

**THE IMPACT OF DIVORCE ON  
BENEFICIARY DESIGNATIONS IN ERISA RETIREMENT PLANS:**

**DISCUSSION OF SELECTED PROBLEMS  
COMMENTS ON VARIOUS PROPOSED SOLUTIONS  
OUTLINE OF ALTERNATIVE PROPOSAL**

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Beneficiary Designations in Retirement and Life Insurance Plans**

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I would like to thank the ERISA Advisory Council for inviting me to provide testimony today. My name is Elizabeth Wells and I am the principal of the Law Office of Elizabeth M. Wells in Chicago, Illinois. Since 1997 I have limited my full-time legal practice to addressing issues that arise with retirement benefits in divorce. My practice does not involve general retirement benefits work (e.g., ERISA compliance); my practice does not involve general divorce work (e.g., child custody). My practice is limited to cases only where these two areas are combined. In addition to working with divorce attorneys and divorcing parties, I have written articles in legal journals, taught segments in numerous legal education programs relating to this topic, and been involved in various related activities. For example, starting in 2004 I embarked on a mission to improve the efficiency of addressing Illinois state and local retirement benefits in divorce situations. Working with legal and administrative staffs of these local retirement systems, I developed a proposal for changes to the then existing system. In 2006 relevant Illinois laws were changed to reflect this proposal. I have attached my Summary Curriculum Vitae to this testimony.

## **I. SCOPE**

In my testimony, I have chosen to comment only on ERISA retirement plans that by law accept Qualified Domestic Relations Orders (“QDROs”) from state domestic relations courts. There are many retirement plans that accept NO Orders allocating retirement benefits from state domestic relations courts (e.g., various supplemental and other plans offered to executives in the private sector that provide federal income tax deferments and reductions for plan participants and/or sponsors). There are many retirement plans that accept other types of Court Orders from state domestic relations courts (e.g., the Federal Employment Retirement System (FERS) accepts “Court Orders Acceptable for Processing”). This is not to say that problems and inefficiencies do not result in divorce situations that involve retirement plans that do not accept QDROs. On the contrary, in divorce cases where private sector executive plans that do not accept QDROs are involved, the problems that arise in addressing their division are often insurmountable. Because the Advisory Council’s time is limited, however, I will limit my comments to beneficiary designations in ERISA retirement plans that by law accept

QDROs.

## **II. PROBLEMS AND COMMENTS ON SOME PROPOSED SOLUTIONS**

In my testimony I have chosen to focus on the problems that involve Defined Contribution plan (DC plan) benefits. Further, I have chosen to address only those problems that are relatively common in divorce situations where DC plan retirement benefits are involved. Although, I have seen issues arise on occasion that I have not addressed in this testimony, in the interest of the Advisory Council's limited time, I have chosen to focus on those problems that in my experience are the most common problems.

My choosing to omit a detailed discussion regarding Defined Benefit plans (DB plans) beneficiary designation problems, is *not* based upon any belief that the problems with DB plans are less severe than the problems with DC plans. In fact, in my experience the problems with DB plan designations can lead to the most devastating consequences for non-participant former spouses. Problems with DB designations can become so complex, however, that the time required to address them in detail can easily become extensive. I will make some general comments regarding the problems with DB plan beneficiary designation provisions.

For the sake of simplicity, in the scenarios outlined below I have assumed that the Husband is the participant in the retirement plan(s), and that the state domestic relations court will determine if the Wife is entitled to all or a portion of the Husband's benefit. There are, of course, many cases where the Wife is the plan participant and the Husband is not, and many cases where the Husband and Wife are both participants in one or more retirement plans.

### **A. Defined Contribution Plans**

In discussing Defined Contribution plans (DC plans), I have limited my comments to those plans where benefits are accrued via contributions made by the participant, the employer (e.g., profit sharing plans) or both (e.g., 401(k)s with employer match provisions), and where the default form of benefit is a lump sum payable upon retirement. I have also limited my comments to those DC plans that have chosen to opt

out of the Joint and Survivor Annuity requirements of Section 401(a) of the Internal Revenue Code (IRC §401(a)(11)(B)); in other words those DC plans where the plan provisions indicate that the participant's spouse is entitled to full vested account balance upon participant's death (except if there is a valid spousal waiver) and where the plan does not offer a life annuity or the participant does not elect to receive benefits in the form of a life annuity.

In divorce situations that involve DC plans, the most common problems occur where a Husband and Wife are married, the Wife has not waived her right as beneficiary, the parties divorce, and then the participant dies.

### **1. State Court Order: Wife to receive all or a portion of benefit**

#### **The situation:**

The most common problem that arises in this situation is when the state divorce order indicates that the Wife is to receive some benefit from the DC plan. Assuming the Wife has not yet received a benefit via a QDRO processed by the Plan prior to the Husband's death, the analysis of whether or not the Wife will receive a benefit in this situation will depend upon several factors.

- Was a Domestic Relations Order ("DRO") qualified prior to the Participant's death? If so, does that Order secure the Wife's benefit if the Husband dies prior to the Wife receiving her distribution? If a DRO has been qualified and the DRO properly secures the Wife's benefit in the case of the Husband's predecease, then the Wife should be paid the benefit as directed in the Qualified DRO.
- If a Qualified DRO does not properly secure the Wife's benefit in the case of the Husband's pre-decease, arguably the Wife will receive no benefit. If, however, the Wife was Husband's designated beneficiary on the date of Husband's death, then she may be entitled to receive less, as much or more than the amount awarded to her by the domestic relations court.
- If no DRO has been qualified prior to the Husband's death, whether the Wife receives a benefit and the amount of that benefit will depend upon certain facts and how the Plan Administrator interprets 2010 DOL

guidance regarding such situations. If, however, the Wife was Husband's designated beneficiary on the date of Husband's death, then she may be entitled to receive less, as much or more than the amount awarded to her by the domestic relations court.

**The problem:**

The state court has ordered (very possibly with the agreement of the parties) that Wife is to receive a part of Husband's DC Plan benefits. Because Wife did not "do the paperwork" required to effect the state court order (obtaining Plan Administrator approval (i.e., qualification) of a DRO) before Husband died, the state court order (and very possibly the parties' agreement) will be frustrated. If the Wife was not the Husband's designated beneficiary when the Husband died, the Wife will receive less (possibly hundreds of thousands of dollars less) than Wife should receive. If the Wife was the Husband's designated beneficiary when the Husband dies, the Wife may receive the amount the state court said she should receive, a greater amount or a lesser amount (depending on the details of the beneficiary designation).

**Possible solution A1a:** Current situation. The Wife should ensure that the divorce is not finalized until the domestic relations court enters a DRO which has been preliminarily approved by the Plan Administrator. This solution is not ideal because parties rarely know that QDROs are required to secure their benefits. Particularly in the current difficult economic climate, many non-participants divorce without retaining attorneys (pro-se). Even if the non-participant is represented by an attorney, standard operating procedure is to wait to have any detailed discussion of retirement benefits and QDROs until after a divorce is finalized! This procedure survives because many attorneys who practice divorce (even reputable attorneys) know nothing (or next to nothing) about ERISA, about survivor benefits, or about the potential consequences of failing to understand ERISA's survivor benefits before allowing a divorce to be finalized.

**Possible solution A1b:** Once the parties are divorced, if the divorce decree indicates that the Wife is to receive a portion of the Husband's benefit, in addition to Wife securing a QDRO (if not begun until after the divorce is finalized the QDRO process may take many months), the Husband should change his beneficiary designation to reflect the Wife's proper share. The most obvious problem with this possible solution is that the Husband participant may change his beneficiary designation in a way that does not reflect the state court orders. For example, if the state court order indicates that the Wife is to receive 50% of the Husband's DC plan, the Husband may change his beneficiary designation so that the Wife will receive no benefit upon his death. Although a proper Qualified (Plan approved) DRO assigning Wife a benefit will override such an erroneous designation, if the DRO has not been approved prior to the Husband's death, the Plan Administrator may determine that the DRO cannot be approved, and the Wife may receive no benefit.

**Possible solution A1c:** ERISA could be changed to allow state court orders regarding traditional DC Plan allocations that are not QDROs (for example, divorce Judgments) to override ERISA preemption. This possible solution would present many problems from a Plan Administrator's perspective. From a more general ERISA perspective, this possible solution could also present additional problems in that it could begin an erosion of the ERISA pre-emption of state law.

## **2. State Court Order: Wife is to receive no benefit.**

### **The situation:**

A far less common problem that may arise in situations where a Husband and Wife are married, the Wife has not waived her right as beneficiary, the parties divorce, and then the participant dies is when the state divorce decree indicates that the Wife is not entitled to any benefit from the DC plan. This situation occurred in the United States Supreme Court's Kennedy case (Kennedy v. DuPont, 129 S. Ct. 865, 2009 U.S. LEXIS 869 [U.S. 2009]). In this situation, whether or not the Wife will receive the survivor benefit will depend upon

beneficiary designation in effect at the time the participant dies, and upon how the specific plan handles beneficiary designations. In Kennedy, because the Husband did not change his beneficiary designation after his divorce, and because the Plan's provisions did not automatically remove the Wife as beneficiary upon the parties' divorce, the Wife was the beneficiary of the Plan's benefit on the date the Husband died. Thus, despite a state court order (divorce decree) that indicated the Wife should receive no benefit from the Plan, the Supreme Court determined that the Wife (as beneficiary) was entitled to the survivor benefit.

**The problem:**

The state court has ordered (very possibly with the agreement of the parties) that Wife is to receive no part of Husband's DC Plan benefits. Because Husband did not "do the paperwork" required to effect the state court order (changing his beneficiary designation), the state court order (and very possibly the parties' agreement) will be frustrated. Wife will receive more (possibly hundreds of thousands of dollars more) than Wife should receive.

**Possible solution A2a:** In light of the Kennedy decision, arguably most direct method of avoiding this particular problem under current law is to be certain that a participant, once he or she is divorced, changes beneficiary designations pursuant to the provisions of his or her divorce decree. The most obvious problem with this possible solution is that participants may not know that these designations should be changed. Even if a participant's divorce attorney has informed the participant that a beneficiary designation should be changed, the participant may neglect to actually complete the required paperwork. Particularly in the current difficult economic climate, many participants divorce without retaining attorneys (pro-se). Even if the participant is represented by counsel, many attorneys (even reputable attorneys) know nothing (or next to nothing) about ERISA, about beneficiary designations, and about the potential consequences of failing to follow through on beneficiary designations after a divorce is finalized.

**Possible solution A2b:** Plan sponsors could draft plan documents that automatically remove the participant's spouse (former spouse) as beneficiary upon a participant's divorce. This possible solution may present many problems (expense, practicalities, legalities) from a plan sponsor's perspective.

**Possible solution A2c:** ERISA could be changed to allow state statutes regarding automatic changes in beneficiary designations to override ERISA preemption. This possible solution may present many problems from a Plan Administrator's perspective. For example, what state law would apply (the state in which the employer has its main office, the state in which the participant is employed, the state in which the participant was divorced)? If the state law that applied was the state in which the employer had its main office, could valid notice arguments be raised by non-participant former spouse's who did not reside in said state? If the state law that applied was in a state other than the employer's main office, what if the participant resided in one state and his former spouse resided in another? If the state law that applied varied from one participant to another, what would be the cost of the Plan's remaining up to date on all relevant state laws? Could participants raise other issues if one participant was treated differently from another regarding beneficiary designations? From a more general ERISA perspective, this possible solution could also present additional problems in that it could begin an erosion of the ERISA pre-emption of state law.

## **B. Defined Benefit Plans**

In discussing DB plans, I have limited my comments to traditional DB plans; plans in which the participant makes no contributions, where the plan is funded by the employer, where the participant has no account or balance (or hypothetical balance) in his or her name, where benefits accrue generally based on salary, years of service and age, where the default form of benefit for a single participant is a single life annuity

(SLA), and where the default form of benefit for a married participant is a qualified joint and survivor annuity (QJSA).

In divorce situations that involve DB plans the most common problems with beneficiary designations occur where a Husband and Wife are married, the Wife has not formally waived her right as a beneficiary, the parties divorce, and then the participant retires or dies.

### **1. State Court Order: Wife to receive all or a portion of benefit**

A common problem that arises in this situation occurs when the parties' state divorce order indicates that the Wife is to receive all or a portion of a DB plan but a DRO that provides the Wife with survivor benefits has not been qualified by the Plan prior to the Husband's retirement or death.

- Was the DRO qualified prior to the Husband's retirement? If so, Wife should receive whatever benefit is assigned to her in the DRO.
- Was the DRO qualified prior to the Husband's death? If so, did the DRO provide Wife with a "separate benefit" or a "shared benefit"? If a separate benefit, did the DRO name Wife as a survivor spouse if Husband died before her? If Wife is to receive a separate benefit and was not named as a surviving spouse, how does this specific plan address that situation? In some cases, the Plan may determine that Wife will receive no benefit.
- If no DRO was qualified prior to Husband's retirement, Wife may be able to obtain Plan Administrator approval on a DRO submitted after Husband's retirement. Whether the Wife receives a benefit after Husband's death (surviving spouse benefit) will depend upon various facts and how the Plan Administrator interprets 2010 DOL guidance regarding such situations.
- If no DRO was qualified prior to Husband's death, whether the Wife receives a benefit after Husband's death (surviving spouse benefit) will depend upon various facts and how the Plan Administrator interprets 2010 DOL guidance regarding such situations.

**The problem:**

The state court has ordered (very possibly with the agreement of the parties) that Wife is to receive a part of Husband's DB Plan benefits. Because Wife did not "do the paperwork" required to effect the state court order (obtaining Plan Administrator approval (i.e., qualification) of a DRO) before Husband died, the state court order (and very possibly the parties' agreement) will be frustrated.

## **2. State Court Order: Wife to receive no benefit**

Another problem that may arise in situations where a Husband and Wife are married, the Wife has not formally waived her right as a beneficiary, the Husband has retired, the parties divorce, and then the participant Husband dies, is when the parties' state divorce order indicates that the Wife is to receive no portion of a DB plan. Under current law this author knows of no mechanism whereby the Husband can assure that his former Wife will not receive the Joint and Survivor Annuity benefit payable upon his death.

### **The problem:**

The state court has ordered (very possibly with the agreement of the parties) that Wife is to receive no part of Husband's DB Plan benefits. Because there is no known mechanism for removing Wife as Husband's beneficiary, the state court order (and very possibly the parties' agreement) will be frustrated.

## **III. ALTERNATIVE SOLUTIONS**

Before considering potential solutions to problems with DC plan and DB plan beneficiary designations, I believe it is imperative to examine how those potential solutions will affect divorcing parties. To be effective, such an examination must recognize the realities of divorcing parties' situations.

One reality is that divorcing parties and their attorneys often have only a rudimentary knowledge of retirement plans (and often virtually no understanding of DB plans). Reputable attorneys who limit their practices to domestic relations work routinely fail to understand the basic differences between DC plans and DB plans, and the differences between qualified and non-qualified plans. Many attorneys who handle divorce "dabble" in such work and are less likely to possess even a basic understanding of retirement benefits. Due to recent economic downturns, the percentage of individuals

who are not represented by attorneys during their divorce process has been rapidly increasing.

Standard operating procedure in divorce situations is that the language in the documents regarding the parties' property division indicates that each party will receive "50% of the retirement benefits" without the parties or their attorneys knowing the plans that are involved, whether the plans are DC plans or DB plans, the value of the plans, whether survivor benefits are or can become payable, and even whether or not such plans can be divided via a QDRO (or other Court Order). Divorces involving retirement benefits are routinely finalized (judgments are entered) before any party or attorney has made any attempt to obtain plan information much less begin to draft a QDRO. Practices like these coupled with the present beneficiary designation and QDRO rules often result in state domestic relations court orders not being effected as intended. Because QDROs are not submitted in a timely manner, alternate payees often do not receive the benefits they were awarded by the domestic relations courts. Occasionally, because a participant does not timely change a beneficiary designation, an alternate payee receives more than he or she was awarded by a domestic relations court.

There is no easy and equitable solution to these problems in divorce situations. I believe the best solution would be a combination of state law with ERISA guidance based on the premise that the vast majority of divorcing parties and their attorneys have little or no knowledge of ERISA, survivor benefits or beneficiary designation issues.

As an example, it might be possible to enact a state that mandated in every divorce case where either of the parties had or may have accrued retirement benefits, the Court must provide the parties with a standardized Retirement Benefits Notice. Said Notice might address the following:

#### RETIREMENT BENEFITS NOTICE

1. Retirement benefits are property. Under \_\_\_\_\_ state law, retirement benefits may to be deemed to be marital property and as such may be divided between the parties in a divorce proceeding.
2. In order to ensure that you receive your fair share of the retirement benefits in your case, it is important to determine what retirement plans are involved in your case and what law regulates those plans.

3. If it is determined that you are to receive a share of your spouse's retirement benefits in this case, it is likely that you will **not** receive those benefits unless a special Court Order that addresses only the allocation of those benefits is prepared, entered and sent to the retirement plan.
4. If this special Court Order is not entered *at the same time* that your divorce Judgment is entered (when your divorce is finalized), the benefits assigned to you by this Court may be permanently reduced or eliminated.
5. If a retirement plan in your case is regulated by the federal law called ERISA, the plan may require a special Court Order called a Qualified Domestic Relations Order or QDRO.
6. If it is determined that your spouse is not to receive a share of your retirement benefits, in order for this provision to take effect, it may be necessary for you to complete a change of beneficiary designation with your retirement plan after your divorce is final.

Further, the state law could indicate that the Court would also distribute a form relevant to the applicable laws that regulate the retirement plans involved. For ERISA plans, it would be ideal to have guidance from DOL on a standardized form that would be accepted by all ERISA Plan Administrators. Such a form might look something like the following:

#### ERISA RETIREMENT BENEFITS INFORMATION FORM

To obtain information on the retirement plans in your case, complete the following information and forward it to the Plan Administrator in care of your (or your spouse's) employer:

1. Participant name:
2. Participant address:
3. Email address to send information on Participant's behalf:
4. Participant social security number:
5. Non-participant name;
6. Non-participant address:
7. Email address to send information on non-participant's behalf :
8. Non-participant's social security number;

9. Copy of relevant pages of a court document that evidence a pending domestic relations proceeding (e.g., Petition for Divorce, Petition for Dissolution, Petition for Legal Separation)
10. Name of known retirement plan(s)
11. Check this box if you want us to supply the names of and information for of any other retirement plans in which you (your spouse) participate
12. Check box if you want the following information for each of the Plans in which you (or your spouse) participate. We will forward these documents to you at no charge via email. If you wish to receive the documents via a method other than email, we will assess you a fee.
  - a. QDRO Procedures
  - b. Model QDRO if available
  - c. Summary Plan Description
  - d. Plan Document and Summaries of Material Modifications
  - e. Most recent Account Statement/Benefit Statement
  - f. Information on beneficiary designations (i.e., who is the beneficiary under current designation, what will happen with current designated beneficiary after divorce if no action taken)

My belief is that if the Department of Labor worked plan administrators and with ERISA savvy domestic relations attorneys to develop guidelines for forms similar to the above, all parties would benefit. Plan Administrators would benefit immediately because they would know what plan information would likely be requested and the form in which it would be requested and thus could more easily process information requests. Additionally, Plan Administrators would be likely to experience a reduction in complaints from divorcing parties and their attorneys regarding obtaining plan and related information. Domestic Relations attorneys would benefit because they would have an “easy” way to obtain plan information. And perhaps most importantly parties in divorce proceedings would benefit because they would gain a better understanding of the retirement benefits involved in their cases, and a better appreciation of the potential consequences if paperwork related to retirement benefits is not timely completed and processed.