

BENEFICIARY DESIGNATIONS: THEIR ROLE WITHIN AN ESTATE PLAN

Charlie Munger, the 96 year-old Vice Chairman of Berkshire Hathaway has been quoted as saying “All I want to know is where I’m going to die, so I’ll never go there”. If only it were that easy. While our mortality is an uncomfortable topic to address, having an up-to-date estate plan is one of the ways that one can pre-emptively alleviate stress for their loved ones when it comes to a future event that is simply unavoidable.

At 35 years old with a young family, my hope is that I’m a long way off from needing to rely on my estate plan. However, I’ve made it a point to regularly review my plan, making sure that any new accounts or assets have appropriate beneficiary designations. In my case this is having everything flow to my wife followed by a living trust, which would put family members in charge of any funds in the event that something happened to both of us. The trust is important in our case, since our 18 month old daughter isn’t quite old enough to oversee her own finances. We also have financial and healthcare powers of attorney, which would allow individuals to make decisions on our behalf regarding financial and healthcare matters if we became incapacitated. Living wills spell out our desires for end-of-life care and organ donation. Last but not least, we’ve named guardians for our daughter. The process of setting everything up felt a bit morbid, but I’m comforted knowing that if something happened, our affairs would be in order.

While we encourage all of our clients to work with an estate planning attorney to discuss and implement a complete plan, a lot of potential headaches can

be avoided simply by making sure that beneficiary designations are up-to-date. In fact, it is not uncommon for us to have clients who have all of the aforementioned documents, yet they have accounts, assets, and/or life insurance with incomplete beneficiary designations, thereby rendering much of the planning that they’ve done ineffective.

Add Two Layers

For most clients it makes sense to have multiple layers of beneficiaries listed. A spouse is the most common primary beneficiary, followed by any offspring or a trust for the offspring. If a second layer of human beneficiaries does not exist, having a charity or charities listed may make sense. Leaving pre-tax assets (i.e. IRA’s, 401(k)’s, 403(b)’s) to charities can also make sense due to the fact that the dollars will never be subject to a taxable distribution.

Per Stirpes vs. Per Capita

When beneficiary designations are set up per stirpes, if something happens to one of the listed beneficiaries, their share of any inheritance is split evenly amongst their own next of kin and stays within their own family tree. When beneficiaries are set up per capita, if something happens to one of the beneficiaries, their share is added to that of the other surviving listed beneficiaries.

Avoid Probate

The most common headache associated with not listing beneficiaries on an account, asset, or life insurance policy is that the probate courts get to decide who is entitled to a benefit. While the cost and complexity of probate differs from state to state,

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we usually try to avoid having assets end up in probate. As a planner, I cringe when I hear someone say “I have a will, so I’m all set”. Wills are subject to probate, which is public and can be contested. On the other hand, accounts, assets, or life insurance policies with beneficiaries listed or that are owned by a trust avoid probate and flow directly to the intended beneficiaries. There are certain states and circumstances where probate is very simple and intentional, but this tends to be the exception to the rule.

Common Oversights

There are several oversights that we come across regarding beneficiaries, which can include bank accounts, real estate, savings bonds, and personal items.

Bank accounts tend to have modest balances and many clients will add a non-spousal family member as a joint owner out of convenience. While this will keep funds out of probate, that account owner has now connected themselves to someone else legally (i.e. implications for lawsuits, divorce, etc.). Further, when the original owner passes away on a joint account, the surviving owner (usually a son or daughter) is 100% legally entitled to the balance. I’ve seen this create family problems when a sibling who is listed as a joint owner with an elderly parent decides to keep 100% of the proceeds from a bank account for themselves. Adding a transfer-on-death or pay-on-death beneficiary designation is a much cleaner way to handle bank accounts.

Real estate can be an oversight because if one’s home is not owned by a trust and it is not jointly owned with someone else, the owner’s death will subject the title of that property to probate. Many

states allow for the execution of a life estate deed or a Ladybird deed for real estate. This is essentially a beneficiary designation for real estate. The original owner retains full control of the asset while they are living, but the asset goes directly to the named heirs outside of probate upon the owner’s passing. We use life estate deeds often for clients who opt to not have a trust and want to keep their house out of probate.

Savings bonds end up in the ‘oversight’ category because they tend to be purchased and then forgotten about for 30 years. There are ways to add beneficiaries to savings bonds, but many owners forget to do so.

Last but not least are personal items like gold coins, jewelry, furniture, etc. which do not have titles and do not exist in an account. As a result, an itemized list should be made, signed and notarized indicating the intended beneficiaries. These smaller items which may or may not have much monetary value can create a lot of friction between heirs when the intended recipient is not documented.

Life Event = Beneficiary Review

A general rule of thumb is to make beneficiary reviews a regular habit whenever there is a material life event. This may include but is not limited to marriage, divorce, birth, death, a real estate purchase, or a new job. We are happy to serve as a resource on this topic and are also willing to coordinate with a client’s attorney for more complex estate planning matters. In many cases, reviewing beneficiary designations as a part of an overall estate plan can save your loved ones a lot of time and frustration down the road.

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