



OLD NORTH STATE TRUST, LLC

Beneficiary Designations- are you sure yours are up to date?

One of the easiest mistakes to make in estate planning, and one that can have the most serious negative consequences, is to get your beneficiary designations wrong.

You can have the most carefully drafted will, or an elaborately planned-out trust, and still not have your wishes fully honored after your death. To understand how that can be, it's important to know that the beneficiary designations on insurance policies, investment accounts and bank accounts override anything a will or trust may say about those assets.

It is shockingly easy to overlook this important fact. You might designate a beneficiary when you first open an account or buy a policy, and then never give it another thought. That despite your personal circumstances changing drastically as the years go by.

Here's one very common example. An unmarried young person might name a parent, or sibling, or friend as beneficiary of a life insurance policy or investment account. That makes sense at the time. But then that young person matures, marries, and has children. The family that depends on the breadwinner should stand to benefit from that asset. But that won't happen if the money goes to the distant cousin or old college roommate who's still listed as beneficiary.

Does your will say all your assets go to your surviving spouse, with provisions to benefit your children? That's great, but it won't matter if that insurance policy still lists your mom and dad.

What if you had listed your adult children as beneficiaries, but one of them dies?

We have a client who had several children, but only one grandchild. That young woman ended up estranged from her father. Our client, in doing his estate planning, did not know who to leave his estate to after his children's deaths or if one of his children died before he did. We kept after him to make a decision, but he never would do it. Being elderly, he never thought he would outlive one of his children. He kept saying the inheritance dilemma would be "their problem to deal with."

Well, his only granddaughter and his son both died within a month or so of each other! The terms of the trust he had created for the son gave the remainder of the trust to the son's estate. That, in turn, paid out to the son's wife, a woman our client had only met a few times and couldn't stand! He was upset and felt betrayed. If only he had made one small change to his document, ensuring all the beneficiary designations jibed with his preferences, that would not have happened.

Fortunately, it's somewhat harder these days to completely ignore this issue. Brokerages, mutual funds, insurance companies and the like are getting pretty diligent about sending periodic reminders to their clients: Check your beneficiary designations. Make sure they're up to date. If they aren't, fix them now.

But whether you're first designating beneficiaries, or updating them later, don't make one of several common errors.

First is to make a minor child, or an adult who's seriously disabled, a direct beneficiary. Children and people with certain developmental disabilities are not considered competent under the law. That means they can't make their own decisions about inherited assets but must have a guardian appointed to look after their interests.

Who that guardian is, and what restrictions they may face in how they administer the child's estate, are matters for the courts. In addition to taking away much of the guardian's flexibility and discretion, that can also deplete the estate by requiring time-consuming and expensive legal proceedings.

Another problem with this sort of court-mandated guardianship is that it ends the moment the child turns 18. Suddenly that newly minted adult has total control over the inheritance. Now, as generous as most parents are, few believe it's a good idea to just hand an 18-year-old a big chunk of money. (Or, often, even a small one, unless it comes with some limits on how it can be used.)

So, among the negative consequences of making a child a beneficiary is the likelihood that the inheritance may be squandered, or that a windfall of cash will tempt the recipients into bad decisions about how to manage their lives.

For a disabled person, taking direct ownership of inherited assets may make them ineligible for important public benefits. For example, in North Carolina, many developmentally disabled adults receive necessary and costly services through state-run Medicaid programs. Those are not available to persons who hold assets in their own names.

To avoid these problems, naming a trust as beneficiary — and structuring the trust so it operates on behalf of the minor or disabled adult — is an excellent solution. A trust gives you far more protections for the loved ones you want to benefit. It also guarantees privacy by eliminating the need for intrusive court proceedings.

For many people, the natural inclination is to name their spouse as primary beneficiary, trusting that the spouse will make responsible decisions on their children's behalf. That may well be the best option. But what if the marriage ends in divorce?

Sadly, updating beneficiary designations is one of those many, many details that can get overlooked in the trauma of a divorce. Any child custody agreement should address how beneficiaries are named in both parties' financial accounts and insurance policies.

Retirement accounts are a special case, because of complex tax rules that cover 401(k)s and IRAs. Usually, to preserve the tax advantages, it's best to designate a spouse as primary beneficiary. But when it comes to naming contingent beneficiaries, it gets really tricky. It's wise to involve professional advisers when making these decisions.

It's worth knowing, by the way, that you don't necessarily lose the tax benefits on one of these retirement accounts if you name a trust as beneficiary. That's a common misconception. But the trust has to be structured carefully, and that's definitely not a do-it-yourself job.

Remember, keeping up with all the nuances of beneficiary designation can be a big responsibility, and it's easy to get the details wrong. That's why managing beneficiaries on all your assets should be closely coordinated with your estate plan, with the advice and expertise of an experienced financial planner. The trust experts at Old North State Trust can help make sure you understand all the numbers.

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