To: 2012 ERISA Advisory Council

From: Steven B. Gorin

Date: August 29, 2012

Re: Current Challenges and Best Practices Concerning Beneficiary Designations in Retirement and Life insurance Plans

My Background

I am a partner in Thompson Coburn LLP, a large law firm. My practice focuses on trust and estate planning and administration, business succession planning, and tax planning. I serve on the Employee Benefits in Estate Planning Committee of the American College of Trust & Estate Counsel. I am also on the governing Council of the American Bar Association's Real Property, Trust & Estate Law Section. I served as ABA Advisor to the Uniform Law Commission regarding 2008 changes to the Uniform Principal & Income Act to help facilitate securing the marital deduction for retirement plan assets payable to marital trusts.

My comments are based on years of experience and recent and past discussions with other trust and estate lawyers regarding qualified retirement plans and IRAs as a key part of individuals' estate plans. My remarks do not represent the position of my law firm or any professional organization in which I am involved. Although my testimony comments on administrative burdens to plans, I am assuming that you are relying on those representing plans to push back on those issues as appropriate; for example, my partners who represent employee benefit plans might very well recommend less of a burden than might be suggested for consideration here (such as not imposing a mandatory annual beneficiary designation notification requirement).

Responses to the Stated Objective and Scope

A. The scope of preemption of state laws that impact beneficiary designations and powers of attorneys. The subjects of these state laws include, but are not limited to, revocation upon divorce, community property laws, slayer statutes, survivorship determination in cases of simultaneous death, and the doctrine of substantial compliance.

The Uniform Power of Attorney Act (www.uniformlaws.org/Act.aspx?title=Power of Attorney) is a model that the Uniform Law Commission has suggested that states adopt. Its predecessor is the Uniform Durable Power of Attorney Act (www.uniformlaws.org/Act.aspx?title=Durable Power of Attorney). These model laws include a variety of alternative statutory language, reflecting that states are free to choose their own policies.

Durable powers of attorney are very important parts of estate plans, whether simple or complex. They allow individuals to designate agents to implement their wishes, while they themselves are not in a position to do so (by reason of absence or inability). If an incapacitated individual does not use a durable power of attorney, or if a plan refuses to accept it, then decisions on behalf of that individual are made by a court-appointed and supervised conservator. Courts supervise conservators strictly, imposing costly accounting and bond requirements, with the goal of protecting an incapacitated person's assets. Appointing a conservator is a very invasive procedure, in that the court needs proof that the individual is incapable of making decisions, which can be a humiliating process. The result is that the individual is stripped of his or her legal authority to make decisions, a fundamental loss that lawyers are discouraged from effectuating absent a compelling situation. Using a durable power of attorney helps a person retain his or her dignity, in that the agent can act on his or her behalf without a costly and invasive court proceeding.

We should promote acceptance of durable powers of attorney. Beyond helping the participant preserve his or her dignity, accepting such documents avoids court delays. Furthermore, courts tend to require conservators to invest in a manner designed to conserve the nominal principal that is invested, without considering that, over the long run, inflation will erode an investment portfolio's purchasing power.

A person's capacity has always been a state law determination. ERISA preemption of state law in this area would leave a void that would increase costs by relying on slow, costly court action.

Regarding revocation upon divorce, community property laws, slayer statutes, survivorship determination in cases of simultaneous death, and the doctrine of substantial compliance: testimony presented to the Council for its June 14, 2012 hearing included suggestions about ways to reduce the frequency of disputes and promote fair results. In promoting fair results, judges have developed a federal common law, creating uncertainty and potential uneven application of certain doctrines.

Revocation of a beneficiary upon divorce would tend to reflect most participants' intent. The issue that would then arise is how to avoid revocation upon divorce when a participant does not want to revoke the beneficiary designation. A new beneficiary designation signed after the divorce becomes final should not be invalidated because of the divorce. A qualified domestic relations order would certainly govern.

Slayer statutes, which prevent a person who commits a homicide from receiving benefits, seem to be a matter of fairness, subject to appropriate procedures to protect plans that make payments without knowledge of homicide.

Many estate planning lawyers who do not regularly deal with community property laws do not have sufficient knowledge of community property laws, so those of us in that situation sympathize with plan administrators' concerns. Among states that have adopted community property, approaches towards the character of income from separate property vary. Furthermore, participants might move from a common law state to a community property state, or vice versa, making plan assets community property only in part. I am unaware of a proposed resolution to issues involving community property in qualified plans.

Survivorship determination in cases of simultaneous death is generally clear under state statutes.

Also, please note that many states have anti-lapse statutes, providing benefits for descendants who are inadvertently omitted.

State law reformations of trusts are generally allowed, when there is an error, but reforming an erroneous beneficiary designation might be another matter.

All of these are important state law issues that have or might be litigated at some point. Sometimes judges who are sympathetic to a party will make a decision under federal common law. Avoiding litigation will help ease the burden on plan administrators. Perhaps an approach along these lines might be helpful:

1. In many cases, these issues could be successfully addressed by plans clearly setting forth what happens in various situations, whether a participant can override the result, and the requirements for a participant to override the result, if permitted.

2. The Department of Labor might consider adopting uniform rules that will apply in absence of a plan clearly setting forth the rules, which rules would preempt state law and codify any current federal common law.

The question of substantial compliance raises the question of procedures for acknowledging that a beneficiary designation complies with a plan's requirements. From the perspective of a trust & estate lawyer, I would like to see plans required to acknowledge in writing receipt of a beneficiary designation, together with a copy of the beneficiary designation form attached. If the plan wants to reject a beneficiary designation form's validity, I would like to see a rejection notice be required, along with information about who to contact as to what is necessary to make the form acceptable. If a beneficiary designation is accepted as a clerical matter but later turns out to have been ambiguous, comments below about dispute resolution would kick in.

One lawyer informed me that she submitted identical beneficiary designation forms for plans sponsored by the same employer. The third party administrator had different departments processing 401(a) plans and 403(b) plans. One department accepted the beneficiary designation, and the other did not.

The complexity of the required minimum distribution (RMD) rules encourages trust and estate lawyers to use complex beneficiary designations. My usual practice is to write "see attached" in the beneficiary designation form and incorporate by reference an attachment, signed by the participant, to enable each beneficiary's interest to be paid over that beneficiary's life expectancy. Common concerns that push trust and estate lawyers to do this include:

- Although revocable trusts are common estate planning vehicles, making them beneficiaries can lead to sub-optimal – even disastrous – results. For example:
    - Suppose a participant has two children, A and B. B predeceases the participant but is survived by children. B's children need trusts to protect them until they reach the age of maturity, so referring to trusts created for them under the participant's revocable trust is natural. If the revocable trust is the beneficiary, then generally B's children will be forced to use the life expectancy of A, their aunt or uncle, rather than their own. If I use a customized attachment, allocating the account per stirpes and saying that a trust created for each beneficiary under

the revocable trust agreement will receive the plan benefits on the beneficiary's behalf, then each child of B can use his or her own life expectancy.

  - A charity being a beneficiary of a revocable trust can preclude the use of all other beneficiaries' life expectancies. The RMD rules deem entities not to have ascertainable life expectancies. Trusts must use the least favorable life expectancy of any beneficiary that must be counted. Counting the charity as a beneficiary would mean that no beneficiary's life expectancy can be used if the revocable trust is the beneficiary. A customized attachment, however, can solve this problem. (There are ways to try to fix this problem, but we would rather avoid the problem.)

- Spousal disclaimer planning is common. For income tax purposes, the spouse is often the best beneficiary, because the spouse can roll over benefits and use the longer uniform life expectancy tables. However, such a plan might result in not using the decedent's estate tax exemption. It is not unusual to provide that, if a spouse disclaims, benefits are payable to the credit shelter trust, but, if a spouse predeceases the participant, then benefits go to trusts for children. Beneficiary designation forms generally do not provide for disclaimers resulting in beneficiaries that differ from what would have happened if the disclaimant had actually died.

Whereas estate planning lawyers would prefer complex beneficiary designations because of the complexity of the regulations governing required minimum distributions, plan administrators would prefer to keep beneficiary designations simple to make them easy to administer. Also, estate planning attorneys are often very frustrated when dealing with IRA custodians over this issue. Perhaps this tension might be resolved if regulations preempting state law would authorize plans and IRAs to rely on the executors of the participant's/owner's estate. See item D. below.

B. <u>The interrelationship of spousal consent and beneficiary designations, including lost or missing spouses, impact of qualified domestic relations orders on spouse's rights, and impact of prenuptial agreements.</u>

I am unaware of the frequency of lost or missing spouses.

Qualified domestic relations orders are an extra hurdle, but the requirement does not appear unreasonable or unworkable. Getting divorce lawyers and judges to ensure appropriate orders are issued seems to require ongoing education.

As far as prenuptial agreements are concerned, I am unsure why a spouse-to-be cannot sign appropriate consents before the wedding. Ideally, the spouses should sign consents immediately after saying "I do." As a practical matter, it is not unusual to hear of a couple neglecting to follow through with spousal consents after returning from the honeymoon. Those aware of this issue will include an irrevocable durable power of attorney authorizing consents to be signed on behalf of the spouse who has agreed to waive.

C. <u>The responsibility, if any, of plans and service providers to notify participants of the ability or necessity to update beneficiary designations due to life changes, a change in service provider for the plan, or regulatory changes.</u>

Testimony presented to the Council for its June 14, 2012 hearing suggested annual notification of participants of their beneficiary designations. Estate planning lawyers would be delighted to have plans inform participants periodically that a review is in order. We would find it especially helpful to include suggesting that participants review their beneficiary designations when life changes occur. With electronic storage of records, consider whether a copy might be practical to provide with this reminder. As the testimony indicated, it would be helpful to confirm whether electronic records are sufficient to maintain records of beneficiary designations, except where notarization is required (for example, spousal consent of a beneficiary designation other than the spouse).

It is not uncommon for changes in service providers to result in lost beneficiary designation forms, particularly when one service provider merges into another. Notification of a change in service provider, together with a copy of the beneficiary designation on file or notification that no beneficiary designation form can be located, would help avoid problems that occur when the participant dies.

Whether notification of regulatory changes would be helpful is unclear. Our tax laws change frequently. Notification of changes governing the rules governing distributions might be helpful, whereas changes in the law regarding beneficiary designations might be extremely important to communicate. Although changes in rules governing contributions would be relevant as to how much might eventually be accumulated, the connection between that and beneficiary designations is less clear, as participants should already be regularly reviewing how their assets are accumulating.

D. <u>A review of current plan and service provider practices to deal with issues surrounding beneficiary designations including types of plan provisions, techniques for locating beneficiaries, how plans find and locate the designations, procedures for updating beneficiary designations and differences, if any, depending upon the type of plan; and types of notification(s), if any, to participants.</u>

The other testimony suggested use of the government's service of forwarding information to a person using that person's social security number. This is a good reason to require beneficiaries' social security numbers.

If a beneficiary cannot be located, consider authorizing the plan to contact the executor (as defined in Internal Revenue Code section 2203) of the participant's estate. The executor typically would be the person appointed by a probate court to handle the participant's estate. If no such person is appointed but the participant's will names a revocable trust to receive the residue of the participant's estate, the trustee of that revocable trust generally would be the executor.

In fact, both plans and executors could benefit from increased contact. Please consider:

- Authorizing plan administrators (and IRA custodians) to rely on information about beneficiaries provided by the executor, including interpretations of complex beneficiary designations. Perhaps plans or regulations could provide for reliance on an affidavit signed by the executor.

- Requiring plans to respond to the executor's requests for information about the plan, including the date-of-death account balance (or present value equivalent if a defined benefit plan) and identity of the beneficiaries. This information is necessary to prepare any estate tax returns and determine any generation-skipping transfer (GST) tax liability, as well as the availability of various exemptions. If portability of estate tax exemption becomes permanent, the estate of any married decedent should consider filing an estate tax return, even if significantly below the estate tax exemption. Furthermore, benefits paid to skip persons (generally, grandchildren or remote descendants) affect the use of GST exemption.

E. Methods for resolving disputes over beneficiary designations, including consideration of current practices in utilizing a plan's claims review procedure.

Missouri has a thorough statute, its Nonprobate Transfers Law, covering these procedures, found at http://www.moga.mo.gov/statutes/chapters/chap461.htm and reproduced in a separate document. I advise a very large qualified retirement plan about handling uncertainty in making payments, and we have found that the Nonprobate Transfers Law is quite workable. See also the Uniform Nonprobate Transfers on Death Act, found at www.uniformlaws.org/Act.aspx?title=Nonprobate Transfers on Death Act.

Some state court procedures require delivering the disputed property to the court. If a plan were to deliver plan assets to a court, what is the tax consequence, and who pays the tax? Here is another area where ERISA preemption might help. It would be great if any payment to a court in an action to determine the beneficiaries were deemed to be a payment to an agent of the plan – in other words, the plan would be deemed to have retained the assets. It's possible that a penalty for failure to make required minimum distributions might result, but that could be addressed either by interim distributions or obtaining a waiver for reasonable cause.