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The Importance of Reviewing Beneficiary Designations

Having a well drafted last will and testament and/or trust is only the first step to comprehensive estate planning. A proper estate plan is not the result of a singular event. It is an ongoing process, affected by life events, relationships, births and deaths and changes in assets. To be truly effective, an estate plan requires periodic review. In particular, one should review beneficiary designations to ensure that they are correct, that the intended beneficiaries and contingent beneficiaries are properly named and that their respective shares or portions are properly delineated.

Assets that pass to beneficiaries directly, and not by the terms of a will or trust, such as life insurance proceeds, retirement plans, and IRAs, are distributed pursuant to a contractual form, or beneficiary designation, provided by the financial institution holding the asset. Although many people are under the mistaken impression that beneficiary designations provide a simplified means of distributing assets, the truth is that they are replete with potential pitfalls for the unwary.

Often, after a financial institution receives a beneficiary designation form from its account holder, the in- formation is entered into a computer. The form itself is discarded and the permanent record is only as accurate as the data that was entered. If the data was incorrectly entered, problems occur. It is always a good practice to request a copy of your beneficiary information after a beneficiary designation has been submitted to ensure that the information is correctly recorded.

What happens if the beneficiary dies before the account holder?

The answer to this question depends on whether the account holder has named contingent beneficiaries and what the financial institution’s contract provides. It is possible that the assets will be distributed to the estate of the account holder, and be subject to probate, if the named beneficiary predeceases and there is no contingent beneficiary. Do not think that, if you name your children as beneficiaries and grandchildren as contingent beneficiaries and one child predeceases you, that child’s children will receive the predeceased child’s share. The entire account will likely be distributed to your other children.

If the beneficiary designation fails and the asset passes through the estate of the account holder, there are several disadvantages. First, is delay. Assets, like life insurance proceeds, which are paid promptly after the insured's death, are frequently needed to pay funeral and other expenses. If the beneficiary designation fails, the proceeds will not be available until an executor or administrator for the estate is appointed by the court. This can be frustrating if the assets were intended to provide immediate liquidity. The second disadvantage is the loss of asset protection. If assets pass through the estate they are available to creditors. They are subject to estate recovery if the account holder was receiving Medicaid benefits. The failure of a beneficiary designation relating to a life insurance policy may subject that policy to the claim of a surviving spouse when it may have been exempt from the pool of assets available to satisfy the spouse's elective share. The consequences of the failure of a beneficiary designation relating to a retirement plan can also be devastating. If a retirement plan passes through an estate, it must be paid out and taxed within five years of the account holder's death. With a named beneficiary, by contrast, the distributions can be stretched out, along with the tax liability, for decades.

This important estate planning tool should be reviewed to ensure that the maximum benefit is obtained for your loved ones. Let us help you. Contact us to schedule a consultation.