

PUBLISHED WHITE PAPERS

Employee Retirement Plans: Avoiding Problems With Beneficiary Designations

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About The Author:

Strauss Troy Attorney Claudia Allen advises employers of all sizes on employee benefits and employment law.

Four brothers, all serving in the military, received the sad news that their father had passed away. Unfortunately, in my role as an attorney, I had to give them more bad news regarding the payout of their dad's benefits.

Five days after marrying his second wife, their dad died while on his honeymoon. Wife #2 had agreed that the sons should have their father's 401(k) retirement plan. Right before the wedding, their dad had asked his employer for the paperwork to make sure it happened, but the packet arrived when he was away. Dad never made it home.

All qualified retirement plans — whether they are profit sharing, 401(k), 403(b) or defined benefit pension plans — provide for some type of spousal benefit. In some plans, the spouse has the right to 50 percent of the annuity payments after the death. In 401(k) plans, it's typically the right to the entire account. Unless this right is waived, the trustees of the plan have no choice but to pay the account to the spouse according to the terms of the plan.

Unfortunately for the four brothers, you can probably guess that wife #2 changed her mind and kept the money.

Could dad have done anything else to prevent this situation for his sons?

- A pre-nuptial agreement wouldn't have worked since wife #2 wasn't a spouse before the wedding. Courts confronting this situation have uniformly enforced the terms of the plan.
- If dad had asked for the paperwork in advance, he could have had wife #2 sign the waiver after the ceremony and before leaving on the honeymoon. One additional challenge — her signature would have to have been notarized or the documents signed in front of the plan administrator to be valid. Not a likely scenario.

Employers Can Help. Here's How:

A provision could have been added to the plan defining a "spouse" as one legally married at least one year before the death of the participant. (This definition is in military pensions and is the reason one of the sons thought he might have a chance to recover the money.) It wasn't in dad's plan.

I've often seen another provision in plans where the employer's goal is to protect participants from unintended outcomes. For example: upon divorce, the plan automatically invalidates the named spouse as beneficiary. Then, if the participant intends for a former spouse to receive the benefits, a subsequent beneficiary designation would have to be filed.

If you're an employer, find out what your plan says about paying out benefits and then review your files to make sure you comply. But that also would presume that you have all the information needed to make the most accurate decision for your employees. Many times you don't. For example, what if nobody knew dad remarried?

Another question to consider is what if a purported marriage was not valid or not recognized?

The recent Supreme Court decision in *United States v. Windsor* invalidated the federal law defining marriage as between a man and a woman. Same sex marriages are now recognized for purposes of federal law, and federal law (ERISA) governs qualified retirement plan benefits. While only 18 states currently allow same sex couples to marry, the other states don't have to recognize the marriage, and some do not.

The Internal Revenue Service (IRS) and the U.S. Department of Labor (DOL) recently issued a technical release stating that, for ERISA purposes, employers are required to recognize marriages that are valid in the state where the marriage was celebrated. If the employer offers other benefits, such as health coverage to spouses, the fact that an employee was legally married to a same-sex spouse in another state might be known when the employee applies for family coverage. But if the new spouse was already covered under another employer's health plan, it's unlikely that the participant's employer would be told of the marriage.

What happens if the plan's trust pays the benefit to the wrong beneficiary? It's not good news: the trustee (often a small business owner) would be liable to pay the right one anyway.

The trustee would have to try to recover, but it's often impossible. If the employer knows of the dilemma in advance of paying out the benefits, the best course of action is to deposit the money with the court and file a proceeding to decide the right beneficiary. Of course, there's a cost to this.

Send An Annual Notice To Your Employees

I recommend employers annually send a notice to all employees reminding them that these rules are in place. At the same time, the employer can ask for an update on the employee's marital status, dependents, current address and contact information and maybe even send out a copy of the employee's current beneficiary designations asking for confirmation. Also, if an employer becomes aware of something that might change the outcome of a beneficiary designation, such as a divorce or marriage, the employer can take action to ensure that the form on file reflects what the employee really wants to happen in regard to his or her benefits. 

If you have questions about your employee retirement plans, please contact Claudia Allen at cgallen@strausstroy.com or 513-629-9462.