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Putting financial affairs in order is key, even when facing a terminal illness

By: Julie Halpert, Special to CNBC.com
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Certified financial planner Catherine Latto recalls a former client who received a breast cancer diagnosis in 2005. The client, who was in her 50s, underwent a mastectomy and chemotherapy. Three years later she was diagnosed with another, more aggressive cancer. She died in 2009.

Latto, president of financial services practice Latto and Associates in Charleston, S.C., said the client had created a health-care power of attorney and living will when she was first diagnosed. But she never set up a durable power of attorney designating someone to manage her financial affairs, and she never made a will. The woman had many antiques and family heirlooms, as well as an interest in property held in common with relatives. While she wanted her children to keep the heirlooms and property, she never put her wishes in writing.

In short, a difficult situation for her family was made worse because the woman didn't specify how she wanted her affairs settled. Ensuring that your family will be financially secure "is the greatest gift you can leave your loved ones," Latto said, adding that things can get complicated when someone is diagnosed with a terminal illness. "You don't care that the market was up or down—you care that you're sick," Latto said. "Your focus is very narrow." But effective planning can help avoid adding messy finances to an already devastating experience.

Financial experts suggest these steps for those facing a life-threatening illness:

Get a will: Only about 40 percent of Americans have one, experts say. "A lot of people think ... they'll get around to it," said William Kirchick, a partner in the Boston-based law firm Bingham McCutchen and a board member of the National Association of Estate Planners & Councils. But not leaving specific written instructions behind means that your assets may not go where you intended—especially in cases of untimely death. A will identifies beneficiaries and your other wishes regarding your estate. Those can include naming people to inherit a particular items, such as jewelry or art—potentially preventing conflict after you're gone.

Update your will: If your will hasn't been reviewed within the last decade, your beneficiary list may be outdated and include people no longer in your life or even deceased, said attorney Lauren Detzel, chair of the estate and succession planning department at law firm Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth in Orlando. Gil Armour, a certified financial planner at SagePoint Financial in San Diego, noted that some people still have former spouses listed as beneficiaries. "It's not uncommon to have big inheritances going to places where they're not intended," he said.

Consider a revocable trust: To avoid having your estate go through probate, which can take 12 to 18 months, weigh the value of a revocable trust. The process consists of transferring your assets into a trust, in your own name, whereby the provisions can still be changed or canceled. This is easier to do if assets are concentrated in just a few areas, such as a home or bank and brokerage accounts. You receive income distributions from the trust until your death, at which time all assets are transferred to your beneficiaries.

"It's like probating your estate while you're alive," Detzel said. "You're doing the work while you're able to tell people what to do." A revocable trust also allows you to name a co-trustee right away. That way, if you're unable to manage your affairs, someone else can immediately transfer monies and pay bills. In addition, Detzel said, this type of trust is private, preventing others from knowing estate contents or inheritance decisions. According to Armour, revocable trusts are more suitable for people with significant assets. That's because states have various thresholds—for example, $30,000 in New York—below which an estate isn't subject to probate, so it's sometimes simpler to name beneficiaries outright in a will, he said. A trust can also cost as much as $2,000 or more to set up, depending on the extent and complexity of the estate.

Get your medical directives in order: This includes drafting a living will, which stipulates what type of medical care you do or do not want should you become incapable of communicating. For example, it may state that you do not want to be kept alive by artificial means if you're suffering from an illness or injury from which there is no reasonable expectation of recovery.

A living will also may contain a "do not resuscitate" (DNR) order, stating that no heroic measures should be taken to keep you alive should your heart or breathing stop. You also may appoint a health-care agent, someone with the authority to make medical decisions on your behalf if you become mentally unable to do so.

Determine power of attorney: An agent with power of attorney is someone designated to act on your behalf in financial matters should you become mentally or physically incapacitated. The agent, or attorney-in-fact, is also an executor who can distribute your assets to the beneficiaries of your will, pay your remaining debts and ensure that your final tax returns are prepared and filed.

Consider giving gifts: To reduce the amount that your estate will have to pay in taxes, consider starting to make gifts now. Gifts of up to $14,000 a year are tax-free.

Pass on your passwords: Create a list of your passwords for Internet accounts and give them to trusted loved ones. This will ensure that they have immediate access to important financial websites in the event of your disability or death, and will allow them to pay bills in a timely manner.

Don't blow your savings: Latto has had several clients who didn't think they had long to live and, therefore, cashed in their retirement plans. "Just because you were diagnosed with a terminal illness doesn't mean you'll die from it," she said. Spending money you may need for daily living expenses or for medical treatment not covered by health insurance is never a good idea, she said.

The more you specify what you want done with your assets, the more helpful it is for your beneficiaries, Detzel said. She recalls a case in which parents of adult children, in their 20s, were killed in a plane crash. The kids "came in with shoeboxes of information, but that's all they had," she said. "We knew there had to be assets ... but we couldn't find them."

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