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## Beneficiary Guidelines

The beneficiary of a life insurance policy is the person(s) or entity that is entitled to receive the death benefit of the policy. In most cases, life insurance is purchased with the intention of providing some degree of financial protection for an individual's loved one's in the event the unexpected happens. Because the beneficiary designation is not subject to broad interpretation, it is necessary that the designation be as specific as possible to avoid delays in paying the proceeds to the proper individual. Beneficiary designations should be reviewed periodically to insure that circumstances have not changed such that the current designation is obsolete. The purpose of this manual is to answer frequently asked questions and to be a reference in drafting beneficiary designations based upon specific policyholder needs.

### Types of Beneficiaries

A beneficiary designation may be either revocable or irrevocable. A revocable beneficiary designation allows the policy owner to retain the right to change the beneficiary at a later date. The revocable beneficiary may expect to receive the policy proceeds, but there is no guarantee the expectation will materialize.

An irrevocable beneficiary designation provides an immediate vested interest in the death benefit to the irrevocable beneficiary. The policy owner must have the irrevocable beneficiary's consent to make any changes to the policy, including policy loans.

The primary beneficiary will receive the death benefit proceeds if he or she is living at the death of the insured. There can be more than one primary beneficiary, who may share the proceeds equally or by a formula determined by the policy owner. If no primary beneficiary is living at the time of the policy owner's death, the proceeds will be paid to the contingent beneficiary if one has been named. Contingent beneficiaries do not have any rights to the policy proceeds if the primary beneficiary is living. If the primary beneficiary should die while receiving death benefit proceeds, the balance of any proceeds due would be paid to the primary beneficiary's estate unless the settlement option provided for contingent payment. The contingent beneficiary would not receive the balance of the proceeds unless he or she was the contingent payee within the settlement option.

A donee beneficiary gives no consideration to the policy owner in return for being named beneficiary. This is the most common type of beneficiary designation in life insurance contracts.

A creditor beneficiary is a person to whom the policy owner owes a debt. Benefits becoming due and payable to a creditor beneficiary are used to extinguish the debt to the extent of the proceeds due and paid. As part of the death claim, a creditor will submit an affidavit stating the debt amount, which needs to be repaid. Keep in

mind that there should be a beneficiary named to receive the balance of the proceeds after the debt has been paid.

## Designations

A policy owner's designation should be as clear and descriptive as possible so the individual may be identified with ease. Percentages should be used, and always total 100% for all designations. A spouse should be identified by name as well as relationship to the insured. For example, Charles Smith's designation should read as follows: Mary Smith, wife of the Insured. Not Mrs. Charles Smith and not "spouse" since this can result in great ambiguity if the marital status should later change. A designation of "spouse" has been held to be the insured's spouse at the time of death not the spouse at the time of the designation. It is also important to note that in most states, Mary Smith will receive the proceeds under the designation "Mary Smith, wife of insured" even if she is not married to the insured at his death.

Children may be identified by name and/or class. A class designation names several people as a group, without listing them individually. "Children of the insured" is a class designation. However, locating all members of a class designation, without names, may prove difficult in the future. On the other hand, listing the children individually could result in leaving out a child who is born or adopted later. Whether you use a class designation or a list of the children, you will want to also indicate whether or not this includes adopted children or children from a previous marriage or children born after the designation is made. The clearer the designation, the more quickly Bankers Life can pay the proceeds.

EXAMPLE: Tom Smith 12/01/65 33% SS#

Dick Smith 03/02/61 33% SS#

Harry Smith 01/01/66 34% SS#

Children of the insured and any other children of the insured hereafter born or adopted

A per capita beneficiary designation means by head or by individual and that the shares are equal. This is the most common form of designation. This designation is commonly written as "Tom, Dick and Harry share and share alike. If the policy owner wants the primary beneficiaries who survive him to receive the proceeds, the words "and to the survivor or survivors" is added. For example, if three beneficiaries are named, each will receive 1/3 of the proceeds unless otherwise specified. If only two survive, each will receive 1/2 of the proceeds. If the policy owner wants the share of a deceased primary beneficiary to go to the contingent beneficiary, it is important to clearly state that intent. Bankers Life, like most insurance companies, will assume a designation is a survivorship per capita designation unless the designation clearly indicates another intention.

A per stirpes designation means by family branches. Children (or other descendants) of deceased beneficiaries share their ancestor's portion of the benefit equally. The descendants do not share equally with the other beneficiaries but are entitled only to their ancestor's share. If the beneficiary dies without descendants, his share is split among the other "branches" of primary beneficiaries.

## Minors

Naming a minor as irrevocable beneficiary is not advisable since the policy owner will need the minor's consent to do anything with the policy. A policy owner may have to wait until the minor reaches the age of majority and can give consent before he may exercise any ownership rights.

If proceeds become due and payable to a beneficiary who is a minor, Bankers Life Insurance Company of N.Y. will not be able to pay the proceeds to the minor. It may be necessary for a guardian to be appointed by the court and the proceeds will be paid to the guardian who can give a binding release. Fortunately, there are several alternatives to naming children that will avoid this problem.

One method frequently used is to name a trusted friend or relative as beneficiary with the hope that person will act as the child's guardian. Keep in mind that the friend or relative who is named as a beneficiary will be entitled to the proceeds and will be under no obligation to use the proceeds for the benefit of the child nor to turn the money over to the child once the child becomes an adult. Secondly, the child may have reached adulthood prior to the insured's death, making payment to the friend or relative unnecessary. If the policy owner is confident that the friend or relative will follow his wishes, he should name the child as primary beneficiary and direct Bankers Life Insurance Company to pay that person if the child is a minor at the insured's death. Again, Bankers Life Insurance Company will not be responsible for directing the use of the proceeds on behalf of the minor children.

We refer to this as an "informal trustee". Another solution to the problem of minor beneficiaries is to use a settlement option.

## Trusts

At times, a policy owner will want the insurance proceeds to be paid into a trust and designate the trust as a beneficiary. A trust can be more flexible than a settlement option and allow the trustee discretion in making payments to the trust beneficiary. Trusts are frequently used in situations involving minor children, incompetent beneficiaries, wasteful adult children or beneficiaries without financial skills. The main drawback to a trust is the expense. The trustee, especially a corporate trustee, may charge a fee for administering the trust. The trust document must be prepared by an attorney who will charge a fee for his services.

There are two types of trusts—inter-vivos or living trusts and testamentary trusts. The living trust is created

during the lifetime of the person establishing the trust. It can be funded or un-funded, revocable or irrevocable. The testamentary trust is established in the insured's will. This type of trust does not exist until the will is probated.

It is important to remember that an irrevocable trust can be named as a revocable beneficiary. This means that the policy owner can change the beneficiary at any time but cannot revoke the trust. There will be instances where the owner decides to change the beneficiary to someone else or another trust. This is perfectly permissible to do. Bear in mind that the trust is irrevocable, not the beneficiary. As long as the trust is not the irrevocable beneficiary, the beneficiary can be changed anytime the policy owner desires to do so. Also, the trustee of an irrevocable trust can change. It is the trust itself that is irrevocable not the trustee or the beneficiary designation.

## Divorce

Only a few states have laws that will automatically change the beneficiary designation if the policy owner and beneficiary get divorced. In most states, if the divorce decree or some other agreement does not specify a beneficiary designation, the policy owner is free to change the designation and if the policy owner does not change the designation, the ex-spouse will be entitled to the proceeds. Frequently the divorce decree will require the policy owner to name the ex-spouse as the beneficiary. Keep in mind that if the policy owner does not sign the beneficiary form that will satisfy the court order, there is nothing that Bankers Life can do. It is up to the attorney for the ex-spouse to see that the policy owner signs the form. The court order binds the policyholder not us.

There may be instances where the attorney or the ex-spouse or both will want to be notified of any changes in the policy, or if the policy holder stops making payments. Due to system limitations, this may be difficult or impossible to do. Unless the ex-spouse is made the irrevocable beneficiary, Bankers Life is under no obligation at all, and actually needs to have the policyholder's permission to notify them of any changes. Anytime a policy is subject to a court order such as a divorce decree where the policy owner has restrictions placed upon him/her, a code specifying legal restriction should be placed on the policy.

## Assignments

There are instances where the policy owner assigns the policy as security for a debt—a collateral assignment. Bankers Life has collateral assignment forms. If an assignment form other than our own is used, it should be sent to the Legal Department for review. A creditor will prefer a collateral assignment over being named as a creditor beneficiary since the collateral assignee's consent is required for any transaction that affects policy values. A creditor beneficiary can be changed at any time unless it is an irrevocable designation.

The assignee acquires most of the rights under the policy but the policy owner is still required to continue the

premium payments. If the premiums are not paid, the assignee can continue the premiums and just add them to the debt being secured. Keep in mind that if the beneficiary of the policy is irrevocable, the beneficiary must be joined as part of the assignment. In most cases, the assignor can still designate and change the beneficiary. There can be more than one assignment on a policy, however the payment of proceeds will follow the order of the assignments.

An assignment can only be removed if you receive a release of assignment from the assignee. Even if the policyholder shows documentation that the debt has been paid, only a release from the assignee will release the assignment. If you receive more than one assignment on a policy, it is a professional courtesy to contact the second assignee and let him know that he will be the second assignee and his rights will be subject to the first. Subsequent assignments should always be labeled at the top "second assignment", "third assignment" and so forth.

## Death of irrevocable beneficiary

Bankers Life follows the rule that if an irrevocable beneficiary predeceases the insured, the policy owner may name a new primary beneficiary. If he does not, the proceeds will be paid to the contingent beneficiary.

## General Guidelines for Beneficiary Designations

1. A trust can be a beneficiary. It can be a living trust or one created by a will. Always be sure the living trust is in existence. Also, the trust should be clearly identified, including the name of the trustee, the successor in trust, the date of the trust and, if applicable, the trust TIN.
2. If an estate is named beneficiary, it must be the Insured's estate.
3. If more than one beneficiary is named always be sure the shares and order of payment are shown.
4. If fractions or percentages are used for multiple beneficiaries, be sure they add up to 100% and more.
5. When multiple beneficiaries are named, it is often designated "In equal shares or to the survivor or survivors."
6. When children are named, the designation often reads "In equal shares, per stirpes." This way, the children of a deceased beneficiary will share that deceased beneficiary's share of the proceeds.
7. Key man policies almost invariably name the employer as beneficiary.
8. The name and relationship to the Insured of any beneficiary should always be shown, unless unborn children as a group are a contingent beneficiary. In that case indicate " All children born to, or adopted by, the Insured" after the living ones have been named.
9. The beneficiary change form must be witnessed by a disinterested person, never by a beneficiary. An agent should not sign as a witness unless he has, in fact, witnessed the signing of the form.
10. The actual dollar amount of the death proceeds are usually unknowable. If dollar amounts must be used, be sure the order of payments is spelled out and provide a residuary beneficiary or identify who gets the "balance" of the proceeds. Never accept a designation where the dollar amounts exceed the face value of

- the policy.
11. Creditor beneficiaries are acceptable, but it is preferable to use a collateral assignment. Unless it is irrevocable, the creditor beneficiary is not protected from the policy owner changing the beneficiary designation. A collateral assignment may more adequately protect the creditor.
  12. Irrevocable beneficiaries are acceptable however irrevocable beneficiaries make the administration of the policy more difficult because the irrevocable beneficiary's consent is required for all policy changes.
  13. Bankers Life will accept a funeral home as a beneficiary. The policy owner should periodically review this type of designation. The funeral home could go out of business or the policy owner could move out of state. If circumstances such as these arise, and the beneficiary designation is not updated, proceeds could become payable to an unintended recipient. It is strongly advised to limit the amount payable to a funeral home.
  14. It is always advisable to name a contingent beneficiary and even a residuary beneficiary so if a long-lived insured dies, there is someone to pay other than the insured's estate.
  15. In some states, divorces and/or the divorce settlement can have an effect on a beneficiary. State laws should be checked.

## Types of Beneficiaries

### Estate as Beneficiary

The estate can be the beneficiary of the insurance proceeds. In this case, the proceeds will be used to pay creditors of the estate. Keep in mind that the proceeds will be subject to Federal estate taxes and also state death taxes in most states. (You would need to check individual states to see if they have such a statute) Also keep in mind that some states provide a spouse the option to take a share of the estate—an elective share. If the proceeds are large enough, the spouse may decide to elect against the estate rather than accept the provisions of the will. The decedent's plans for the insurance proceeds are also dependent upon the effectiveness of the will in disposing the assets. The will must be probated, and the will can be elected against or "disproved" (challenged by someone as having been revoked prior to death, signed under duress or undue influence or while incompetent or some other cause of invalidity.) There are legitimate situations where the proceeds should be paid to the estate but payment to a trust is much more efficient and cost effective.

### Living Trust as Beneficiary (Inter Vivos Trust)

Naming a trust as beneficiary removes the guesswork out of several contingencies that cannot be predicted or covered by the insured. A trust solves the problems arising when the primary beneficiary predeceases the insured. It also guards against the incompetency or financial immaturity of the beneficiary. With a trust, the professional management and financial expertise is utilized in handling the insurance proceeds. The proceeds are free from the claims of creditors of the beneficiary and the trust can be drafted to meet the changing needs of the family financial situations. Another advantage with a trust is that the trust is treated as a

separate taxable entity for income tax purposes. It is then possible to divide the income between the trust and beneficiaries in order to lower the income taxes.

On the other hand, a living trust must be in existence before it is named as the beneficiary. A trust must be drafted which involves expense and also the administration of the trust is not without expense either.

A trust is most appropriate when the insured would like to postpone the beneficiary's control over the proceeds or protect the proceeds from creditor's or 'predators' of the beneficiary.

## Testamentary Trust

A trust can be named as part of the insured's will. The funding of the trust can begin almost immediately after the death of the insured. Completion of probate is not necessary to have the proceeds paid to the trust. However, the will must have been submitted to the court and the court must have appointed the trustee. In regards to taxes, some states will not charge an inheritance tax on proceeds paid to a testamentary trust. On the other hand, some states include the proceeds in state inheritance tax. Make sure to check with the state tax laws regarding this. Keep in mind that the trust only becomes valid if the will is probated. If the will is held to be invalid or the insured dies intestate, the trust will not be created and the proceeds will be paid to the contingent beneficiary or to the estate of the insured if there is no contingent beneficiary.

## Settlement Options

The policy owner can pick from several settlement options offered through the policy itself. Settlement options available may vary among policy forms. Consult the policy to see if the settlement option desired is available.

Option 1. Fixed Period death benefits will be paid out in equal monthly installments for a fixed period of time.

Option 2. Life Income with installments certain equal monthly installments for a period certain such as 10, 15 or 20 years and there after during the life time of the insured.

Option 3. Annuity Settlement the proceeds will be paid out in the form of an annuity with no survivor options.

Option 4. Proceeds at interest proceeds will be held at interest and may be withdrawn at any time. (Unless mode of payment restricts)

Option 5. Installments of fixed amounts proceeds will be paid in a stated monthly amount until they are fully paid.

Option 6 Joint and Survivor Life Income with installments certain proceeds will be paid in equal monthly installments for a period of ten years and thereafter as long as either of the two payees is alive.

It is possible to use several settlement options together. Frequently, policy owners will have proceeds otherwise payable to minor children held under Option 4 (with interest to accumulate) until the child reaches age 18, then payments begin under option 5 or option 1. Examples of this type of designation can be found at the end of this volume.

## **Annuities**

A beneficiary in an annuity contract is very similar to a life insurance beneficiary. The beneficiary can receive the death benefits of an annuity contract should the annuitant die prior to annuitization. Bankers Life will accept a regular change of beneficiary form for this. Keep in mind that once annuitization occurs, the beneficiary designation is canceled due to the selection of the settlement option that the annuitant chooses. The annuitant will choose a contingent payee—the person to receive the balance of the annuity if the annuitant dies before payments are completed. If the annuitant chooses life with ten-year certain option and dies three years after annuitization, the contingent payee will receive the present value of the remaining seven payments in a lump sum.

## **Frequently Asked Beneficiary Questions**

Yes. Our policy is that any form that contains a witness signature line must be completed. If the beneficiary form is returned without a witness signature, send the policy owner a new form and emphasize that the witness line must be signed by a disinterested person.

Yes. An assignment has no effect on the policy owner's rights of changing the beneficiary although the assignment does have an effect on the proceeds that the beneficiary will receive.

This has been an issue associated mainly with ownership transfers and tax consequences but the question has been raised with beneficiary changes as well. Bankers Life will record the beneficiary change as of the date that it is received, however, the effective date is the date that the policy owner made the change. If the form is dated 12/31/97 and we receive it 01/01/98, the effective date is 12/31/97. All beneficiary designations should be recorded immediately. If the insured dies we will pay proceeds to the beneficiary on record.

A faxed beneficiary form is acceptable for the purpose of getting it recorded however the original must be sent in for the policy file.

Absolutely. Many policies are owned by trusts or corporations where the insured is the trustee or president. Their title should accompany any signature on a form that makes a policy change. For example: John Doe, President or James Bond, Trustee. The validity of the signed document rests upon the whether the person signing it has the authority to affect a policy change.

There is nothing that Bankers Life can do in matters such as these. Many times you will have to deal with an ex-spouse or their attorney and they will argue that they have a court order that states such and such person is to be the beneficiary. Regardless, the policy owner must sign a change of beneficiary form. The court order binds the policyholder, not Bankers Life. Bankers Life is not a party to the divorce and cannot make any policy changes without the written authorization of the policyholder.

If you receive a beneficiary designation that appears to be quite complex, refer it to Legal for review. Bankers Life is fairly flexible when it comes to paying claims, however, there are limitations to how claims can be paid and what settlement options are available.