The Burwell Burden – New Criteria for Valuing Term Life Insurance
R. Ann Fallon: Interview with Matt Taddei, Life Insurance Expert, February 28, 2014

In re Marriage of Burwell (2013) 221 Cal. App. 4th 1; 164 Cal. Rptr. 3d 702; Opinion by Justice Poochigian, Court of Appeal of California, Fifth Appellate District, Justices Franson and Pena concurring.

FACTS: In *Burwell*, during divorce proceedings, husband had not revealed a term life policy insuring his life although he had kept Wife 1 as his beneficiary during their marriage. After a Judgment bifurcating marital status, while the ATROS were still in effect, husband changed his beneficiary to his new spouse and then died by suicide. When both spouses sought the life insurance proceeds, the trial court found that the policy was an omitted asset, husband had violated the ATROS and the change of beneficiary was void. Proceeds were found to be the community property of the first marriage. Former spouse and the Decedent's estate were each awarded 50% of the proceeds. The surviving spouse was found to have standing to appeal. The Appellate Court vacated the trial court's ruling and remanded for further fact findings and application of the rules set forth by the *Burwell* Court. Request for Review was denied; request for depublication was denied.

***BURWELL RULES*:** The appellate court framed the question and answer in *Burwell* as follows:

QUESTION: Are the proceeds of a term life policy community property or separate property of the spouse who pays the final premium?

ANSWER: It depends. The effect of the rules governing characterization of term life insurance proceeds depends on **multiple factors**, including:

- Who paid the premium for the final term of the policy;
- Whether the insured became medically uninsurable during a term of the policy that the community paid for;
- Whether post-separation premiums were artificially low due to a cap on premiums paid for in part by the community

INTERVIEW WITH MATT TADDEI, LIFE INSURANCE EXPERT

ANN: Matt, the *Burwell* court has stated that the methodology for allocating proceeds of term life insurance policies is unfortunately intricate and that expert witnesses may be needed. As a life insurance expert, is that good news?

MATT: Not necessarily. The AALU Report I read on this case (Association for Advanced Life Underwriting) summarized that the appellate court held that the characterization of term life insurance death benefits as community or separate property depends not only on who paid the final premium but also on other factors such as the insurability of the insured and whether the amount of the final premium payment is capped or otherwise discounted against the current market cost of comparable life

insurance coverage. These last two factors seem especially murky to me and I think their introduction will add much more confusion than clarity in determining the rightful recipient of life insurance proceeds in a case such as Burwell.

WHO PAID THE PREMIUM
FOR THE FINAL COVERAGE TERM OF THE POLICY?

ANN: *Burwell's* first criterion for the characterization of term life insurance is who paid the premium for the "final term" of the insurance coverage and from what source.

Matt: Term Life Insurance is viewed in different ways.

- **Series of Renewable Policies:** A term policy can be viewed as not one policy but a series of annually renewable policies, renewable at the option of the owner.

- **One Policy Approach:** Or it could be argued that a policy such as a 20 Year Level Term policy is one whole contract for that entire period of time, i.e., 20 years.

Burwell finds that each renewal period creates a separate contract, and some contract terms create enforceable property rights for the community that remain viable until the death of the insured under that policy.

ANN: *Burwell's* insight is that even if the community did not pay the final premium, it may still have enforceable contractual rights if the insured became medically uninsurable during a term of the policy that the community paid for; or, if post-separation premiums were lower due to a cap on premiums paid for in part by the community. B*urwell* holds these contract rights are distinct property interests. As an expert, what do you think of this approach?

MATT: A term policy could be viewed as a bucket with many valuable contract rights bestowed on the policy owner. *Burwell* specifies that the expert examine the right of renewal when the insured is medically uninsurable and examine the right to continue lowered premiums under a premium cap policy. Both of those rights are important, but I wonder if as an expert, I would be asked whether other contractual rights also create a property interest, such as:

- the right to change policy ownership
- the ability to assign the policy to a third party, such as a bank
- the right to change the beneficiary designation in the future
- the option to convert the policy to a permanent policy regardless of insurability at the time of option exercise
- the right to continue to renew the policy at pricing based on the original underwriting classification regardless of future health
- the right to sell the policy for cash in the secondary market if the insured's health has diminished
- The right to payout on the contract notwithstanding Suicide and
- guaranteed maximum premium

MEDICAL UNINSURABILITY

ANN: *Burwell* ruled that where the insured spouse becomes medically uninsurable during a term paid for by the community, the community has a contractual interest in the insured's "right of renewal." The Court suggested the following formula.

Formula re Right of Renewal if Insured became medically uninsurable during a term paid for by the community:

> A proper apportionment of the proceeds
> is between community and separate property
> in the same ratio that the amount of premiums paid from
> community earnings bears to the amount of premiums paid from
> separate property. CA(9)(9) at page 22.

MATT: One problem I would have in applying this formula is that during the divorce process the insured is alive, so how could the denominator of this formula be determined?

ANN: Who would qualify as an expert to testify as to when an insured became medically uninsurable and how would such a determination be made?

MATT: I think that determining insurability is an exercise that can only be definitively addressed by an underwriter as part of a formal underwriting process.

ANN: Describe the underwriting process.

MATT: The formal underwriting process completed at the time of initial life insurance application includes the following steps:

- Application
- Paramedical exam
- Review of medical history & driving record
- Underwriting decision

The paramedical exam is a key source of information for an underwriter. In addition to obtaining answers to health questions and taking physical measures such as height, weight, and blood pressure, the paramedical exam includes taking blood and urine samples for laboratory analysis. Typically, over twenty tests are run on the samples to help determine if the applicant is insurable. These include inspecting Albumin, Blood Urea Nitrogen (BUN), Cholesterol Ratio, Triglycerides, A1C and Alkaline Phosphatase, among many other tests. The paramedical exam, along with the applicant's medical records, is vital in determining insurability and underwriting class-based pricing at the time of issue. Trying to ascertain insurability at some later date without these key sources of information is difficult to fathom.

Ann: So in the case of the insured dying many years after the original policy was underwritten, a court may not be able to determine if an individual was insurable at an earlier date such as the date of separation; or if so, at what classification and price?

> **Matt:** Correct. Level term policies are popular so it might take 20 or 30 years to have finality on such policies. There are also Universal Life policies that look and act very much like "level premium term policies for life." It is difficult to imagine how the court could make an allocation using the *Burwell* formula without an insurance company underwriter, and that begs the question of how comparisons could be done years after the insured had medical exams associated with the original policy and/or after the death of the insured.

Ann: Even with medical records, what are the odds of being able to opine on or determine at what point an individual went from being insurable to uninsurable?

> **Matt:** That cannot be an exact science from a practical standpoint. We have had many experiences when some companies have deemed an applicant uninsurable and other companies have deemed the applicant insurable. We have also often experienced wide ranges in policy prices offered by different companies. It seems to me that the court's reasoning, while perhaps theoretically plausible would not be practical in the real world.

LESSENED INSURABILITY
THE VALUE OF THE "CAP"

ANN: A third scenario in which the community retains an interest in the contractual right to the policy proceeds is "Lessened Insurability" defined as where, over time, a spouse becomes more expensive to insure. The *Burwell* court held that the right to continue coverage under a policy which has a "cap" on premiums has value. Is this criterion easier to ascertain than medical insurability, discussed above?

> MATT: First, the term "premium cap" is not a term used in our industry. But I think the court's meaning is fairly clear. Let me explain.
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> Historically, term life insurance or "Annual Renewable Term" life insurance or "ART" closely mirrored mortality tables. As we age, premiums increase. ART was the predominant term life insurance policy sold for generations.
>
> For the past two decades "guaranteed level term" has replaced ART as the most popular form of term life insurance. The Level Term Insurance category includes policies with guaranteed level premiums for 10, 15, 20, and even 30 year periods. For example, a 20 year guaranteed level term life insurance policy will have a level premium for the first 20 years the policy is in force.
>
> Guaranteed level term policies artificially flatten what should be an annually increasing cost and lock in a level premium over a period of time. As one would understand, in the early years of the policy, the premium for level term is higher than what might be

reflected on the mortality tables. At some point an age midline is reached after which the premiums become lower than what might be charged under the mortality tables. This likely is what the court means by the "cap" on premiums.

Alternatively, the term "cap" could mean that the contract reflects a right to have a cap on the premiums that might be charged **after** the 20-year level premium term is over. This is typically referred to as a "guaranteed maximum premium."

The court attributes a community interest to the term life insurance if there is some perceived value between the actual premium paid and some presumed market price if the insured were to reapply for like coverage in a given year. By this provision, I assume the court is suggesting that we compare the actual price (premium cost in a given year) of the current policy to like coverage for the individual at the age of the insured in that year of comparison.

ANN: The *Burwell* formula to allocate the value of artificially low premiums in the face of "lessened insurability" is as follows:

$$\frac{\text{(percentage of total premiums paid by community) x (effective premium discount for final term of coverage)}}{\text{(actual premium paid for the final term of coverage) + (effective premium discount for final term of coverage)}}$$

The example given in *Burwell* to illustrate this formula is as follows:

The community pays 50 percent of the premiums over the life of a policy. Without the premium cap, the insured spouse would have had to pay $1,000 for the premium for the final coverage term. However, because of the premium cap, the insured spouse only had to pay a $400 premium for the final coverage term.

$\frac{50\% \text{ x } \$600}{\$400 + \$600}$ yields $300 / $1000

In this scenario, the community would be entitled to three-tenths, or 30 percent, of the proceeds.

MATT: The court attributes a community interest to the term life insurance if there is some perceived value between the actual premium paid and some presumed market price if the insured were to reapply for like coverage in a given year. By this provision, I assume the court is suggesting that we compare the actual price (premium cost in a given year) of the current policy to like coverage for the individual at the age of the insured in that year of comparison.

ANN: But Matt, as you have explained above, in the early years of a level term policy, the premium for level term is higher than what might be reflected on the mortality tables. So comparing "like" with "like" level term policies may be a distortion.

MATT: I have the same concerns. Would the court have us compare the current policy cost to a one year ART policy or to the same plan of coverage as the policy in place?

Any comparison is difficult without the benefit of a formal underwriting process and key sources of information such as the original paramedical exam.

But also, mortality assumptions and competition are very fluid in the life insurance industry and so rates in effect in 2014 for term insurance are different than those that were in effect, say, in 2008. Underwriting standards can also vary widely among carriers and tends to evolve industry-wide over time.

The underwriting treatment for conditions such as cancer and heart disease has become increasingly more liberal. Would we need to utilize 2008 underwriting standards for such a comparison?

These are problems that any expert faces in applying the *Burwell* rules.

ANN: Please summarize your comments on the *Burwell* court's RULES for valuing term life insurance at death or dissolution of marriage, quoted as follows:

MATT:

- Looking at who paid the final premium is straight-forward and seems to lend itself to an easy determination.
- Where the court concludes that the final premium is paid entirely by separate property and the insured spouse was medically insurable at the end of the last term paid for by community funds, the community is not going to have an interest in the proceeds.
- But where either the insured spouse's health was such that he or she could not have purchased a comparable policy at a comparable price when the separate estate began paying premiums, or the policy did or did not contain a premium cap when the separate estate began paying the premiums is much more difficult to determine in the real world and I would argue, is not an ascertainable standard.

ANN: Do you have any advice on how we as Family Law Attorneys can reach settlement on term insurance values to avoid a trial on the *Burwell* issues?

MATT: Of course I am not an attorney and am looking at this case as a financial advisor. It seems to me that even though term life insurance does not typically have a cash value, it should be considered a valuable asset.

Disclosure: After *Burwell, disclosure of term life seems obligatory*. There should be a line or two for spouses to enter term insurance on the FL-142 form (The Schedule of Assets and Debts). Right now that Form only requires disclosure of life insurance with cash surrender value or loan value. If the form cannot be amended, attorneys should specifically inquire about the existence of term life insurance.

Market Value: One idea to avoid the burden of Burwell is to settle on the market resale value.

> Not only is term life insurance valuable to the beneficiary upon the death of the insured, but it is now possible that a term policy might have a market value in the Life Settlement Market while the insured is still alive, if his or her health has deteriorated since the policy was originally issued.
>
> But this is not a silver bullet for avoiding all the *Burwell* complexities as the Life Settlement Market may only work for individuals who have lessened insurability or are uninsurable and the market inquiry will likely trigger an underwriting process as described above.

Policy Ownership: Assuming the existence of term (and/or permanent) life insurance is known, obviously a winning move is to successfully have your client-spouse named as the owner of the policy, for it is the owner who holds the power to change the beneficiary designation, even if it means paying the premiums.

Investigate Any Change of Beneficiary for Fraud: It may be interesting to note that we are finding that some life insurance carriers are requiring both the owner and the spouse to sign a change of beneficiary form when the policy was written in a Community Property State. At least one company we are aware of will require the policy owner, former spouse <u>and</u> current spouse to sign a change of beneficiary form. Attorneys may want to obtain a copy of any prior change of beneficiary form with this in mind. There may be a smoking gun there.

Creative Thinking: Burwell leaves many questions unanswered. For example, it is interesting to me that the beneficiary change was made less than two years prior to Mr. Burwell's suicide. The *Burwell* court rejected the notion that the community gained a contractual right because the insured could have the proceeds paid despite his suicide if the policy was in effect for more than two years. The *Burwell* court held that was a right of the Policy Provider, not of the inured.

> But looked at another way, since the court would have us impute value by comparing the cost of current coverage to a new policy price, could the same comparison be done at that time the beneficiary was changed?
>
> That is, had a new policy been put in force at the time that the beneficiary change was made, the two years might not yet have elapsed and the only benefit payable would be refunded premiums paid plus interest because such coverage was subject to the Suicide Clause.
>
> Could an argument still be made that the policy was put in force years earlier and initially paid past the suicide clause period with Community Property funds. Should that not be considered a factor of great value in a case where the death of the insured-spouse occurred by suicide?