

SURVIVOR OPTIONS ON BONDS

A popular estate planning feature.

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Have you heard of the “survivor option”? How about a “death put”? These rather bleak terms reference a very useful choice for beneficiaries who inherit certain kinds of corporate bonds. This option has become increasingly common.

What does a death put do? If a bondholder dies before a bond reaches maturity, a death put lets the beneficiary sell the bond back to the bond issuer at face value. If your children inherit a corporate bond from you, a death put may be a much better choice than keeping the bond until maturity or selling it in the secondary market.

Why has it become so attractive? Look at the current interest rate environment. If rates go up and beneficiaries decide to sell a corporate bond before maturity, they may have to take a loss. With a survivor option, that problem is off the table. If your heirs exercise the death put feature, they will be able to redeem the bond at par value even if it is trading at a steep discount.

Of course, this feature comes at a price. It is a “sweetener” - one of those things you pay for up front or indirectly via a lesser return rate on the security.

Are there limits on survivor options? Most certainly. Most retail bond issuers will only take back a small amount of their bonds in a year (in the neighborhood of 1-2% of the original retail issue). There is also usually a per-estate limit (\$200,000 par value per estate is a typical figure).¹

Often issuers require a minimum holding period before a survivor option can be used - a year from the original issue date is common. If a bondholder dies before those 365 days go by, his or her estate must hold the bond until the one-year window closes.²

One more detail to note: the beneficiaries of the bond have to implement the survivor option before they take possession of the bond. For the option to be used, the bonds must be held in the deceased bondholder's account.²

Do your bonds have a survivor option? Do your loved ones know about that feature? You and your beneficiaries will want to acquaint yourself with the details. If you don't own bonds with a survivor option, ask a financial consultant for information on them.

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Citations.

¹ cfainstitute.org/memresources/communications/privatewealth/2009/august/article_3.html [8/09]

² incapital.com/index.cfm?fuseaction=newsArticles.viewArticle&NewsID=100223 [7/19/05]