The Importance of Beneficiary Designation Reviews

Beneficiary designations are a fundamental part of most clients' estate plans. For accounts that allow for them, the designation instructs the company holding the account who to pay the proceeds to after the original owner's death. Who or what the beneficiary is, and their relationship to the original owner, will determine what options they will have to take the proceeds from the account.

Beneficiary designations are equally as important as other estate planning documents, such as a will or a trust. In most instances, a person's will does not direct accounts that have proper beneficiary designations. Life events, such as births, deaths, marriages, and divorces, can fundamentally alter a client's estate plan. If major life events have occurred, it may warrant a beneficiary review with a client. Incorrect or out-of-date designations can lead to significant problems later, and once an account owner has died, there is often little that can be done to fix a mistake. This could result in having to explain to family members why beneficiary designations were not correct. Therefore, it is crucial to periodically review beneficiary designations with clients to ensure that they reflect their current wishes.

Consider these four steps to conduct beneficiary reviews with clients:

Step 1: Using the following list, identify accounts that allow for a beneficiary designation:

- Insurance: life insurance policies, annuities, and long-term care policies
- IRAs: Traditional, Roth, SEP, SIMPLE
- Qualified plans: 401(k)s, 403(b)s, profit sharing plans, pensions, ESOPs, etc.
- Other: Health Savings Accounts (HSAs) and 529 College Savings Plans

Step 2: Determine who or what is named as the beneficiary for each account. Clients may be unsure of the beneficiary on some accounts, so this may require some effort. If accounts are outside of your management, clients may need to reach out to companies holding the assets.

Step 3: Based on the beneficiary that is currently listed, do any of the following scenarios apply and is there a deeper conversation you should considering having with the client?

- Naming "the estate" as beneficiary:
  - An account with "estate" named as beneficiary will pay to the estate of the deceased account holder and will be subject to the cost and delay of the probate process. Distribution options may be limited as well.
- Leaving a designation blank:
  - A blank designation will likely cause the asset to pay to the estate of the deceased account holder and will be subject to the cost and delay of the probate process. Distribution options may also be limited in this case as well.
- Not naming a contingent beneficiary:
  - Whenever possible, both a primary and contingent beneficiary should be named. If the primary beneficiary is deceased at the time of the account owner's death, and no contingent

1071110-00001-00 Ed. 06/2023

is listed, account proceeds will likely have to pay to the estate of the deceased account holder.

- Naming an incorrect or out-of-date beneficiary:
    - Ensure the beneficiary is someone the client still wants to inherit the account. They may no longer want this individual named as a beneficiary. Ex-spouses and deceased persons are common errors that can be uncovered.
- Naming a spouse as beneficiary:
    - Surviving spouses have special rules when it comes to inheriting accounts. For retirement accounts, they can elect to have the account retitled in their own name, move the proceeds to an account in their own name, or elect to retitle it as an inherited account.
- Naming a non-spouse as beneficiary:
    - Unlike a spouse, a non-spouse cannot request that a retirement account be retitled in their own name. Their age and relationship to the original owner will determine what options are available to them.
- Naming a minor as beneficiary:
    - A minor child cannot legally inherit assets that exceed their state's minor inheritance law threshold, and many states have a relatively low threshold. If a minor is named outright as the beneficiary, someone will have to be appointed by the court to manage the asset for the minor child until they reach the age of majority. All states allow for a UTMA (Uniform Transfers to Minors Act) or UGMA (Uniform Gifts to Minors Act) designation. It allows the original owner to appoint a custodian of their choosing to manage the asset on the minor's behalf, avoiding the need for a court-appointed custodian.
        - **Note:** *An UTMA or UGMA designation is unenforceable once a minor reaches the age of majority in their state. If longer term control is desired, other arrangements should be considered.*
- Overlooking the difference between per capita and per stirpes designations:
    - If multiple beneficiaries are named, (ex. son and daughter 50/50) what would happen if one of them predeceased the owner and the designation was not updated? In a per capita arrangement, the deceased beneficiary's share would pay to the other beneficiary, disinheriting grandchildren, if there are any. In a per stirpes arrangement, the deceased beneficiary's share would pay to any living descendants they have.
- Naming a spendthrift beneficiary:
    - Some individuals may wish to control how a beneficiary receives an inheritance. In the instance of a spendthrift beneficiary or a beneficiary with limited financial experience, there may be a desire to put controls in place dictating how the beneficiary receives the inheritance. Without any controls, the beneficiary would receive the asset with no limitations, potentially resulting in an outcome that was not desired by the original owner. (ex. a new sports car, a new boat, a trip to Las Vegas, etc.)
- Naming a special needs beneficiary:
    - Special needs beneficiaries can require additional planning. If a special needs beneficiary is receiving needs-based aide, inheriting assets may disqualify them from the aide. Often, a special needs trust can be set up to receive the inheritance on behalf of the special needs individual. This arrangement can keep the inheritance out of the special needs individual's name but may allow the assets to be used for their benefit.
- Naming a trust as beneficiary:
    - It is important to ensure that the trust is needed to accomplish the desired outcome.

- Designations that conflict with other estate planning documents (ex. wills, trusts, etc.):
    - It is important to make sure that beneficiary designations do not conflict with other documents in a client's estate plan. Wills, trusts, and beneficiary designations are all important pieces, and they should work together to build a cohesive estate plan.

Step 4: Now that you have determined who the beneficiaries are and uncovered any potential problems, are any changes necessary? It's not only important to make sure that designations are up to date today, but also to continue reviewing them in the future. Consider making a beneficiary review part of an annual review you have with clients. Keep in mind, it is important to ask clients about changes in their personal life. When a client has a change in their life, they may not realize how significant the change may be.

Consider asking if any of the following events have occurred recently:

- Marriage (including children)
- Remarriage (including children)
- Divorce (including children)
- Birth/adoption of a child
- Birth/adoption of a grandchild
- Child reaching age 18 or 21
- Job change
- Opened new accounts
- Death in the family
- Creation of a trust

Using Beneficiary Reviews to Grow Your Business

Conducting beneficiary reviews with clients provides you with a great opportunity to uncover assets you may have been unaware of. Often, clients may have forgotten to mention old accounts they have, or perhaps forgotten about them altogether. It also gives you an opportunity to discuss assets that may not be under your management. Beneficiary reviews show the value you can provide to clients, and that you are there to help ensure assets transfer seamlessly after their death.

Prudential's Advanced Planning team is here to support you and help you with any questions as you prepare for annual reviews. For questions or to discuss how life insurance can help a client's particular situation, contact the team at 800-800-2738, option 4.

This Advanced Planning Insights and Ideas bulletin was published June 2023.

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