No Beneficiary Designation. Who Gets the Money?

According to a recent Wall Street Journal article, retirement plans and IRAs account for about 60 percent of the assets of U.S. households investing at least $100,000. Both state and federal laws govern the disposition of these assets, and the results can be complicated, especially when the owner of the account has been divorced and remarried. Therefore, it is important for plan fiduciaries of qualified retirement plans to understand their role regarding beneficiary designations and the regulations that dictate.

Under ERISA and the Internal Revenue Code, in the case of a defined contribution plan that is not subject to the qualified joint and survivor annuity rules, if a participant is married at the time of death, the participant's spouse is automatically the beneficiary of the participant's entire account balance under the plan. A participant may designate someone other than his or her spouse as the beneficiary only with the spouse's notarized consent.

If the owner of a retirement plan account is single when he or she dies, the assets go to the participant's designated beneficiary, no matter what his or her will states. In addition, the assets will be distributed to the designated beneficiary regardless of any other agreements including even court orders. If the participant fails to designate a beneficiary, the terms of the plan document govern the disposition of the participant's account. Some plan documents provide that in the absence of a beneficiary designation the participant's estate is the beneficiary, while others provide for a hierarchy of relatives who are the beneficiaries. Because of the variances in plan documents, it is important that fiduciaries review the terms of their plan document when faced with determining who the beneficiary is in the absence of the participant's designation.

The beneficiary determination can become complicated when a retirement plan participant divorces. Where retirement benefits are concerned, both the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code contain provisions requiring plans to follow the orders of state courts overseeing domestic disputes that meet certain requirements. These orders are referred to as "qualified domestic relations orders" (QDROs).

Until recently, the federal courts have failed to adopt a reliable and uniform set of rules for adjudicating disputes among beneficiaries with competing claims. Some courts, adopting a strict reading of ERISA, simply pay the benefit based on the express terms of the plan; while others, with a nod to such concepts of "federal common law," look to documents extraneous to the plan (e.g., the divorce decree, a waiver, or some other document) to make the call. In Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, the U.S. Supreme Court settled the matter, coming down squarely on the side of the plan document.

The facts in Kennedy are straightforward: A plan participant married and designated his wife as his beneficiary. The plan participant and his wife subsequently divorced. Under the terms of the divorce decree, the participant's spouse surrendered her claim to any portion of the benefits under the participant's retirement plan. As sometimes happens, the participant neglected to change his beneficiary designation under the plan to reflect the terms of the divorce. As a result, his ex-spouse remained designated as his retirement plan beneficiary. Upon the death of the participant, the plan administrator, following the terms of the plan document and the beneficiary designation, paid the

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participant's account to the ex-spouse. Predictably, the participant's heir (his daughter in this instance) sued on behalf of the estate. The Supreme Court ruled that under the terms of the plan document, the designated beneficiary receives the participant's death benefits, and in this case, the ex-wife was the designated beneficiary entitled to the participant's account.

Another common example occurs following a divorce, when a plan participant designates his or her children as beneficiaries. If the participant later remarries, and dies while married to the second spouse, the second spouse is automatically the participant's beneficiary unless he or she consents to the participant's children being designated as the beneficiaries.

There are steps that plans can take to make the beneficiary process less prone to error. For example, a plan document can provide that divorce automatically revokes beneficiary designations with respect to a divorced spouse. It also behooves plans to review their communications materials to help ensure that participants are made aware of the rules that apply to the designation of beneficiaries.

Many plans that have had to deal with issues like these have decided to take inventory of their current beneficiary designations on file and attempt to remediate any deficiencies directly with the participants. Some have also requested their recordkeeper to insert a note in participants' quarterly statements reminding them to confirm their beneficiary designation is current and accurate. Both are good ideas.

As a plan sponsor you have the best wishes of your participants in mind and helping ensure their beneficiary designations are in order and up to date is another way to protect them and help ensure their intentions are carried out.

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