Life insurance and divorce

When William joined his employer's saving and investment plan (SIP), he signed a beneficiary designation to identify the person to receive the account balance, if any, at his death. He named his wife, Liv, the approach most people ordinarily would take. William was free to change or revoke the beneficiary designation at any time, and if no one were designated, the funds would pass to his estate.

William and Liv later divorced. In the divorce decree, Liv abandoned any interest that she had in this account. However, when William went through his beneficiary designation forms at his company after the divorce, he never ordered Liv's name removed from this account. Whether this was intentional or an oversight is unknown. However it happened, at William's later death the plan paid the account balance to Liv, in accordance with the form in its files. The executor of the estate (William's daughter) filed suit, arguing that under the divorce decree the money should have gone to the estate.

The case made it all the way to the U.S Supreme Court. That Court ruled that the plan was not required to honor the divorce decree, because it was not in the form of a Qualified Domestic Relations Order (QDRO), the approach authorized by law for dividing pension rights in divorce. A QDRO formally brings the matter to the attention of the plan trustees. A pension or savings plan is not required to conduct an independent investigation or look to external circumstances in order to decide where the money should go. Here, the plan was required to follow William's instructions.

The better approach

William could have prevented this result by revoking his beneficiary designation. If he had, the money would have passed to his estate. Or he could have named his daughter the beneficiary, as he did with his pension and retirement plan. But because the SIP had a separate beneficiary designation, it had to be taken care of independently.

The implication of the Court's decision is not as narrow as one might first suppose. Other assets (life insurance, bank and brokerage accounts, and IRAs, for example) can be governed by beneficiary designations. Other life events (marriage, birth or death in the family) can affect how one wants property distributed. Regularly reviewing your beneficiary designations along with your will should help to prevent unintended consequences.