You Should Know

Divorce and Qualified Plan Beneficiary Designations

You would think that in a divorce case where a spouse waives all rights to his or her ex-spouse's qualified retirement plan, that would be enough to prevent the spouse from getting any of the assets in that plan. Sounds reasonable, but you would be wrong! The following is a summary of a Supreme Court case that all financial professionals should be familiar with. The case is Kennedy v Plan Administrator for DuPont Savings and Investment Plan, U.S. Sup. Ct. No. 07-636, Jan. 26, 2009.

William Kennedy married Liv Kennedy in 1971. In 1974, he completed a beneficiary designation form naming her beneficiary of his benefits under the E.I. DuPont de Nemours & Company Savings and Investment Plan ("SIP"), without naming a contingent beneficiary. They divorced in 1994, and in their property settlement, Liv relinquished all right, title interest and claim in and to all sums and proceeds from any retirement plan, pension plan, or life benefit program by reason of William's past, present or future employment.

Unfortunately, William failed to change his beneficiary designation form with the SIP, and it was determined that the divorce decree did NOT meet the standards necessary to qualify it as a qualified domestic relations order ("QDRO") under the Employee Retirement Income Security Act (ERISA) of 1974. When William died in 2001, his daughter, the executrix of the estate, asked DuPont to pay the $400,000 in the SIP to his estate. The Plan Administrator instead paid the funds to Liv pursuant to the beneficiary designation form on file with the plan. The estate sued the plan administrator, filing a claim for benefits under ERISA, contending the divorce decree constituted a waiver of benefits under the plan.

The case ultimately reached the U.S. Supreme Court which concluded that the benefits were properly paid out to Liv. The court addressed two important issues in contention in the lower courts.

First, the appeals court had ruled that paying the benefit to the estate would have amounted to an illegal diversion of benefits under the plan to someone else other than the named beneficiary, in violation of ERISA provisions against assignment or alienation. Notwithstanding that there was a divorce decree issued by a state court, the federal appeals court ruled that there would be an illegal diversion if the state court decree was followed because the decree did not qualify as a QDRO. There have been decisions in other appeals courts to the contrary, ruling that a divorce decree could amount to a waiver of benefits, even if not specifically a QDRO under ERISA. The Supreme Court, on that issue, ruled that a divorcing spouse could waive plan benefits through a divorce decree under state law, and such a decree was not an illegal diversion of benefits under ERISA.

Regardless of the first issue, the Supreme Court then, however, ruled that the "plan document rule," found at Section 404(a)(1)(D) of ERISA, would control the case. Under this provision, plan fiduciaries are required to act in accordance with plan documents and instruments insofar as they are consistent with Titles I and IV of ERISA. Accordingly, the court stated, "… the question remains whether the plan administrator was required to honor Liv's waiver [in the divorce] with the consequence that the benefits should have been paid to the estate. We hold that it was not, and that the administrator did its statutory ERISA duty by paying the benefits to Liv in conformity with the plan documents." Applying a "… straightforward rule of hewing to the directives of the plan documents …", the court found that William's failure to drop Liv as his beneficiary of the SIP, as the plan documents allowed him to do but which he did not do, ended the matter so far as the plan distribution was concerned. It concluded, "William's designation of Liv as his beneficiary was made the way required; Liv's waiver was not."

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Important points to consider in light of this case:

1. **Life Insurance** – If there is life insurance in a qualified plan, the reasoning of this court should apply. The designated beneficiary in the plan will govern the ultimate payment of benefits, regardless of the named beneficiary with the life insurance company. Since the court's reasoning applies "the plan document rule," and that rule applies to qualified plans and welfare benefit plans, this decision would appear to apply to the latter as well. To avoid ANY question or issue, Guardian requires that life insurance policies in qualified plans name the plan as beneficiary.

2. **Plan Administrators and Trustees** – Administrators and fiduciaries should review Summary Plan Descriptions (SPDs) and other plan communications to ensure they advise divorced participants of the need to revise their beneficiary designations if they wish to remove their former spouse. *Kennedy* holds that external papers such as divorce decrees or property settlements will not prevail if they contradict beneficiary designations on file with a plan under the plan's procedures.

3. **Automatic Revocation** – Some plans provide that a designation of a participant's spouse as beneficiary is automatically revoked if the participant and the spouse divorce. While under *Kennedy* these provisions should continue to be valid, such a provision is not required in plan procedures.

4. **Waiver procedure** – Plan administrators might want to consider adopting a formal waiver process as part of their procedures. As noted, *Kennedy* resolves a split among the federal appeals courts and holds that a beneficiary may waive his/her right to a participant's benefit without violating ERISA's rule against assignment of plan benefit. The DuPont SIP plan had such a procedure in place. The fact that the divorce decree did not comply with that procedure was a factor considered by the court in its decision.

5. **Footnote 10 of the opinion** – The court noted there that there was a possibility the estate could have recovered the benefits from Liv *after* she received them, citing prior rulings where a previous contractual agreement to forfeit funds may be enforceable after the distribution without violating ERISA. Once the money is paid out, it loses its ERISA protection.

Most importantly: Plan Administrators, trustees, and participants should regularly review beneficiary designations for qualified plans and the investments held by them, and update them as needed.

Please consult with your Guardian Financial Representative if you have any questions concerning this document.

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