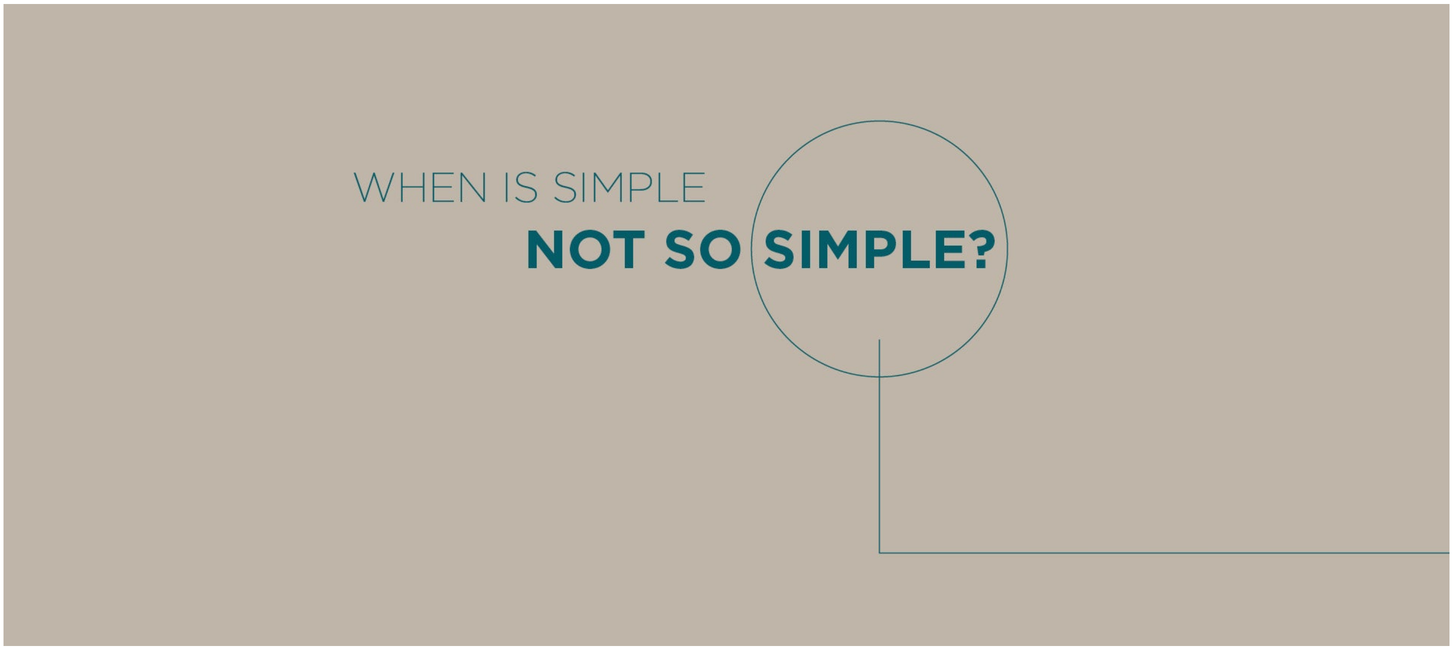
CAPTRUST



When Is Simple Not So Simple?

By Teresa Rhyne

My father is a big fan of the K.I.S.S. principle (“Keep it simple, sweetie.” What? Your father calls it something else?). He mentions it a lot. And as a lawyer, I’ve been accused of over-complicating things (not just by my father). But I’m not without appreciation for simplicity. It’s just that there is a time when what seems simple is far from it.

More often than not, a simple beneficiary designation — on your bank account, your retirement plan, your life insurance — isn’t all that simple. I’m convinced there are more ways a beneficiary designation can go wrong than right.

You may have taken the time and care to put into place a thoughtful, customized estate plan that includes a living trust, powers of attorney, healthcare directives, and all the usual documents, including a schedule of assets attached to your trust delineating all that you own that is intended to be part of your trust. Maybe that list includes your bank accounts, your life insurance, and your retirement plans. Good for you! This is terrific, and it puts you ahead of most folks. Then a few years go by, or a lot of years, or maybe even a few months. Maybe you open a new bank account, buy a new insurance policy, or rollover your IRA. You’re handed a beneficiary designation form and look, it’s only a page! It’s so simple! You fill it out, naming your spouse, and should your spouse not survive you, you’ve listed all four of your children as the contingent beneficiaries. Perfect, right? Well … Let’s move ahead 10 or 15 years (or more, if that makes you feel better), and sadly, you’ve passed away with your well-planned trust still in place. What’s going to happen to your bank accounts, your life insurance, and your retirement plans?

If you properly funded your trust and changed the bank accounts into the name of the trust, your carefully thought out trust terms will control what happens in a variety of circumstances. Yay for you and your lawyer! (Oh come on, lawyers can use a little cheering!) But, if you didn't change your account into the name of the trust, or (and I shudder to think of this) you never put a trust in place, the accounts will belong to whomever you named on your beneficiary designation form — and that could be something you filled out many, many years ago — maybe even before you were married. Or before you were divorced. If there is a beneficiary designation form, it will trump the terms of a trust or will almost every time. But wait, you say, I listed these accounts on the schedule attached to my trust! Nope. Beneficiary designation wins if you didn't actually change title on your bank account.

I know what you're thinking here: So why bother with the schedule? You're just complicating things. The schedule will help if there is no beneficiary designation form. The schedule is a piece of evidence for the trust or probate attorney to take to probate court and say, "Your honor, my client meant to put this asset in the trust, but she just didn't get around to it. Please don't make us do a full probate, and just give us an order to transfer these accounts to the trust." It's a back-up plan, not a plan. Now, back to those assets …

As for your life insurance, even if you transfer ownership of the policy to the trust, what matters is still the beneficiary designation. Whatever it says, whenever you filled it out, that's how the proceeds will be distributed, with only a few narrow exceptions.

You aren't going to be surprised when I tell you it's the same for retirement plans, right? See? I can keep it simple! Retirement plans can't be owned by a trust — all you can do is properly fill out the beneficiary designation.

Now, why isn't that actually simple? Let's look at those beneficiary designations …

Did you name your spouse as the beneficiary? Great! She's happy to receive those funds free of the carefully planned trust the two of you set up. Now she can freely spend it on whatever she pleases, or her next spouse, or, less happily, be forced to give it all to a creditor. She can also decide to leave the proceeds at her death to whomever she likes, which may or may not be your kids from a prior marriage, or even your kids from this marriage. The proceeds are completely free of the limitations and protections outlined in your trust.

Did you name a prior spouse as a beneficiary way back when you first got a life insurance policy? Or perhaps you named your mother (she always did like you best) on that policy you got with your first job long before you had a husband, let alone kids. Well, prior spouse or mom is going to get the policy proceeds. If you live in a community property state, your current spouse may have some community property claims, but he's going to have to fight for it and prove how much of the policy is community property (and he'd be entitled to 50 percent of that … if he wins the fight).

Is the designated beneficiary suffering from an addiction or otherwise incapacitated? He'll still get the money outright, which could have disastrous consequences, including, in the case of an incapacitated beneficiary dependent on needs-based government aid, the loss of that aid.

Is the beneficiary a minor? She'll get the funds when she turns 18. That's always a great age to responsibly handle money, isn't it? (Keeping it sarcastic, sweetie.)

Did you name all four kids? If one of your children pre-deceased you, his share may or may not go to his children; it will depend on the form and the person interpreting the form. Is one of your children in the middle of a divorce or having financial troubles? His or her share will be at risk.

Is the full beneficiary form available? I had a client who had six children and named all six on the beneficiary form — four on the first page and two on the "see attached" page. The bank lost the "see attached" page and would only give the account to the first four children. And no, they didn't share. Mom really did like the four of them best.

Did you name one beneficiary, and he is deceased? If the default provision on the account or policy is your "estate," there will likely need to be a full probate proceeding to get the proceeds paid to the estate (though this is where that schedule of assets would be handy).

Did you name exactly who you wanted to, and are they all responsible, wonderful, living people who can handle the money outright? Great! Will they contribute their share of estate taxes or will your trustee have to chase them down? (Yes, insurance proceeds are subject to estate taxes; it's only income taxes they are exempt from.)

A carefully planned out trust, named as the owner of bank accounts and the beneficiary of life insurance proceeds, can generally prevent all of the above issues and more. A trust is a document that adjusts to a variety of contingencies based on your preferences and family circumstances. A beneficiary designation form is a tool to make things quick and easy for the financial institutions — and to ensure they aren't caught up in probates or long legal battles.

There are times when the simplicity of a beneficiary designation form is just what's needed. If you have children from a prior relationship and you want to have a policy pay directly to them in the event of your death, that's a great use of a direct pay policy (as long as your spouse has agreed). And retirement plans paying directly to a trust can have adverse tax consequences (seek advice from your tax advisor on this), so designating a spouse or adult children as the beneficiary may make more sense. But, if the retirement plan is the most significant asset of the estate, some careful planning needs to be done — and that can't be done in a couple of fill-in-the-blank lines on a form.

I give you three simple rules:

- If you use beneficiary designation forms, please make certain you review and update them regularly.
- Generally, naming your customized, well-planned-out trust as the beneficiary of insurance and owner of bank and investment accounts is going to prevent a lot of heartache.
- Work with your estate attorney and your financial planner to make certain you've properly handled the titling of your accounts and any beneficiary designations.

If you too are a big fan of the K.I.S.S. principle, think of it this way: life changes constantly. When you have to adjust to those changes, do you want to change one document (your trust) or one document for every asset you have (the beneficiary designations)?

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948, or schedule an appointment with a retirement counselor today.
