

INVESTING IN FUNDS

Beware the Beneficiary Form

Naming the wrong people or failing to update documents can create a mess for your heirs



BY CAROLYN T. GEER

Think your estate planning is done once you've gone to the trouble of making a will? Think again. All your hard work can be undone with a stroke of a pen when you open a bank, brokerage or retirement account.

NEED TO KNOW

Increasingly, investors have the option of naming beneficiaries directly on a wide range of financial products. The appeal: When the account owner dies, the assets go directly to the beneficiaries named on the accounts, bypassing the sometimes long and costly probate process. The problem: Because these beneficiary designations override your will, they need to be carefully coordinated with your overall estate plan.

"People don't realize the importance of this," says Martin Shenkman, an estate-planning lawyer in Paramus, N.J. A carelessly named beneficiary on a financial account can cause a loved one to be disinherited, a disabled child to lose government benefits, and heirs to be slapped with a big tax bill. Mr. Shenkman is seeing so many cases like this that he's coined a term for it: "bank-teller estate destruction."

Many people simply don't remember whom they named as beneficiaries of accounts they opened years ago. Boston lawyer Harry Margolis tells of one man who wrote a will leaving his entire estate to his longtime girlfriend, and on his deathbed recalled that he had certificates of deposit naming relatives, some since deceased, as beneficiaries. The man tried to change the beneficiary designations before he died, but the case is now mired in a lawsuit.

Advisers tend to recommend reviewing all of your beneficiary designations regularly, at least every few years, but certainly after you experience a life-changing event, such as a marriage, divorce, birth or death of a loved one. Job-changers and retirees also take note: Beneficiary designations on retirement plans don't carry over when you roll a 401(k) to a new employer's plan or to an IRA, or when you convert a regular IRA to a Roth IRA. What you need to know:

What kinds of accounts can have beneficiaries?

U.S. savings bonds have had forms for naming beneficiaries for more than 50 years. Bank accounts and certificates of deposit that can be made payable on death (POD) to a beneficiary followed suit. Then came so-

called Transfer on Death (TOD) registrations for securities, including stocks, bonds and mutual funds. Life-insurance benefits and retirement-plan assets are paid directly to the beneficiaries named on those accounts.

POD and TOD accounts were devised as alternatives to joint accounts, which also bypass probate. When one owner of a joint account dies, the assets automatically go to the surviving owner. But this is not a particularly safe way to leave funds to anyone because the assets are subject to your co-owner's whims and creditors.

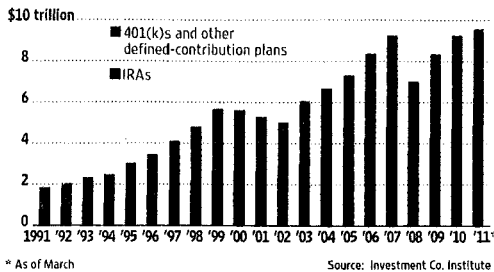
Whom can I name as beneficiary?

Individuals, trusts, charities and other organizations, your estate, or no one at all. You might specify one or more people, or name a specific group of individuals, such as "all my grandchildren who survive me." This might include current and future grandkids and spare you from having to update forms as families change and grow. However, it generally would not include stepgrandchildren; they'd need to be designated by name.

Avoid the tendency to choose a different beneficiary for each of your accounts. One woman left her estate equally to her two daughters in her will, but named

Big Dollars at Stake

The assets in accounts with beneficiary designations have ballooned in recent decades, as shown in these figures for individual retirement accounts and for defined-contribution plans including 401(k)s



* As of March

Source: Investment Co. Institute

one daughter or the other as beneficiary of her various bank and brokerage accounts. The result: Just about all of her assets passed outside of her estate, and one daughter received much more than the other.

"That was very unpleasant for everybody," says Patricia Beuregard, a lawyer at Pullman & Comley in Bridgeport, Conn., who handled the case. It would have been better, she says, if the mother had named both daughters as beneficiaries of each of her accounts—or not named anyone and allowed the assets to flow into her estate, where the assets would have been distributed according to her will.

Watch out, too, for beneficiary forms that don't allow your assets to pass "per stirpes," or equally among the branches of a family. Say you name your three adult children as beneficiaries of your IRA. If one of them predeceases you, you might want that child's share to go to his or her children. However, many standard beneficiary forms provide that your two remaining adult children would share the pot.

Whom should I not name as beneficiary?

Minors, disabled people and, in certain cases, your estate or spouse.

Avoid leaving assets to mi-

nors outright. If you do, a court will appoint someone to look after the funds, a cumbersome and often expensive process. Also think about what can happen when the money reverts to the child at age 18 or 21, depending on the state.

Helen Modly, a financial planner in Middleburg, Va., has seen three 18-year-olds receive proceeds from life-insurance policies. While one of them still has her money, "the other two bought and wrecked brand-new cars, splurged on clothes and champagne, lent money to friends and generally went from \$150,000 to actually owing money in just over one year," she says. The problems could have been avoided if the parents had set up trusts for the kids payable at, say, 25, and named the trusts as beneficiaries of the life-insurance policies.

Disabled children—and adults—require special, or "supplemental needs," trusts that preserve their ability to receive government benefits, as even a small outright inheritance can prevent them from getting aid.

For retirement plans, the biggest mistake is to name your estate as beneficiary, because that means when you die, the full amount of the plan must be paid out—and taxed—within five years. Individual beneficiaries, by contrast, could stretch out the distributions—and the

taxes—for decades. Because many people have a large portion of their assets in retirement accounts, they also should be sure that the combination of the distribution arrangements on those accounts and their will provide for family members as they wish, particularly in complex situations such as a second marriage when there are children from the first union.

What if I don't name anyone as beneficiary?

For nonretirement assets, the funds would typically flow into your estate and be distributed according to your will, assuming you have one.

For retirement assets, it's not so simple. The funds would be distributed according to your administrator's plan document—for example, to your spouse if you are married, or to your estate if you are not. This can happen inadvertently if you don't update beneficiary forms when beneficiaries die, or if you don't name contingent beneficiaries. (A contingent, or secondary, beneficiary is the person or entity you want to get the proceeds of your accounts if the primary beneficiary predeceases you. There can be multiple contingent beneficiaries.)

Ms. Modly had a client, a widow, die suddenly last year. If the widow's beneficiary designation hadn't been updated after her husband died, her \$1 million IRA would have gone to her estate instead of directly to her children, triggering a big tax bill and preventing her children from stretching out the IRA distributions for decades.

How can I ensure my wishes will be honored?

Financial institutions merge. Records can be lost. Keep copies of all your beneficiary forms and send them certified mail, return receipt requested. Then check regularly, perhaps at tax time, to make sure that what your institution has on file is correct. Don't expect your bank, broker or IRA custodian to tell you if something is amiss with your beneficiary designations.

"Don't assume it's right," says Mr. Shenkman. "Life is not that simple."

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