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Wealth Insights

Beneficiary Designations

You've worked hard over your career to build your retirement savings with the expectation that you've been preparing for a long and comfortable retirement. Regrettably, not everyone lives long enough to enjoy the fruits of these labors. While a healthy lifestyle may reduce your chances of passing prematurely, we all know that our life expectancy is unknowable. So what happens to your retirement savings if you don't live long enough to spend them yourself? Simply put, they pass to your heirs and become available for them to spend. To whom these funds pass is determined in many cases by beneficiary designations.

A beneficiary designation is a simple form that lists who gets what percentage of the assets in a specific account in the event of your passing away. They are used in IRAs of all types (Roth, Traditional, Rollover, SEP, SIMPLE, Inherited/ Beneficiary), employer sponsored retirement plans (401(k), 403(b), 457, pensions, etc), and insurance contracts (life insurance and annuities). You can also add a beneficiary designation on taxable accounts, such as individual or Joint Tenancy with Right of Survivorship, through a Transfer on Death (TOD) designation (sometimes call Payable on Death, or POD). Remember that each account you have must have its own beneficiary designation form specific to that particular account. As an example, if you have two IRAs, you will have two beneficiary designation forms. They don't have to all be the same, but be sure this is done with purpose and not simply because you forgot to update them.

There are two main reasons to use the beneficiary designation; clear and concise instructions for how you want your assets to be distributed to your heirs, and the avoidance of probate. These forms make it clear how you want to structure your inheritance, potentially reducing the risk of contested estates, and makes it easy for your heirs to claim their funds. Typically, they simply need to provide personal identification along with a copy of a death certificate to begin the process of claiming their share. Even more importantly, it allows your heirs to avoid going through the probate court system to claim their portions. Remember that probate is the process where your local court system distributes assets based on your will, or by a statutory hierarchy determined by your state's intestacy laws when no will exists.

It's generally considered a good idea to avoid probate where possible since it can be a long process, it could be months or even years depending on the state and the complexity, during which assets can be tied up and unavailable to support surviving loved ones or pay bills. Naturally, anything that takes time in court can also get quite expensive. Finally, everything done via the

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probate court is public information, which means details of your probate estate are out there for anyone to see. All of this can be avoided by keeping an up to date beneficiary designation on file for the account types that permit it.

There are two types of beneficiaries that you will be asked to name on a beneficiary form; Primary and Contingent. You can think of them as two teams, your A team and your B team. Your A team, the primary beneficiaries, is the person, or persons, that you'd like to receive some portion of the money. If none of your primary beneficiaries survive you, or are willing to accept their portion, then your B team will step up and take the place of the primary beneficiaries. As such, the allocation amongst members of each team needs to equal 100% (primary beneficiaries must equal 100%, contingent beneficiaries must equal 100%).

You also have options for how to handle situations where a portion of your beneficiaries, primary or contingent, are not able to claim their portion of their inheritance. The most common, and often default, option is to redistribute their share amongst the remaining beneficiaries in that class *pro-rata*, also known as *per capita*. As an example, say you name your two children as primary beneficiaries each with a 50% share. If one child predeceases you and you've selected a pro-rata option, their share will go to the remaining child. Only if both children are unable, or unwilling, to claim their share will the contingent beneficiaries step in. The second option for situations like this is called a *per stirpes* designation. Per stirpes is Latin for "by the roots", and allows for a beneficiary's share to pass to their descendants if they aren't available to claim it themselves. Going back to our previous example, if you had instead opted for a per stirpes election then the 50% share that was intended for your deceased child would go to their heirs in equal shares. The other child, and original beneficiary, would still receive their 50%. In this situation, only if both primary beneficiaries had predeceased you with no living heirs would the contingent beneficiary(s) step in.

You are permitted to name anyone as a beneficiary on your account in any amount. However, be aware that there are special rules for people that are married. When dealing with employer sponsored retirement plans, like a 401(k), there is a federal law, called ERISA, that gives your spouse a right to be 100% primary beneficiary. You are allowed to name someone instead of, or in addition to, your spouse, however they must sign off on the election form waiving their right to be the sole primary beneficiary. This is often also required to be done in front of a notary. If you don't have your spouse sign off on the form then they will have the right to supersede your beneficiary election and claim it as their own.

Non-ERISA accounts, like IRAs and insurance contracts, are not subject to the federal spousal beneficiary rule. Rather, they are handled at the state level. Most states don't require a spousal waiver, however certain states, especially community property states like Wisconsin may. It's important to discuss this with a qualified estate planning attorney to understand your state's requirements. When in doubt, it won't hurt to have your spouse sign off on the designation form if you want to be certain those other beneficiaries get their share.

One common concern for people is what would happen if a minor child that was named as beneficiary would inherit a large sum of money. In those cases, the appointed guardian of the minor child would be tasked with managing that money until the child reached the age of majority. They'd be required, as fiduciaries, to act in the best interest of the child and only to spend those dollars on the child.

What happens if none of your beneficiaries survive you? In that case it depends on the type of account. For most ERISA employer sponsored retirement plans, like 401(k)s, there will be a built in beneficiary hierarchy in the plan document. If there isn't, or none of their prescribed beneficiaries exist, then the account will be sent to the probate court to be distributed per your will. This is a highly inefficient way to pass a tax preferenced retirement account, as the beneficiaries lose the ability to continue the tax preference, often referred to as the stretch benefit. You also then have to deal with the short comings of the probate court discussed above.

In summary, beneficiary designations are powerful contracts that should be considered carefully and routinely reviewed and amended as life events unfold. Having an accurate beneficiary designation takes minutes to accomplish, and is the best gift you can leave to your heirs. Don't force them to give up tax benefits, lose some or all of their inheritance, or potentially have to fight each other at a time when they're already under stress from your passing. This is a big decision, but remember that your financial advisor, in coordination with your estate planning attorney, can be a helpful resource to ensure your desires are being properly expressed. Please

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