Rachel Leong, BT

Rachel Leong is a senior manager in BT's Product Technical team. With over 15 years' industry experience, Rachel uses her in-depth knowledge of product and industry, together with financial planning strategies, to develop and deliver effective advice strategy tools and collateral. She has a sound understanding of adviser needs, through daily interaction about risk recommendations.
As a regular contributor to industry media, Rachel seeks to provide a source of information and guidance that can be easily translatable to client strategies.
Rachel holds a Bachelor of Commerce and Administration (Finance), Bachelor of Science (Mathematics), and the Advanced Diploma of Financial Services (Financial Planning).

CONSIDERATIONS WHEN PROVIDING INSURANCE ADVICE TO DIVORCEES

Rachel Leong

Approaching a difficult topic

Some may consider raising the topic of life insurance during a divorce as bad timing, however, it is an important conversation to have because the splitting of finances and responsibilities between two people may leave one or both exposed.

Divorce is a common part of Australian society and it can have a negative financial impact on many people who go through the process. While the financial focus is often on assets and cash, life insurance is also an area where advisers can offer value, particularly where young children are involved.

Around the world (Vulliamy 2016, 'The nine most common reasons couples get divorced', *The Independent;* Institute for Divorce Financial Analysts n.d., 'Certified Divorce Financial Analyst® (CDFA®) professionals reveal the leading causes of divorce'; Goldhart & Associates 2015, 'Top 5 reasons for divorce in Canada'), the top reasons cited for divorce include financial issues, along with lack of communication, and infidelity.

This paper offers some tips on where advisers should look when dealing with a divorced person to ensure they have sufficient cover after separation. In doing so, advisers can help remove one area of concern during an emotional and stressful time.

The impact of divorce on children

A striking fact is that nearly half of the divorces in Australia involve families with minor children (Australian Institute of Family Studies 2019, 'Divorce rates in Australia'). Sadly, overall, nearly one in five young Australians suffer long-term social and economic setbacks due to parental divorce (Kunder & Kinsella 1991, 'Divorce, change and children: effects of changing family structure and income on children', Australian Institute of Family Studies).

Maintaining the parent-child relationship can be challenging for the parent no longer living in the family home (usually, but not always, the father), and can also be an issue for the primary-care parent who has to deal with the day-to-day pressure of child-rearing on their own. After divorce, there is often the loss not only of a partner, but also an extended family network which may no longer be available in the form of providing casual care, causing further stress to the main caregiver.

Studies have shown that children who live solely with their mother do not reach the same educational and occupational standards of children from two-parent families (Kunder & Kinsella 1991, 'Divorce, change and children: effects of changing family structure and income on children', Australian Institute of Family Studies). While it is unclear whether this is due to a change in family structure or a

reduction in resources (Kunder & Kinsella 1991, Australian Institute of Family Studies: 'Divorce, change and children: effects of changing family structure and income on children'), financial advisers can provide solutions to help ease the economic strain resulting from a marriage breakdown.

Addressing clients' changing needs

Further, both parties' financial situation worsens after divorce, particularly for women (Brown & Li 2016, AMP.NATSEM Income and Wealth Report Issue 39: *For richer, for poorer: divorce in Australia*). Studies show that, on average, divorced mothers spend a higher percentage of their household budget on necessities such as groceries, clothing and utility bills compared with their married counterparts (Brown & Li 2016, AMP.NATSEM Income and Wealth Report Issue 39: *For richer, for poorer: divorce in Australia*).

Therefore, insurance advice should to be tailored according to clients' changing requirements. Addressing the specific financial protection needs of a newly divorced client may help reduce conflict with their former spouse, and allow a more harmonious existence for their children.

There is a variety of situations that apply to both parents, which put at risk the ability for the main caregiver to pay household expenses and maintain stability for the children, including:

- temporary disablement
- permanent disablement
- critical illness (where the choice has been made to take time off work to recover)
- death.

There is a broad range of life insurance policies that cater for these circumstances. Each parent should assess their financial contribution to the welfare and care of their children, and determine an appropriate amount of cover accordingly.

Keep in mind that a client's situation may have changed dramatically due to divorce, for example, they may need to enter or return to the workforce, or give up work to look after young children. Following are some tips to help guide clients through the different types of cover that may apply after a marriage or relationship breakdown.

Tip 1: Through income protection (IP) insurance, a client and/or their former spouse can cover up to 80% of their monthly income, helping maintain the children's lifestyle and wellbeing in the event of disability.

Income protection insurance

If the non-residing parent is working, then insuring their income is just as important as the main carer's income (or their ability to perform home duties), to ensure that any financial child support can continue in the event of temporary or permanent disability.

Inevitably, there will be situations where the main carer wants the other parent to obtain IP cover, but they are reluctant to, because of the strained relationship between them that now exists. Even though most parents want to provide financial, emotional, and physical stability to their children, deterioration of the relationship with their former spouse can get in the way. This is why it is critical for the parents to maintain an open dialogue with each other and to keep the children's welfare front of mind.

The amount of child support payable can be determined through an informal or formal agreement between both parents. However, if this is not feasible, the amount will be calculated by a Department of Human Services (DHS) assessor and based on the:

- amount of adjusted taxable income derived by each parent
- individual percentage of care that they provide to their children
- number of children
- children's ages.

Therefore, any changes to the income of either parent may affect DHS child support payments.

With regard to how much IP cover should be recommended in these situations, for the child-support-paying parent, cover could be provided up to when mandated payments would normally cease — generally at age 18. The required level of cover may decrease at this point. However, the maximum amount of IP cover (75% or 80%) may be chosen, as any excess can be used at their discretion. It would also be common for the main caregiver's income (if applicable) to be insured up to the maximum level possible.

It should be remembered that the main carer may work full-time, part-time or spend 100% of their time caring for children and the household. Whatever responsibilities they may have, there is a range of IP policies that cater for all of these situations.

Tip 2: Living insurance can help cover medical costs in the event of a parent suffering a serious illness or injury, and help with the continuation of support for the children.

Living insurance

Living insurance (also known as 'trauma insurance') can provide a lump sum payment for people suffering from one of a range of specified medical events. A lump sum payment could be crucial to helping someone living with the illness or injury, to assist with medical and accommodation expenses. Trauma insurance proceeds can also be used to reduce debt to allow more flexibility with work. This can be important in situations such as where a parent wants to work part-time or change careers after the illness or injury.

In addition, trauma payments could be used to replace income, if the choice is made to take time off work to re-

The quote

While trauma payments are not contingent on the insured's inability to work, allowing for this in the sum insured provides flexibility.

cover. While trauma payments are not contingent on the insured's inability to work, allowing for this in the sum insured provides flexibility. If the child-support-paying parent chooses to take leave from work after suffering from a specified medical event, their adjusted taxable income will reduce and their required payments to their former spouse may also reduce. However, parents who are focused on the best interests of their children can use trauma proceeds to continue the financial support that would otherwise be provided by child support payments.

For the main carer, trauma payments could be used to replace their income (if applicable) and/or to pay for professional help with domestic duties, allowing time away from these responsibilities in order to regain their health.

Tip 3: There are different total and permanent disability (TPD) definitions that are relevant for divorced clients and their changing circumstances.

TPD definitions

In more serious circumstances, if a client becomes totally and permanently disabled as defined under the policy, TPD insurance can pay a lump sum benefit.

There are two main types of occupation-based TPD insurance: 'own occupation' and 'any occupation'. Own occupation TPD insurance proceeds are payable if a client is permanently unable to work in their current occupation. Any occupation TPD insurance proceeds are payable if they are permanently unable to work in an occupation that they would be suited to with their education, training and experience. Some policies will also pay a benefit if a client is able to work, but in a severely reduced capacity.

Again, while mandatory DHS child support payments may reduce, allowing for lost income in the TPD sum insured will allow the contributing parent to continue to financially support their children.

While an occupation-based TPD policy may be appropriate for an income-earning main caregiver, there are also policies available for homemakers where a benefit is payable if a client is permanently unable to perform normal household duties. Insurance proceeds can be used to pay for someone to perform these duties if they are no longer able to.

Tip 4: Term life insurance can help pay off debts and maintain the children's standard of living if either parent passes away.

Term life insurance

Term life insurance pays a lump sum benefit if the insured dies or suffers a terminal illness. If a client is deemed to have less than 24 months to live, an advanced payment can be made for terminal illness, under a generous policy definition.

The non-residing parent can provide for their children's future by allowing for their portion of lost income and education expenses in the term life sum insured. Where there is concern that insurance proceeds would *not* be used for the genuine maintenance, care, education and medical needs of the children, a testamentary trust could be established (via their Will) upon death, to ensure that payments are used for their intended purpose. A reliable family member or friend of the non-residing parent could be the trustee of the trust, to ensure that payments from the trust are used appropriately. A term life payment could also ensure that property is passed onto their children debt-free, if the mortgage is fully covered.

Claim proceeds from a policy owned by the main carer can be used to discharge the mortgage on their home, and allow the children to remain there, where suitable. Cover can also be for the remaining portion of lost income and education costs, as well as any final expenses.

Conclusion

The dissolution of a relationship can have wide-ranging impacts on all of the members of the family. Each parent may experience significant lifestyle change and, if so, their insurance needs are likely to change. A review of their current insurance portfolio is paramount, with an assessment of whether existing definitions and level of cover are still suitable.

If a change in the underlying definition is required, this can sometimes be achieved through a simple policy amendment. Where a cancellation and reissue of policy is the only option, documentation to support the application are often far less onerous compared with the full application process; and may avoid medical underwriting, depending on the particular policy series and when the original policy commenced.

If a change in the level of cover is required, many lump sum policies allow an increase to the level of cover upon divorce, without underwriting. Often a divorce will result in both parents taking on more debt, due to the sale/purchase of property/ies. This creates greater financial exposure if either parent becomes disabled or dies.

While dealing with a marriage breakdown is always going to be difficult, eliminating financial exposure or instability as an additional reason for tension will help parents focus on what matters most. **FS**