Written Comments Submitted to the U.S. Department of Labor Advisory Council on Employee Welfare and Pension Benefit Plans

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Current Challenges and Best Practices Concerning Beneficiary Designations in Retirement and Life Insurance Plans

Thank you for this opportunity to provide comments on the topic, Current Challenges and Best Practices Concerning Beneficiary Designations in Retirement and Life Insurance Plans.

My name is Robert Richter and I am speaking today on behalf of the American Society of Pension Professionals and Actuaries (ASPPA) where I serve as President.

ASPPA is a national organization of more than 10,000 members who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA a unique insight into current practical applications of ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers.

I am also a vice president at SunGard's Relius retirement services division in Jacksonville, Florida. SunGard is a global leader in technology and services to more than 25,000 customers worldwide and is a leading provider of software and services to retirement plan professionals in the U.S. I am responsible for the area that drafts and supports qualified retirement plan documents and related forms, such as beneficiary designation forms.

My comments are focused on qualified retirement plans, and more specifically on plans sponsored by medium to small plan sponsors. While some of my comments have equal application to group-term life insurance (and to larger qualified plans), there are also clear distinctions. The Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974, as amended (ERISA) mandate that qualified plans provide certain minimum death benefits to surviving spouses.[1] In addition, the operation of a qualified plan involves more service providers than the operation of a group-term life insurance program. These differences have a material impact on the way beneficiary designations are handled.

As part of my preparation for today, ASPPA sent a condensed version of the Advisory Council's potential questions to a group of ASPPA members. I have attached to this testimony a summary of the responses we received.

Responsibility for Handling Designation Forms

In the small to medium retirement plan market, the plan sponsor (*i.e*., the employer) is typically the named plan administrator. The employer usually hires one or more service providers to assist with fulfilling its duties as plan administrator. The providers offer an array of services. In the vast majority of arrangements, the service provider has little involvement with beneficiary designations. The employer, as the plan administrator, is responsible for the distribution, retention and interpretation of beneficiary designations. The service provider will usually make distributions to the beneficiaries as directed by the plan administrator and has no discretionary authority.[2] Those providers who provide a service to retain designations may only charge a nominal fee for doing so.

The advantages of having the employer handle all aspects of beneficiary designations are somewhat limited. In addition to possible cost savings, some employers may be aware of changes in a participant’s family situation and therefore be able to be proactive in reminding the participant to review his or her beneficiary designation. Another significant advantage is that there is no exchange of information or files necessary merely because of a change in service providers.

There are, of course, disadvantages to this approach. Employers will not consistently remind participants to periodically review their designations. More problematic, employers are not in the best position to provide a detailed review of designations upon receipt in order to ensure designations are complete and unambiguous. This does not necessarily mean service providers would be willing to take on this role, especially where it entails ambiguous designations because service providers will avoid any activities that involve discretionary actions in order to avoid fiduciary liability.[3]

Most service providers will provide the plan sponsor with beneficiary designation forms. These are made available as part of the enrollment process when an employee is first eligible to participant in the plan. Completion of designations at the time of initial

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[1] *See generally*, I.R.C. §§ 401(a)(11), 417; ERISA § 205; Treas. Reg. §1.401(a)-20.
[2] *See*, DOL Reg. § 2509.75-8, Q D-2 (providing that “a person who performs purely ministerial functions such as the types described above for an employee benefit plan within a framework of policies, interpretations, rules, practices and procedures made by other persons is not a fiduciary”).
[3] *Id.*

enrollment is encouraged, but it is rare that completion of a form is mandatory. The practice of encouraging participants to complete a designation might be worth re-considering because some participants may be better off if no designation is made. This is because the law requires that plans provide certain minimal spousal death benefits.[4] For unmarried participants or benefits in excess of the spousal minimum, the participant can designate any beneficiary he or she wants. If no designation is made, then most plans include certain default provisions. For example, many plans provide that if there is no designation, the entire death benefit will be paid to the spouse, if there is no spouse then it will be paid to the children, and if there are no living children or descendants, to the parents (if living) and last to the participant's estate. If a participant makes no affirmative beneficiary election, then under the plan's default provisions, changes in a participant's family situation will automatically result in a change to the beneficiary. Once an affirmative designation is made by a participant, it is up to the participant to initiate changes as family circumstances change (unless the change is marriage where spousal benefits automatically apply).

Disputes

Disputes among potential beneficiaries are not a common occurrence (e.g., some providers have never had any). This is because many plans, especially those sponsored by small to mid-size employers, permit distributions upon termination of employment, even if that is prior to the plan's retirement age. It is common for larger plans, especially defined benefit plans, to not permit distributions prior to the plan's normal retirement age. This means there is higher likelihood of having former employees who die with benefits in a plan.

When disputes do occur, they can be very hostile and expensive. Some potential beneficiaries have the attitude "If I can't have it, no one can." When a plan is on notice of a potential dispute, benefit payments are almost always delayed until the situation can be resolved. Interpleader is rarely used as it can be very lengthy and costly.[5] For defined contribution plans, these costs are typically paid out of the deceased participant's account. The hope is that these disputes can be resolved either as part of probate or by mutual agreement among the parties.

The reasons for the disputes vary considerably. Many of the disputes involve situations where there has been a change in a participant's family circumstances (e.g., divorce) and the participant does not update his or her beneficiary designations. There is a plethora of case law dealing with participants who name their spouses as beneficiaries and then fail to change those designations upon divorce. The U.S. Supreme Court issued two seminal cases relating to this issue. In *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001), the Supreme Court held that Washington's so-called "redesignation statute" is pre-empted by ERISA. In *Kennedy v. Plan Adm'r for Dupont Sav. and Inv. Plan*, 129 U.S. 865 (2009), the Supreme Court held that plans may follow designations they have

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[4] *See generally*, I.R.C. §§ 401(a)(11), 417; ERISA § 205; Treas. Reg. §1.401(a)-20.

[5] Interpleader is a legal proceeding that can be brought by the plan to have a court determine the ownership rights of the plan assets. It allows the plan to turn the matter over to a court and to be dismissed from the legal action.

on file rather than having to look at extrinsic documents (such as a domestic relations order) to determine whether an ex-spouse waived benefits.

The courts have generally held that ERISA pre-emption of state laws is broad.[6] ERISA and the Code do not contain provisions dealing with the determination of beneficiaries with limited exceptions (*i.e*., the 1 year of marriage option and the mandatory spousal benefits).[7] Federal common law, at best, is vague on what happens in some of these contentious circumstances such as simultaneous death, beneficiaries who intentionally cause the death of a participant, or designations of an ex-spouse as beneficiary that is made prior to a divorce from the ex-spouse. This means plan administrators are responsible for making determinations and that always leaves room for disagreements and ensuing litigation.

Some practitioners take a strict constructionist approach based on the *Kennedy* decision. These practitioners follow the literal terms of the plan and any beneficiary designation. The participant is responsible for designating the beneficiaries he or she wants and the plan must follow any designation completed by the participant. Others will look at the circumstances and if there is any ambiguity, will try to come up with a result that conforms to the law and to the participant's likely intent. There is no way to be certain what the participant intended. Rather, plans assume there are certain individuals that the participant does *not* want to benefit (such as an ex-spouse).

The holding in the *Kennedy* case does not preclude the use of provisions to address the contingencies that typically result in disputes among potential beneficiaries. Many plans include a provision whereby a divorce revokes a designation in favor of the ex-spouse unless the designation is reaffirmed (*e.g.*, by completing a new designation form). There is considerable debate among practitioners on whether to include this provision in their plans. Some practitioners believe it makes it more difficult for the plan (*e.g.,* the plan must determine whether there has even been a divorce). The concern is that this can result in the "no good deed goes unpunished" as it shifts the problem from the participant to the plan. Others believe plans should try to ensure that benefits are paid in accordance with the participant's intentions (or at least not paid to what may be an unintended beneficiary such as an ex-spouse). Many states believed this was appropriate, which is why they had enacted redesignation provisions.[8]

There does not appear to be any reason why plans cannot specifically address simultaneous death or intentional killings of a participant. While we are not aware of plans that include such provisions, that may change in light of some recent cases which highlight the fact that these events, albeit rare, can and do occur in qualified plans.[9]

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[6] *See generally,* Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 522-23 (1981); Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 98 (1983).

[7] *See generally*, I.R.C. §§ 401(a)(11), 417; ERISA § 205; Treas. Reg. §1.401(a)-20.

[8] The U.S. Supreme Court held that in Egelhoff v. Egelhoff that Washington's "redesignation statute" was pre-empted by ERISA. Egelhoff v. Egelhoff , 532 U.S. 141 (2001).

[9] *See, e.g.,* Atwater v. Nortel Networks, Inc., 388 F.Supp.2d 610 (M.D.N.C. 2005).

There is disagreement on whether sample forms would reduce the number of disputes that occur upon a participant's death. This is because providers already supply the plan sponsor with designation forms and that most of the disputes are specifically related to problems with the actual form. The proper completion of the forms and the failure of participants to update designations to reflect current intent are the bigger problems. Sample forms may help alleviate some issues by highlighting the problem areas and identifying issues to consider when developing forms for a specific plan, but again, the forms themselves are not the root of the problem.

Other common reasons for disputes to arise are on whether proper designations have been made. These encompass issues such as incomplete forms, ambiguous designations, and fraudulent practices such as forgery and undue influence.

Regarding incomplete forms, there is a split among the Circuit courts as to whether the doctrine of substantial compliance can be used. Under this doctrine, courts will recognize a designation that substantially complies with the plan requirements to effectuate a designation. Case law in this area varies and is based on the facts and circumstances. With respect to qualified plans, the courts apply a stricter standard when it involves spousal consent because of the statutory requirements regarding spousal waivers. When forms ask for extraneous information (*e.g.*, if you designate a person indicate his or her relationship to the participant) then it is open to interpretation as to whether the form should be recognized by the plan. Plan administrators can and should review designation forms to ensure they are complete prior to accepting a participant's designation.

Best Practices

Calling the matter "a cautionary tale for ERISA administrators," the 9th Circuit commented:

> "…plan administrators disserve both plan participants and beneficiaries when they accept a beneficiary designation that does not unambiguously identify the beneficiaries."[10]

I recently read an article regarding communication of employee benefits and how certain marketing tactics might be utilized in the employee benefits area. One must first determine what action or result we are striving for (*i.e.*, the goal). Once that has been determined, there is a three step process (1) education, (2) removal of barriers, and (3) motivating individuals to take action.

For example, one can look at 401(k) plans to see how this approach can be applied. Individuals generally know they need to contribute more to their 401(k) plans so the industry has done a fairly effective job of educating participants. Despite this, we know many individuals do not contribute enough to their plans – they either have barriers (too many forms to read or not enough money) or they aren't motivated. Automatic

[10] Metro. Life Ins. Co. v. Parker, 2006 U.S. App. LEXIS 2561 (9th Cir.2006).

enrollment is a way to remove barriers and matching contributions is a way to motivate individuals. Similarly, we have qualified default investment alternatives because we aren't able to educate, remove barriers and/or motivate individuals to direct the investment of their accounts.

It we try this analysis with beneficiary designations, will we have the same problems? How do we educate participants on estate planning concerns (we know most do not need sophisticated estate plans)? How do we remove barriers to make it easy for participants to determine who the current beneficiary is and to change their designation? How do we motivate participants to change designations when an early death seems to be a remote possibility?

Similarly, what actions do we expect from plan administrators? We want them to (1) provide plan information regarding death benefits, (2) make designation forms readily available and easy to understand, (3) remind participants to review and update designations as necessary, and (4) review designations upon receipt to ensure they are complete and unambiguous.

It's difficult to imagine a system that will achieve all these desired results and eliminate all disputes over death benefits. Nevertheless, improvements can be made. Plan administrators could put into place best practices and make more effective use of technological solutions.

Forms

With respect to forms, there are numerous factors to consider. At a minimum, forms must conform to the statutory requirements for spousal consent to an alternate beneficiary: (1) it must be written, (2) the consent to a different beneficiary must be general or specific, (3) there must be an explanation of the effect of the election, and (4) the spouse's consent must be witnessed by a notary or plan representative.

There are best practices that plan administrators can use to address the spousal consent requirements. Many plans do not permit a spouse to consent to a general designation (*i.e*., "I, the spouse, consent to any beneficiary the participant wants"). The problem with general consent is that it requires the plan to retain the spouse's consent indefinitely.

Many plans also provide that a spouse's consent is irrevocable. This avoids situations where a spouse has consented to a beneficiary designation and then changes his or her mind. If coupled with a specific designation, spousal consent would only be needed again if there is a change to a new beneficiary.

Many plans also only permit a spouse's signature to be witnessed by a notary (and not a plan representative). The reasoning is that a notary provides a level of independence to the process. This may help reduce the number of claims involving fraud or collusion.

There are a number of optional provisions that must be considered for inclusion in the designation forms.

Plans should also ensure that there are enough details on beneficiaries and contingent beneficiaries so they can be easily identified and located. For example, asking for the relationship of the participant and beneficiary, the beneficiary's social security number, or the beneficiary's current contact information.

Plans should also decide whether to use provisions addressing the contingencies referred to above (*e.g.*, divorce revoking a designation in favor of an ex-spouse).

It is also recommended that plans specify whether a designation is only valid upon the plan administrator's "receipt" of the designation or upon "acceptance" of the designation.

Plan Administrator Practices

Plan administrators must have processes in place to handle beneficiary designations. These include processes for the distribution, receipt and retention of designations.

Beneficiary designation forms are provided at the time a participant first becomes eligible to participate in the plan. Plan administrators might consider whether it would be prudent to explain to participants the plan's default beneficiary provisions and suggest that if those default provisions satisfy their needs, that they not complete a designation form (other than perhaps to provide information on the beneficiaries so they can be located). Most beneficiaries may be satisfied with the plan's default beneficiaries and this would reduce the number of designations that the plan must handle and would eliminate the need of participants to immediately change designations when there has been a change in their family status.

Best practices for handling forms would include a review of the forms to make sure they are complete and consistent with the above requirements. If a plan administrator receives a designation form that is not complete or accurate, then there should be a consistent practice of rejecting the designation until it is complete and unambiguous. This includes the completion of all optional information that is requested on the form (*e.g.*, address, dates of birth, etc.). This makes it critical that the form being used by the plan administrator be consistent with the practices being used to review such forms upon receipt.

Plan administrators also must ensure plan provisions conform to the practices being followed. Optional plan provisions that must be considered when drafting a plan include:

- Whether the plan includes the 1-year marriage provision (*i.e.*, a participant is not deemed to be married for plan purposes until he or she has been married for one year). This option provides participants with time to review and change designations based on a recent marriage. If the provision is included in the plan, then plan administrators must be prepared to determine, at a participant's date of death, when the participant was married.

- The plan's default provisions that apply when a participant dies with no designated beneficiary are particularly important. For example, many plans provide that if there is no designated beneficiary, then the death benefit is paid the participant's spouse *(i.e.*, for any amounts in excess of the spousal minimum benefits), children, the parents, and then the estate.

Plan administrators must also have a system in place to store designations in a manner where they can be located easily in case of death or upon a participant's request. Some providers already offer this as a service to employers and others large providers are considering the addition of such services. Caution must be exercised in providing participants with anything other than a copy of the original designation. This is because attempting to summarize the designation may result in misleading information. For example, if a plan reports that Jane Doe is the beneficiary on file, then there's a possibility that information might not be completely accurate (such as if the participant got married or divorced).

It would be best practice if plan sponsors were to periodically remind participants to review their beneficiary designations (regardless of whether the designations were specifically made or were effectively made by use of plan default provisions). There does not appear to be any consistent method on how and when to provide such reminders. Some providers remind the plan sponsor to do this on annual basis, others try to educate small plan sponsors to be cognizant of a change in family status, and other providers include reminders on periodic participant communications (such as benefit statements).

Technology Solutions

There may be technology solutions that can be deployed to 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 would make it easy to retain and reproduce (even on demand) designations. In addition, current E-Signature technology might help reduce claims of forgery.

Unfortunately, current statutory and regulatory requirements for qualified plans make it effectively impossible to have a totally paperless process. This is because of the minimum spousal death benefit requirements. If a participant wants to name a beneficiary other than his or her spouse, then the spouse must consent and the signature of the spouse must be witnessed by a notary or plan representative. The spouse's signature can be an electronic signature in accordance with E-SIGN or state law. The regulations permit a notary or plan representative to electronically acknowledge that he or she witnessed the spouse's signature, but this is tough to implement.[11] For example, the notary or plan representative could use a signature

[11] *See*, Treas.Reg. § 1.401(a)-21(d)(6).

capture pad so the signature can be witnessed. We are not aware of anyone using this approach with respect to spousal waivers because of this cumbersome process. Thus, designations on paper will still be the preferred method for most qualified plans.

This does not mean technological solutions should not be implemented, even if it is simply for the storage of the designations. But, it does mean that until there is a more practical method of obtaining spousal consent, plan administrators must be able to accommodate designations on paper.

Summary

Implementing best practices with respect to beneficiary designations is an ounce of prevention that will benefit plan sponsors, participants and beneficiaries. There is no best solution for all plan administrators as the best practices will vary based on the size of the plan sponsor, the service providers, and even employee demographics. It requires a coordinated effort among all affected parties. Participants have ultimate responsibility to ensure designations are in effect that meet their desires. Whatever processes and tools are implemented must enable and motivate participants to take on this responsibility.