Understanding the Risks of Joint Bank Accounts

By Robyn M. Young

How will you pay your bills when you no longer can? Linda thought she found the answer: she opened a joint checking account with her daughter. Now her daughter, Margaret, can write checks whenever necessary. When Linda dies, her money will go directly to Margaret and stay out of probate. The account was simple to set up at Linda's local bank branch.

Linda felt safe knowing her bills would be paid. She did not realize, however, that this arrangement put her at risk.

Let's consider the fundamentals of joint bank accounts.

- All the people whose names are on a joint bank account are equal owners of the money regardless of who started the account or who deposited the money.
- Any owner can write checks, make withdrawals and deposits, and close the account.
- All owners are responsible for overdraft charges and other bank fees regardless of who caused them.
- Most joint accounts have a "right of survivorship." When one account owner dies, the money transfers straight to the other owners.

While joint accounts are convenient, many people do not understand the risks of equal ownership.

You must implicitly trust the other person. If the purpose of the joint account is to provide for you, you need to trust that the other owners will use the money only for your benefit. If they withdraw money for their own use or even close the account, there is nothing the bank can do. Legal action would be required to try to recover the money. This can be difficult.

Setting up a joint account with an adult child implies love and trust for many people. But, what if your child unknowingly puts you at risk? What if a situation is out of your child's control? What happens in one joint account owner's financial life can create havoc in the other's.

Money in joint accounts is at risk to creditors, liens and lawsuits. Suppose Linda's daughter was involved in an automobile accident and was successfully sued. The money the joint account could be considered Margaret's asset and could be seized for payment. The same is true with loans. If Margaret lost her job and could not make her monthly payments, the money in the joint account could be seized, even though Linda had nothing to do with the loan.

Joint accounts are considered assets in divorce. If Margaret gets divorced, the joint account with her mother can be considered Margaret's asset in the settlement. It does not matter that there is an understanding that this is Linda's money and that Margaret never contributed to the account.

Estate plans may not go as prepared. Linda has three children in addition to Margaret. Her will instructs that each child will inherit her assets equally. When Linda dies, however, her assets will not be equally distributed. The money in the joint account will bypass the will, and Margaret will inherit that in addition to one-fourth of the assets covered by the will. This is not what Linda intends.

Here are some less risky tools that can accomplish your goals.

Set up a "payable on death" (POD) account. If your intent is for your child to inherit your money, you can create a POD account by completing the appropriate paperwork at your bank. When you die, the account will transfer to your named beneficiary after a required 90 day waiting period, avoiding the often longer probate process.

Prepare a "power of attorney" (POA). If you want someone to be able to pay your bills, this document will allow an individual, such as your adult child, to act as your "agent" and use your account when you become ill or incapacitated. Unlike joint bank accounts, POA documents are customized to your situation. You are the owner of your bank account protecting your money from anything that happens to your agent. Your agent is responsible for using your money only for your benefit. When you die, the money will be distributed as you determined in your estate plans.

Have an attorney prepare your POA document. For the protection power of attorney provides, this is money well spent. Once you have a power of attorney prepared, bring it to your bank to have your agent added to your account. The bank may also require that you sign its own power of attorney forms.

Keep only the minimum needed to pay your monthly bills in a joint account. If you decide to have a joint bank account, you can arrange to have money automatically transferred to this account from another account where you are the sole owner. If you use computers, use on-line banking to monitor the account activity.

For many people, including Linda, joint bank accounts seem like an easy solution to allow another person to pay their bills. However, care should be used in considering such an arrangement, especially when there are safer options.