFFECTS OF DEATH ON AN UN-NOMINATED LIFE INSURANCE POLICY

ifpas
INSURANCE AND FINANCIAL PRACTITIONERS ASSOCIATION OF SINGAPORE

15 MARCH 2022, ISSUE NO. 84

TUESDAY TIMES

Effects of Death on an Un-nominated Life Insurance Policy

A life insurance policy is a legal contract between the insurance company and the policy owner. Therefore, when death happens, the insurance company needs to have a legal way to discharge her legal obligation to the contractual party, which is the estate of the deceased policyowner. The purpose of this article is to explain the legal basis of the death benefit settlement of an un-nominated life insurance policy. Let's assume the policyowner and the life insured is the same person.

Section 150 of the Insurance Act

When death happens to a policyowner of an un-nominated life insurance policy, the insurance company needs to fulfill her contractual obligation, which is commonly known as "paying the death benefit". The issue then is, who can the insurance company pay to? The logical conclusion would be to the legal representative of the estate of the policyowner.

This would mean that the life insurance company needs to freeze the death benefit until the letter of administration or grant of probate is being produced. However, it is recognized that a life insurance contract is a critical source of capital and liquidity for the deceased's policyowner's family, hence, the common law development of the Insurance Act provides a conditional way out for this issue. In the Singapore's context, this is Section 150 of the Insurance Act.

Section 150 of the Insurance Act deals with the payment of living or death benefits under life policy or accident and health policy. Subsection 2(b) of this Act provides for a conditional legal way for life insurance company to discharge her legal obligation of paying death benefits without the production of any probate or letters of administration.

(As financial practitioners, we need to appreciate that the ability of receiving the death benefit without probate or letters of administration is an exception rather than the norm compared to all other estate assets. This means life insurance policy triumph all other assets from the perspective of estate capital and liquidity at the policy owner's death.)

Subsection 10 provides for a life insurance policy's death benefit to be paid out conditionally to any proper claimant if the policyowner did not make any nominations or executed a valid will.

Proper Claimant

Next, we need to examine who can receive the un-nominated life insurance policy's death benefit. Section 150(10) of the Insurance Act provides for a proper claimant to receive the death benefit. And Section 150(12) defines proper claimant as a person who is the widower, widow, parent, child, brother, sister, nephew or niece of the deceased.

Amount of Pay-out – Up to $150,000

Section 7 of the Insurance (General Provisions) Regulations, which is the subsidiary legislation of the Insurance Act, gives further clarity by spelling out that the life insurance company may pay up to $150,000 for an un-nominated life insurance policy.

ESTATE PLANNING PROBLEMS

These laws produced a few unintended estate planning problems regarding un-nominated life insurance policy.

A.THE $150,000 PAYOUT IS DISCRETIONARY

The law further spells out that an insurance company may make a payment of $150,000. This means if the insurance company has reasonable basis to judge that a potential conflict could arise from multiple proper claimants, the insurance company has the right to withhold the death benefit until a probate or letter of administration is produced.

Secondly, the current positions adopted by the life companies is $150,000 per life per insurance company. This means if a client has multiple un-nominated policies with the same insurance company, assuming with a combined sum assured of $1,000,000, the insurance company will still pay only $150,000 to the proper claimant and the rest of the $850,000 death benefit will only be paid upon the production of probate or letter of administration. Sometimes, this can lead to an estate liquidity issue.

B.PROPER CLAIMANT RECEIVES THE DEATH BENEFIT AS A TRUSTEE AND NOT AS A BENEFICIARY

One of the common misunderstandings is that the proper claimant is entitled to the death benefit as a beneficiary. This is not the case. The proper claimant actually receives the death benefit in his capacity as a trustee. In other words, he receives the death benefits on behalf of the estate, and he is supposed to distribute the death benefit (of up to $150K) according to the terms of the will, Interstate Succession Act, or Adminstration of Muslim Law Act, or whichever is relevant to the deceased policyowner's estate planning position; or if the policyowner's estate is insolvent, direct the insurance proceed to settle estate debt or to the official assignee for the benefit of the estate creditors. Therefore, it is possible that a proper claimant may receive the death benefits but is not legally entitled to the insurance money. Personally I have seen dispute happened between surviving parent and adult children over such monies.

C.POTENTIAL DISAGREEMENT ON WHO SHOULD BE PROPER CLAIMANT

As the surviving spouse, children, parents, sibling, and sibling's children of the deceased policyowner qualify to be proper claimant, potential disagreements can arise.

This is especially so in a blended family structure where the surviving (adult) children might not agree that their step-parent or step-sibling to be the proper claimant of their deceased parent's life policy.

Under such situations, the life insurance company has every right to withhold the entire death benefit until the probate or letter of administration is being produced. This can cause an estate liquidity problem, especially so if one of the surviving parties needs the capital and liquidity to discharge an outstanding mortgage loan, or a business buy-sell agreement obligation

CONCLUSION

As you can see, there are potential problems and uncertainty that can arise from an un-nominated life insurance policy. Hence, it is not advisable to rely on this method for estate planning. A life insurance policy, being the main source of estate capital and liquidity of a deceased estate, warrants a deliberate consideration on either insurance nomination, assignment, will or trust structure to direct the death benefit to its intended party. This deliberation process ought to be guided by a competent financial practitioner.

ALLEN LIM IS A LICENSED FINANCIAL PRACTITIONER AND HOLDS THE AFC, CHFC®/S, CLU®/S & FCHFP DESIGNATIONS, AND HAS A CERTIFICATE IN LAW (ESTATE PLANNING). HE IS THE CURRENT IFPAS 1ST VICE PRESIDENT, HEADING THE EDUCATION & TRAINING DEPARTMENT AND WAS CONFERRED AS AN IBF FELLOW (FINANCIAL PLANNING) IN 2021.