


THE NUTS AND BOLTS OF LIFE INSURANCE BENEFICIARY ARRANGEMENTS



OVERVIEW: IN THE LANGUAGE OF LIFE INSURANCE, A BENEFICIARY IS THE RECIPIENT OF THE PROCEEDS OF THE POLICY WHEN THE NAMED INSURED DIES. THE OWNER OF A LIFE INSURANCE POLICY HAS A GREAT DEAL OF FLEXIBILITY IN NAMING BENEFICIARIES, AND GENERALLY CAN NAME ANYONE AS BENEFICIARY. THE MOST IMPORTANT CONSIDERATIONS IN NAMING BENEFICIARIES ARE MAKING SURE THE WISHES OF THE POLICYOWNER ARE FULFILLED, AND THAT LEGAL COMPLICATIONS ARE AVOIDED.

**TEST YOUR KNOWLEDGE OF LIFE INSURANCE BENEFICIARY ARRANGEMENTS.
TAKE THIS SHORT QUIZ NOW OR LATER!**

1

A CONTINGENT BENEFICIARY IS:

- A) ENTITLED TO THE PROCEEDS OF THE POLICY UPON THE DEATH OF THE INSURED.
- B) SOMEONE WHO RECEIVES ONLY A PORTION OF DEATH BENEFIT PROCEEDS.
- C) ENTITLED TO THE POLICY PROCEEDS IF THE PRIMARY BENEFICIARY HAS PREDECEASED THE INSURED.
- D) NONE OF THE ABOVE

2

TRUE OR FALSE?

“PER STIRPES” AND “PER CAPITA” ARE TERMS THAT DESCRIBE METHODS OF DISTRIBUTING PROPERTY TO FAMILY MEMBERS OR HEIRS.

3

TRUE OR FALSE?

IF A BENEFICIARY DESIGNATION IS REVOCABLE, THE BENEFICIARY RESERVES THE RIGHT TO MAKE CHANGES TO THE POLICY.

Quiz Answers: 1) c; 2) True; 3) False.

READ HERE TO LEARN MORE ABOUT BENEFICIARY ARRANGEMENTS.

Beneficiaries are typically categorized as primary and contingent.

A **primary beneficiary** is entitled to the proceeds of the policy upon the death of the insured, but such rights expire if he or she dies before the insured.

A **contingent** (or secondary) **beneficiary** is entitled to the policy proceeds if the primary beneficiary has predeceased the insured.

One fairly common arrangement might stipulate that, if policy proceeds are being paid over time to a primary beneficiary who dies before collecting the entire amount, then the remaining proceeds will be payable to the contingent beneficiary.



It is often desirable to have several levels of contingent beneficiaries.

A beneficiary can either be specific (a person is identified by name and relationship), or a class designation (the naming of a group of individuals such as the "children of the insured"). While the naming of specific beneficiaries is usually clear-cut, unintended complications can arise when designating classes of beneficiaries.



For example, if you plan to name your children as beneficiaries, is it your intention to include adopted or "illegitimate" children, or children by a former spouse? If your children are minors, will the insurance company pay the proceeds to a minor beneficiary? (Generally, insurers will insist on paying proceeds to a legal guardian rather than to a minor.)

CONSIDER THE FOLLOWING SITUATION

in which the policyowner's intentions appear straightforward, but which could become complicated. Elizabeth, who is seventy years old, planned for the proceeds of her life insurance policy to be paid to her children (Bob, Sue, and Mary) or her grandchildren. Now, what would happen if Bob and Sue were to die before their mother, with Bob leaving four children and Sue having no children? How should the proceeds of the policy be distributed when Elizabeth eventually dies?

Per stirpes and **per capita** are terms that describe methods of distributing property to family members and heirs. **Per stirpes** means "branches of the family," and **per capita** means "by heads." In the example above, under a **per stirpes** distribution, Mary (one branch) would get one-half of the proceeds and Bob's surviving children (the other branch) would divide the remaining half among themselves. Under a **per capita** distribution, Mary and each of Bob's four children would each receive one-fifth of the proceeds. Remember, there might be complications if any of Bob's children are still minors when Elizabeth dies, and legal guardians have not been appointed.

THERE ARE ALSO DIFFERENT CONSEQUENCES TO BENEFICIARY DESIGNATIONS BEING REVOCABLE OR IRREVOCABLE.



If a beneficiary designation is **revocable**, the policyowner reserves the right to change the beneficiary. A person designated as a revocable beneficiary has only an "expectation" of benefits, because the owner of the policy can exercise any of the policy rights without the consent of the revocable beneficiary.



On the other hand, an **irrevocable** beneficiary designation cannot be changed without the consent of that beneficiary. While this is sometimes desirable for estate planning purposes, the legal status of an irrevocable beneficiary is uncertain. One position regards an irrevocable beneficiary as a "co-owner" of the policy; the beneficiary's consent is needed to exercise any policy rights. At the other extreme of legal opinion is the position that an irrevocable beneficiary's consent is needed only for exercising a change of beneficiary.

The latter position can create the somewhat puzzling effect of having the beneficiary's rights compromised if the policyowner exercises other rights, such as surrendering the policy, or permitting it to lapse. Because of the vague legal status of an irrevocable designation, it is usually preferable to use revocable beneficiary designations.



A further complication can arise when one's estate is named as beneficiary, because the proceeds of the policy can be tied up in the probate process, or reduced by the claims of creditors.

These potential pitfalls make it clear that the distribution desired by the owner of a policy be clearly set forth in the beneficiary designation. Changes in family circumstances after policies are first written (for example, divorce) could leave you with unintended beneficiaries. If you are unsure about how your beneficiary designation has been recorded, check your policies, and take the steps necessary to make your heirs apparent. Ultimately, your family will appreciate your thoroughness.



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