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US DEPARTMENT OF LABOR ADVISORY COUNCIL

ON EMPLOYEE WELFARE AND PENSION BENEFIT PLANS

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

Good afternoon, I am Susan Diehl, President of PenServ Plan Services, Inc. ("PenServ").

PenServ is a full service retirement plan consulting and administration company with offices in PA, SC, and IN. PenServ provides a wide scope of services to over 1200 financial institutions, law firms and CPA firms with IRA, SEP, SIMPLE, qualified plans, HSAs, Coverdell ESAs, 125 plans, 457 and 403(b) plans. PenServ's Consulting Division in PA, in addition to serving as a source of technical compliance information, is heavily engaged in plan design, and is a provider of documents, administrative forms, technical training and technical information to its client base. Over 1000 financial advisors have access to PenServ's hotline for answers to their technical questions. Further, PenServ is a Mass Submitter of prototype/volume submitter plan documents with the IRS and is responsible to ensure that its clients have the most current information with respect to these plans and the administrative forms needed to comply with all areas of qualification, withholding and taxation. PenServ's Operational Center, located in Columbia, South Carolina provides third party administration (TPA) services for over 2000 employee benefit plans (servicing over 250,000 participants) ranging from the smallest plan (1 person) to large plans with thousands of participants. It is on behalf of all of PenServ's clients (including institutional, advisors and employers) that we are here today testifying with the following comments.

First we would like to commend the Advisory Council for identifying that challenges exist in the determination of beneficiaries as well as the many challenges faced by Employers and financial institutions and TPAs in assisting beneficiaries for the proper information resulting from the death of a plan participant. We appreciate the opportunity to comment on the issues listed below and to address the provisions that continue to complicate the administration and servicing of the affected retirement plans.

You have requested that we address the list of "Sample Witness Questions" received from the ERISA Advisory Council, which are outlined below as well as some additional issues that are also important with respect to issues that employers, financial organizations and TPAs face on a daily basis when confronted with beneficiary determination decisions, State law differences and calculating required minimum death distributions.

1. **Use of Beneficiary Designations:**

- What types of plans use beneficiary designations and what benefits under those plans are paid pursuant to beneficiary designations?
- What percentage of participants completes a beneficiary designation? Does it vary by type of plan?
- Do any plans require submission of a beneficiary designation as a condition for enrollment or receipt of benefits?
- Do any plans share beneficiary designations for convenience or to ensure consistency?
- Do practices regarding use of beneficiary designations vary either by size of plan or size of employer?

There is a distinction between the very small plans i.e. those that have a handful of employees, and those that have more than 15-20 employees and up. The small employers typically do not hire a TPA and handle the beneficiary designations on their own. These are almost always handled by way of paper enrollment. In contrast, employers who hire a TPA whether it is an independent TPA or a financial institution as a recordkeeper will typically use electronic enrollment. It should be noted that original signatures in both paper and electronic enrollment, are still more often than not maintained on a paper form, e.g. best evidence rule in certain States, spousal consent requirements, etc.

Generally, insofar as consistency in recordkeeping is concerned, since at the present, there is no recordkeeping requirements or industry standard, investment providers have varied practices in their recordkeeping, and rely on their own processes and procedures in determining what information and in what form is/should be maintained. For example, while some financial institutions maintain only the primary beneficiary information, others expand their practices by maintaining primary and contingent beneficiary data on their systems. In instances where a trust company is associated with the financial institution, and the institution offers trust services including financial planning, the recordkeeping is usually comprehensive and consistent.

Many financial institutions have demonstrated consistent and reliable recordkeeping practices. For example most IRA documents where beneficiary information is collected and maintained by the Trustee/Custodian i.e. the financial institution; and where such financial institutions are required to provide certain disclosures for required minimum distributions while the participant is alive, many IRA participants and beneficiaries receive information regarding death distributions. IRAs typically will have defaults as well. By contrast, in the qualified plan world, such responsibility lies with the employer, where the financial institution may or may not provide assistance to the employer. Prototype Plans do not always have default beneficiaries listed for qualified plans. As a result, there are fewer consistencies in recordkeeping practices under the Qualified Plan beneficiary designations compared to the IRA world.

One other interesting item to note is that under a 403(b) plan, the responsibility for all required minimum distributions as far as the calculation is concerned lies with the custodian or the issuer i.e. the financial institution, not with the employer.

It is our opinion that sharing beneficiary designations for convenience or to ensure consistency among multiple plans of the same employer would not be helpful. We have never seen this under an employer plan.

2. Plan Document and Form Issues:

- What are the most common default provisions where a valid beneficiary designation is not on file?
- Does the plan document specify a procedure for resolving beneficiary claims? Are such claims subject to the plans claims review procedure?
- Does the plan require a specific form of beneficiary designation?
- Would standard or model templates for beneficiary designations be useful?
- Should plan documents provide that beneficiary designations naming a spouse as beneficiary be automatically revoked in the case of divorce?
- Does the plan permit a change in beneficiary designation pursuant to a power of attorney?

The most common default provisions where a valid beneficiary designation is not on file or none of the beneficiaries survive the participant are:

a. Surviving Spouse;
b. Surviving Children;
c. Parents; and
d. Estate.

Usually the plan document will specify a procedure for resolving beneficiary claims. Under some plans they are subject to the claims review procedure.

The *form* of beneficiary designation is almost always referred to under the Plan Document as a "form acceptable to the Employer, Trustee, or Custodian", depending on the type of plan and the entity responsible for the recordkeeping of this data.

Standard or model templates for beneficiary designations would be useful especially in a variety of instances: where per stirpes or per capita designations are used as well as naming a Trust as a beneficiary; in cases of divorce, the automatic revocation of beneficiary designation where a former spouse is named as beneficiary, with a caveat for an administrator who may not know that a divorce has occurred would be helpful; and Powers of Attorney (POA) forms are typically only accepted if they are valid under the State law, and even then complications may arise. For example New Jersey provides that a POA can be used by retirement plans but it is not required that a financial institution have a policy to accept the POA.

3. Service Provider Issues:

- Does the plan sponsor or the service provider maintain records of beneficiary designations?
- Who is responsible for interpreting beneficiary designations?
- How are beneficiary designations handled when there is a change in service provider?
- Is there typically a separate charge for maintaining beneficiary designations?
- What are the costs associated with maintaining beneficiary designations?

Maintenance of beneficiary designations will vary based on the type of enrollment, the size of the employer, and whether there is a TPA (including a recordkeeper) or not. For non-ERISA plans (including IRAs), the financial institutions typically maintain the records. It must be noted that this is not universal. For ERISA Plans it is typically the employer or the TPA or possibly in small plans the institution, or no one and the defaults apply.

In situations where the financial institutions do maintain the beneficiary data, it is typically only the Primary Beneficiary information and not the Contingent or Subsequent Beneficiary information. Subsequent Beneficiaries are beneficiaries named by beneficiaries which have become extremely popular.

The responsibility for interpreting beneficiary designations in ERISA plans lies with the Plan Administrator or if there is a TPA, the TPA will assist the employer.

When there is a change in service provider, there would only be an issue if the service provider does not maintain the beneficiary data, so that upon moving the Plan, new data would need to be received from all participants.

Cost of providing beneficiary service - Typically, there are no separate charges for providing beneficiary services including maintaining the beneficiary designation forms.

4. Keeping Beneficiary Designations Up to Date:

a. Do plan sponsors typically re-solicit beneficiary designations on a periodic basis?

The practice varies amongst those parties in the industry who may maintain such records. This is primarily because such parties may maintain customized information technology systems. For example some recordkeeping systems may have the beneficiary (both Primary and Contingent) listed on the participants screen. Periodically notes may be posted as reminders to participants to review the beneficiary designations for updates. Other recordkeepers may exercise variations of this practice or in the alternative may have different practices.

If so, what are the costs?

The associated costs are minimal when done electronically.

b. Are participants informed of beneficiary designations that are on file? If not, how can participants access information about beneficiary designations that are on file?

See comments above.

c. Are participants reminded to update beneficiary designations when they have a life event (e.g. marriage, divorce, death of spouse)? See comments above.

d. What are best practices and effective tools in educating participants about the importance of ensuring that their designations are up-to-date?

Enrollment materials should contain information on naming beneficiaries and how the death distribution rules work. If the Plan or the participant works with an estate planner this is typically handled in the most efficient way.

e. Do plans or plan sponsors have processes that are easy to follow to change designations?

It varies, depending on the TPA, recordkeeper or financial organization that is maintaining the beneficiary information.

f. Are beneficiary designations reviewed with participants at retirement or other termination of service?

The only time this is required is when the participant is rolling over the distribution to an IRA. There are requirements especially in the case of a beneficiary rolling out of an employer plan and the use of a certification form for the IRA custodian.

5. Identifying and Locating Beneficiaries:

a. Where the beneficiary designation is generic (e.g., “my children”), what steps does the plan take to identify all potential beneficiaries?

The plan may provide for such a process, either specifically or more likely by a general statement such as “at the discretion of the plan administrator”.

In the absence of a process in the plan, the plan administrator may have a formulated process for identifying children, requiring various legal documents and other proof. The investment provider holding the assets may also have its own process for identifying potential beneficiaries.

Many Administrators use DOL Field Assistance Bulletin 2004-02 or the IRS letter forwarding program, which is the one has provided the best results.

b. What steps does the plan take to locate any missing beneficiaries?

The plan may identify the steps specifically, or may provide for the steps in a more general fashion for example through a direction such as “at the discretion of the plan administrator”. The plan administrator may in turn delegate that responsibility to a TPA. The steps referred to in the question are often part of a due diligence process that the administrator either directly or through a delegated agent such as a TPA follows. There is great incentive to perform the due diligence carefully and with dedication, as no plan, plan administrator or TPA wishes to be held liable for incorrect distributions. Many TPAs will use the IRS letter forwarding program and the DOL Field Assistance Bulletin 2004-02 to locate missing participants and beneficiaries.

c. Who pays the costs?

The cost may be borne by the plan, the TPA, the service provider, the Plan Sponsor or whomever the plan’s terms may specify as the responsible party. A plan is usually allowed to charge reasonable search expenses to a participant’s account, provided that such an action is consistent with the terms of the plan and complies with the requirements of ERISA. A factor to consider when deducting the expense is considering the size of an account balance where the costs of the various search methods may be offset.

d. What happens when the plan is unable to locate a beneficiary? Is the benefit distributed to the remaining beneficiaries? Is it forfeited to the plan? Is it treated as abandoned property and escheated to the state?

The answer would depend on the specific facts and circumstances of a given case. There is often a hierarchy of distributees that administrators, TPAs, or other responsible parties look to, the last of which is usually escheating to the state, presuming the path to all other potential distributees have been exhausted. Many Prototype Plans require the plan to forfeit the monies and keep track of it should the participant/beneficiary be found in a later year.

6. Beneficiary Disputes:

a. How frequently do disputes arise over disposition of benefits upon death?

Not frequently i.e. daily/weekly basis, but when they do arise they may be highly charged and contested. The interest of the plan, the plan administrator, TPA, or other responsible party often may not be consistent with the claimants, since the party responsible for the distributions must first establish who is a legitimate claimant.

b. What are the most common circumstances where a dispute arises?

Disclaimers under Code section 2518, filed timely or untimely and then determination of who is entitled to the assets (once again State Laws differ when a qualified disclaimer is filed; Trusts as "named beneficiary" and then determination as to who is the "designated beneficiary"; the named trust terminates and who should get the monies; multiple beneficiary forms; the Will names different beneficiaries than the retirement plan. At times, though not always, the retirement plan beneficiary forms supersede the Will; however, certain factors may materially impact such disputes including state statutes, and State common law.

c. Do plans typically freeze or suspend benefits pending resolution of a beneficiary dispute?

From QPs to IRAs, there is usually language in the documents that indicate that if there is uncertainty as to who should receive benefits, the custodian (or trustee) will not release the monies without a court order or other legal document.

d. Are service providers indemnified against liability for claims where benefits are disputed?

In most cases, yes, but it depends on the language of the relevant contractual arrangements may be in place among the appropriate parties.

e. How are disputes over death benefits usually resolved? Is interpleader an effective process for resolving disputes?

As stated above plans will require some sort of legal documentation prior to paying benefits when a dispute arises.

We do not have sufficient data to conclude whether interpleader is an effective process for resolving disputes of this nature.

f. Are the costs typically paid by the plan, the employer or the service provider?

By any of the above.

g. If paid by the plan, are they typically deducted from the benefit otherwise payable or charged against the plan as a whole?

That would depend on the language drafted into the plan, or other contractual arrangements in place at the time. Since this may be viewed as a "distribution fee", it may be shared pro-rated among all participants; or taken from the affected participant/beneficiary's assets.

7. Issues Regarding QJSA/QPSA's and Spousal Waivers:

Electronic Enrollments work better with Spousal Consent. To illustrate this I will use the methodology that is commonly used in administration systems. If an employee logs onto the website and inserts a beneficiary that is not their spouse, the system will prompt them to print the form and notify them that the designation of a nonspouse will not apply until the spouse executes the beneficiary form consenting to the naming of someone else, and where appropriate the QPSA/QJSA disclosure and waivers are included as well. The beneficiary information is not updated until the forms are returned signed and certified,

What procedures are in place to handle pre-age 35 QPSA designations becoming invalid at age 35?

As stated above, when the process is electronic, it becomes easy to flag a system to create an email or letter to be sent to the participant at age 35 or even upon enrollment if they are attempting to name a beneficiary that is not their spouse. This would trigger an email stating that the naming of a nonspouse is not valid until such time as the beneficiary designation form is executed by the spouse and returned to the Plan for processing.

How do plans handle post-death QDRO's? Does it matter whether the QDRO is issued before or after death?

The plan typically is required to determine whether a domestic relations order meets the requirements of the Internal Revenue Code or is in other words "qualified". Under DOL regulations, if a QDRO meets the requirements of section 414(p) of the Code and is qualified, but is issued after the participant's death, or subsequent to an existing QDRO, it will not fail to be treated as a QDRO solely because of the timing of issuance. In these cases once again, size of the employer, whether the employer has a TPA, recordkeeper, or financial institution that has agreed to assist in the determination of whether a DRO is a QDRO, will all play a role in determining who is ultimately responsible.

a. How do plans comply with state law notarization requirements? Is such compliance necessary? (i.e., "witnessed by a notary public" vs. "notarized")

The answer depends on state law requirements, and the specific facts and circumstances of a given case. Many of the rules provide a choice of approval by a "plan representative" or a notary. Under an electronic system, this would once again be generated for the participant to print the form and take it to be notarized or signed by a plan representative.

8. State Law Issues:

a. Do plans typically treat state laws as preempted by ERISA?

The practice is varied, and difficult to track unless litigated in open court on the issue of preemption. However, there is a substantial body of case law across the country that demonstrates how the strict construction and application of the broad preemption clause of ERISA have resulted in unjust, and adverse consequences to the participants or the deceased participant whose presumptive intent may have been thwarted by such application.

b. Is guidance from the DOL needed on the scope of ERISA preemption in this area?

Yes, guidance from the DOL is needed because:

I. ERISA was primarily enacted to protect the participants of a plan, and to increase the likelihood that participants and beneficiaries receive their full benefits. This objective at times has been unintentionally impeded by the strict construction and application of ERISA's broad preemption clause. Hence the broadness of the preemption clause may be at odds with ERISA's primary objective. The intent behind the preemption clause was to create uniformity of plan administration across the country, and to remove the burden on the plan administrator as it regarded various state laws. That rationale however was never intended to allow a husband who kills his wife to benefit from his crime.

II. The application of Federal common law has been at odds with various state laws, and not proven to be an adequate solution for realizing the likely intent of a deceased participant.

III. Various state laws including divorce, wills, slayer statutes, and doctrine of substantial compliance were intended to validate a deceased participant or testator's likely intent; ERISA's broad preemption clause was not intended to accomplish the reverse.

Note: While there will always be differences between the ERISA and nonERISA world it will be helpful to have further clarity and guidance on the broad preemption clause in ERISA, and existing state laws.

Dealing with state laws is familiar territory for many financial institutions. For example, where there is a Financial Institution that serves as the recordkeeper for the plan or involved in any way with the Employer's Plan, that institution typically trains its work force to answer questions based on all products and plan types including ERISA and Non-ERISA e.g. IRAs, SEPs, SIMPLE-IRAs, QPs, 403(b)s (both ERISA and nonERISA)In practical terms, this among other things, means that these institutions and their work force are accustomed to dealing with state laws when responding to participant/taxpayer inquiries on Non-ERISA and ERISA issues; That is to say, considering state laws and addressing state laws will not be a major stretch, if the broadness of the preemption clause of ERISA was qualified or modified such as to result in being consistent with the spirit of state laws, and or not resulting in consequences that would effectively disregard state laws e.g. Slayer Statutes.

c. How do plans handle the impact of state probate requirements, particularly where the beneficiary is the estate?

This will depend on State law. Under some States' laws there are different documents that can be used or different procedures. Most companies involved will try to discourage the naming of an estate as beneficiary. More frequently a Trust is used as the beneficiary in lieu of a named individual. That said in more cases than not when an estate is named as a beneficiary it is standard to require the executor or the administrator to provide the required documents for distribution to the proper entity and the correct tax identification number.

d. Does the plan or plan sponsors review compliance with small estate probate rules?

We do not have sufficient data to conclude that. However, if that is the case, then the process would typically involve the assistance of the plan sponsor's legal professionals i.e. counsel, which would result in protected and privileged communications under attorney-client confidentiality.

e. Can witness requirements be satisfied through electronic media?

Typically this is required in paper format not through electronic media.

9. Additional Issues Not Addressed Above:

a. Naming of various types of trusts as beneficiary where certain documentation is required to treat the trust as a "look-through" trust for Required Minimum Distribution Rules.

b. Some states do not recognize custodial accounts, and strictly require trusts. This has produced some interesting results when the beneficiaries under the will are different that the beneficiary designation under the plan.

c. Best Evidence Rule:

The Best Evidence Rule, embodied in Federal Rules of Evidence ("FRE") 1002, generally requires "the original writing, recording, or photograph" to be introduced when offered to "prove the content of a writing, recording, or photograph," unless some other exception applies. Many states model their evidence rules on the FRE and usually have corresponding versions of the Best Evidence Rule, with their own variations and exceptions.

The Best Evidence Rule, in the designated beneficiary realm, has at times served to complicate matters where a state that has adopted the "Best Evidence Rule" may require the party who maintains the beneficiary forms i.e. financial institution, the TPA or the plan sponsor to have the *original signature* on the beneficiary form.