

Who Should You Name as a Beneficiary?

The proceeds from your life insurance policy can benefit your loved ones in many ways, from paying off your outstanding debts to providing supplemental income for your spouse and children to covering funeral and burial expenses.

Life insurance policy payouts average \$168,000.¹ As the policyholder, you can—and should—name beneficiaries of the policy. Generally, however, when a policyholder passes, the named beneficiaries receive their share of the death benefit outright and in a lump sum without stipulations or conditions.

You likely purchased life insurance to protect those who depend on you. To make the most of your policy, consider who you name as a beneficiary and how the death benefit distribution method fits into your overall estate plan.

Who Can Be Named as a Beneficiary

A life insurance policy can name a single individual, two or more people, the trustee of a trust, a charity, or your estate as a beneficiary.

You must name both “primary” and “contingent” beneficiaries. The primary beneficiary is the first to receive death benefits from the policy. A contingent beneficiary serves as a backup if the primary beneficiary cannot be located or is dead. If none of the primary or contingent beneficiaries can be found, the death benefit is generally paid to the policyholder’s estate. However, this is not always the case; it is important to review your life insurance policy’s terms to ensure you understand what will happen when you pass away.

When filling out beneficiary designation forms, you should name beneficiaries as clearly as possible by including their full legal names and Social Security numbers (if necessary). Some forms request phone numbers and addresses as well. While this information is usually optional, it is always a good idea to be as complete as possible. In addition, your beneficiary designation forms should be periodically checked and kept up-to-date to reflect life changes, such as the birth of a child, marriage, or divorce.

Although you—the policyholder—name beneficiaries, the beneficiaries choose how they collect the death benefit payout if there is more than one way the insurance company will distribute death benefits. Most insurers allow for lump-sum, installment, specific income, or annuity payouts. One benefit of designating beneficiaries is that this money passes outside of probate (the court-supervised process of settling your affairs at your death).

Surviving Spouse and Child Beneficiaries

If you are married and have kids, you will likely name your spouse and children as policy beneficiaries. The death benefit you leave them can be a significant financial change. It could help pay off a mortgage, assist the children with college expenses, or fill the cash flow gap resulting from the loss of your contribution to household income. Naming a spouse or children as beneficiaries of a life insurance policy comes with a few potential catches, though.

¹ *Average Life Insurance Payout*, AFLAC, <https://www.aflac.com/resources/life-insurance/average-life-insurance-payout.aspx> (last visited May 28, 2024).

Spouse

Naming your spouse as a life insurance beneficiary is an obvious choice. The policy proceeds can be used to pay off debts you owe individually or as a couple.

Because the money passes outside of probate, your creditors likely will not have access to the death benefit. However, the death benefit is fair game to your spouse's creditors once the money is paid out to them.

While using a life insurance death benefit to pay off debt may ultimately be in your spouse's best interest, you should make sure that you purchase enough insurance to adequately cover your debts—and their debts—if this is your intention.

Adult Children

Unlike your spouse, as it relates to certain debts, your children likely will not be personally responsible for your debts after you die, at least not directly. But they may have to pay your creditors from the accounts and property you leave behind at your death through the probate or trust administration process. A life insurance policy can help ensure that other accounts and property (for example, your family home, bank accounts, and investment accounts) go to your loved ones, not debt obligations.

Also, keep in mind that once your adult children receive a life insurance payout, their own creditors can access the money. While paying off debt could benefit them, you might prefer that the money be utilized for something else, like schooling or living expenses.

Minor Children

Insurance companies are not permitted to pay life insurance benefits directly to minor children because they cannot legally own or receive accounts or property in their name until they reach the age of majority. A guardian or conservator might have to be appointed to manage the funds until the child comes of age. This entails added court costs, and the proceedings could hold up the payment depending on your state. Once your child reaches the age of majority, they will likely receive the balance of their share of the insurance proceeds outright in a lump sum.

Some life insurance policies allow a custodian to be assigned to a minor child beneficiary without probate court involvement. A custodian manages the money on behalf of the minor child until they come of age, at which point the money is turned over to them, again, usually in a lump sum.

Charity

Your legacy and estate plan might extend beyond your family and include a charity or nonprofit organization.

You could purchase a new life insurance policy to make a charitable gift, change the beneficiary designation of an existing policy to a charitable organization, transfer policy ownership to a charity, or give the gift of policy dividends to a charity. Each option can provide tax benefits that leave more money in your estate.

Creating a Trust for a Loved One

By creating a trust as the beneficiary of the life insurance policy, you can protect the proceeds from creditors and exert more control over how the death benefit is spent.

For example, a life insurance trust can be used to do any of the following:

- Leave money to minor beneficiaries
- Retain means-tested government assistance eligibility for a disabled loved one
- Keep a young adult from spending the funds all at once or for nonapproved purposes, such as personal expenses instead of their college education
- Prevent commingling the insurance proceeds into marital property if your spouse remarries or your adult child gets divorced

Life insurance proceeds held in trust add assurances that a death benefit will be spent in accordance with your wishes. Trust funds are exempt from probate and may reduce estate taxes, depending on the type of trust used.

Life Insurance and Your Estate Plan

Purchasing life insurance is one of the best ways to provide financial security for your loved ones after you are gone. But if you are not careful and thoughtful about naming beneficiaries, they may not receive the protection you hoped for.

To make the most of life insurance in your estate plan, schedule a meeting with our attorneys to review your plan.