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Qualified Plans Must Come to Terms With Death: Who Is the Beneficiary?

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In a perfect world, all tax-qualified retirement plan participants would live to enjoy their retirement benefits throughout their golden years. However, this is not always the case, and just as individuals should plan for the possibility of premature death, plan sponsors also should do so.

There are numerous federal requirements governing retirement plan distributions upon the death of a participant. There are also a few rules that give a plan sponsor some flexibility in the payment features it wishes to include. The determination of who receives a participant's death benefit falls into both camps with its share of legally required and discretionary provisions. Accordingly, the qualified plan document and its underlying forms should contain tightly drafted language that is compliant with the current regulations and clear enough to guide the plan administrator on the practical execution of such provisions. In addition, the plan sponsor must have administrative procedures that facilitate the accurate identification of the intended beneficiary and provide sufficient supporting evidence for such determination. Failure to do so may result in scenarios where not only does the plan wind up paying death benefits that do not correspond with the participant's final wishes, but also the plan sponsor finds itself faced with legal challenges from disgruntled survivors.

This article examines some of the key issues that qualified retirement plan sponsors should consider when reviewing and updating plan documents and administrative procedures to ensure compliance with current beneficiary designation rules.

Law-abiding beneficiary designations

The foremost step plan sponsors can take is making sure that the document language and plan administration meet the minimum requirements mandated by law. In the case of beneficiary designations, both the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC) must be considered:

- ERISA states that the term "beneficiary" means "a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder."
- The IRC requires most qualified plans to provide spouses a survivor benefit, including a qualified joint-and-survivor annuity and preretirement survivor annuity. Certain defined contribution plans that do not offer annuities are exempt from this requirement, provided that the beneficiary of any death benefit is the spouse.

  A plan may permit a nonspouse beneficiary if the spouse consents to another person being the beneficiary in writing, witnessed by a notary or plan representative. Accordingly, the accurate identification of the beneficiary and consent are essential for a plan administrator to determine who must receive the death benefits. While this requirement may seem straightforward on the surface, various factors may complicate the identification of the "spouse" and there is some leeway in defining what constitutes "consent."

Who is the spouse?

The answer to this question has been the topic of considerable debate over the last several years. Prior to the enactment of the Defense of Marriage Act (DOMA) in 1996, "spouse" was determined under state law. After DOMA, the term was limited to opposite-gender marriages for qualified plan purposes regardless of state law. Since the June 2013 U.S. Supreme Court ruling that a key section of DOMA is unconstitutional, both the IRS and the Department of Labor have confirmed that qualified plans must again look to the applicable state law for the definition of a spouse. Plan sponsors must be sure to accurately communicate this definitional change to affected participants and administer their plans accordingly.

Other issues arising out of the definition of "spouse" that plan sponsors and administrators should consider include:

What about same-gender domestic partners?

To circumvent the restrictions against same-gender partners being able to qualify as a "spouse" under the plan–either because of DOMA or the applicable state's nonrecognition of such marriages–some plan sponsors included language to treat "domestic partners" as spouses if they met various requirements. These could include evidencing such a partnership through a joint bank account, common ownership of property, or co-habitation for a specified period of time. Some definitions were written to apply to both opposite-gender and same-gender couples, while others were limited only to same-gender partners.

If a plan's domestic partnership language only applies to same-gender couples and the participants live in a state that recognizes such marriages, the plan has now gone from equalizing spousal benefits for same- and opposite-gender couples to one that actually provides an additional right to same-gender couples only, i.e., the right to spousal benefits whether or not a couple is married.

Wait until the honeymoon is over?

Some plans require that participants complete one year of marriage before their spouses are recognized as such. If this rule is written into the plan, until that first anniversary is celebrated, the spouse is not automatically the beneficiary or entitled to any automatic pre-retirement spousal benefits payable upon the participant's death. However, if the participant and spouse are married on the benefit commencement date, even though they have not been married for the one-year period, the plan must treat them as married. In that case, if they do not remain married for at least one year, the plan may provide that the spouse loses any right to survivor benefits. In addition, the participant's benefit is not required to be increased to reflect the loss of the survivor benefit.

The rules of consent

While the strict IRS requirement is that a participant may not name a non-spouse beneficiary without obtaining the spouse's written consent, this rule permits flexibility when plan sponsors administer it, thereby creating many choices. For example, who should the plan designate as the "required witness"–a plan representative or a notary? While the plan representative is acceptable, the notary option is the safest method because it provides a level of independence to the process, helping to reduce the number of claims involving fraud, collusion, or undue influence.

Two other questions that must be addressed are the irrevocability and specificity of the spousal consent waiver. Many plans provide that a spouse's consent is irrevocable to avoid the inherent complications, such as where a spouse has consented to a beneficiary designation and then changes his or her mind. Specificity refers to whether the plan permits a general spousal waiver or limits the waiver to a specific designation. For example, the plan and forms could contain spousal consent for the current beneficiary designation and prohibit changes without spousal consent. Without such specific language, once spousal consent to another beneficiary is given, the primary beneficiary may be changed without further spousal consent.

One final rule to note is that spousal consent is only valid if it is given post-nuptials. As a result, the plan sponsor is not permitted to honor a pre-nuptial agreement under which the spouse agrees to waive all rights to the participant's retirement benefits.

The default defense

The preemptive power of ERISA provides plan sponsors with an incredibly strong ally against lawsuits from disgruntled "wannabe" beneficiaries and conflicting state laws. However, to take maximum advantage of the ERISA edge, the plan document and underlying forms must be tightly drafted to remove areas of uncertainty that could leave the plan vulnerable to a successful challenge. Great strides toward this goal can be made by the inclusion of expansive and well-constructed default provisions.

The plan's default provision describes the rules that automatically "kick in" to fill the beneficiary voids that occur during certain circumstances. These include, for example, no beneficiary designation or an invalid designation on file, or designated beneficiaries pre-deceasing the participant. The most common order used for a default is: the current spouse, children, parents, siblings, and the estate. If using this default, the plan must also designate how the benefits will be split in case more than one survivor remains in any of the individual categories. For parents and siblings, an equal shares approach is the norm; however, with regard to children, the *per stirpes* method is common (e.g., if two children, they share 50% each; then if one child pre-deceases the participant, 50% goes to the surviving child and 50% will be split evenly among the children of the child who died before the participant). The alternative to *per stirpes* is *per capita* (e.g., if two children, they share 50% each; then if one child pre-deceases the participant, 100% goes to the surviving child).

Plans can also safeguard against the unintended consequence that may occur if the participant forgets to revisit beneficiary designations after a divorce. To do so, the plan should include a uniform provision that automatically nullifies any existing spousal designations upon the occurrence of a divorce. This forces the participant to affirmatively designate the now ex-spouse, if desired, by completing a new designation. Of course, if such a provision is included in the document, the administrator should vigilantly communicate it to participants and follow up with those who become affected.

Plans may also opt to include other default provisions to protect themselves from rare but possible disputes that may arise from conflicts with state laws. Two examples are "slayer statutes" and "simultaneous death" provisions. Having the plan automatically prohibit a beneficiary from collecting a benefit if the beneficiary is responsible for the participant's death and providing a hierarchy where both the participant and the beneficiary die can go a long way toward avoiding these types of disputes.

What does the box say?

A well-drafted plan document is only the first step in creating a smooth, functioning beneficiary designation process. Extreme care and thought must also go into the design of the beneficiary designation forms so that they can be easily understood and completed by participants. This will help to ensure that the information from, and the boxes checked by, the participant provide the plan administrator a crystal clear picture of who should receive the death benefits.

There are a number of optional provisions that must be considered as well. A designation form should elicit enough details on beneficiaries that they can be easily identified and located. For example, asking for the beneficiary's relationship to the participant, his or her Social Security number, or the current contact information will facilitate this process. In addition, the forms should provide clear instructions on the naming of multiple and contingent beneficiaries (including information regarding the previously described *per stirpes* or *per capita* choice when children are named).

Staying true to form

While clear and proactive plan and form designs are a great head start, the path toward deterring beneficiary disputes does not stop there. Plan sponsors also must efficiently and effectively:

- communicate to participants the importance of completing and updating their beneficiary designation forms;
- deliver to and retrieve the forms from the participants;
- review the completed forms to ensure that they are accurate; and
- maintain and manage the forms.

In addition, a best practice is for plan sponsors to periodically remind participants to review their beneficiary designations in the event of a change in family status.

Technology-based solutions can improve the above processes. For example, an electronic system for designating beneficiaries could ensure that all items are complete on a form before it can be submitted. Electronic storage makes retaining and reproducing (even on demand) designations easy. In addition, current electronic (e-signature) technology might help reduce claims of forgery. Unfortunately, current statutory and regulatory requirements for qualified plans make having a totally paperless process impossible. This is true even though:

- under the spousal consent requirements, the spouse's signature can be an electronic one in accordance with E-SIGN or state law, and
- regulations permit a notary or plan representative to electronically acknowledge witnessing the spouse's signature.

Despite these helpful rules, the spouse is still required to be in the physical presence of the plan representative or notary witnessing the signing of the consent form.

Where there is a will, there is a way

Survivors left behind when a loved one passes away are already in an emotional state; if their mourning is intensified by a perception that they are being cheated out of funds intended for them, a legal challenge could arise. In cases where beneficiary designation disputes occur, plan fiduciaries are required to spend time, as well as financial and other resources, to identify the correct beneficiary. Fiduciaries may have to take various actions such as defending lawsuits, commencing interpleader actions in court, or expending time and financial resources to locate the correct beneficiary. Paying benefits to an erroneous beneficiary could expose the plan and its fiduciaries to liability.

For example, a fiduciary could be placed in the unfortunate position of having to pay the same benefit twice—once to the mistaken beneficiary and again to the correct beneficiary after the appropriate identification and clarification. To avoid such consequences, plan sponsors should make sure that their plan documents and beneficiary designation forms include clear and concise language that anticipates various scenarios and thus leaves little room for ambiguity upon a participant's death. The plan sponsor also must implement and maintain an ongoing process that provides for effective and efficient delivery, receipt, and maintenance of beneficiary designations. A proactive approach would also entail periodically following up with participants to ensure that the designation presently in place reflects their current intentions.

Many plan sponsors have employed a third party to review the plan language and related forms that apply to beneficiary designations. Such assistance often can identify potential problem areas. Taking the initiative to control how a plan complies with the laws and regulations, as well as how it administers the designation provisions, offers a best practice approach for increasing the chance that the deceased participant's benefits wind up with the survivors he or she would have wanted—which is the most favorable outcome for survivors and also for the plan sponsor.

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