Beneficiary Designations Rule!

Take-Away: It is imperative that beneficiary designations be checked to confirm that they continue to reflect an account owner's wishes. This is particularly the case if a qualified plan administrator or IRA custodian changes its system for tracking designations, or there is a new IRA custodian or plan administrator.

Background: Everyone loves a good 'horror story' to make a point. A recent case from Pennsylvania provides a great reminder of why it is so important to continuously review beneficiary designations for retirement plan accounts.

Proctor & Gamble U.S. Business Services v Estate of Jeffrey Rolison, No. 17-0762 (M.D. Penn, April 29, 2024)

Facts: Jeff was employed by Proctor and Gamble for over 28 years. Jeff died in 2015. Jeff participated in the P&G Profit Sharing Trust and ESOP (for ease, the Plans.) When Jeff started working at P&G, he was unmarried. So, in 1987, Jeff named his girlfriend Margaret, as his beneficiary under the Plans. Jeff and Margaret broke up in 1989, and Margaret later married. Often while employed by P&G Jeff was encouraged to review his beneficiary designations. Later, when P&G transitioned to an on-line beneficiary designation system, Jeff was notified that if he did not 'enroll' in that on-line system his 'old' paper beneficiary designation would control. While Jeff logged on-line three times prior to his death, he never made an on-line beneficiary designation. At the time of his death, the balance of Jeff's Plan accounts was $754,000. At the time of the litigation over Jeff's 1987 beneficiary designation, the balance of Jeff's Plan accounts had grown to $1.15 million.

Dispute: Three parties showed up to claim Jeff's retirement account balances: (i) Jeff's estate, claiming it was the default beneficiary; (ii) Jeff's current girlfriend, who claimed she was his 'common law' wife; and (iii) no surprise, Margaret.

Interpleader: P&G faced with these competing claims interpleaded the balance of Jeff's retirement accounts into the trial court, asking the court to decide who was entitled to the retirement account balance. While the P&G Plans were covered by ERISA, ERISA does not tell a plan administrator how to determine the proper plan beneficiary. Consequently, state law was required to make that determination.

Trial Court: The judge found that Margaret was entitled to take the full $1.15 million in her former boyfriend's retirement account. Jeff's most recent girlfriend who claimed she was his common law spouse was dismissed, because she did not take steps or offer any evidence that there had been a common law marriage. Jeff's estate (meaning his surviving siblings) appealed this decision.

Appellate Court: The trial judge's opinion was affirmed on appeal.

No Substantial Compliance: Under state law, a plan participant who has designated a beneficiary is not considered to have changed the beneficiary designation unless the participant was in 'substantial compliance' with the plan's procedures for make a change. Since Jeff did not take any 'positive unequivocal' steps to amend his 1987 beneficiary designation, he was not in 'substantial compliance' with P&G's plan rules for how to change designated beneficiaries of an account.

Circumstantial Evidence Irrelevant: In response to the fact that Jeff accessed the P&G on-line beneficiary designation system 3 times before his death, and relying on the U.S. Supreme Court's 2009 decision, *Kennedy v. Plan Administrator for Dupont,* it found that circumstantial evidence outside of the plan's beneficiary form suggesting an intent to change the beneficiary designation, is irrelevant.

No Breach of Fiduciary Duty: Jeff's estate claimed that P&G violated its ERISA fiduciary duty to Jeff because of its claimed failure to disclose material information to him. The Court disagreed, noting the Jeff was affirmatively and consistently notified for 13 years that his on-line account lacked the beneficiary designation, and that without that on-line beneficiary, his paper beneficiary designation would remain valid.

No Unjust Enrichment: Jeff's estate then argued that Margaret would be unjustly enriched if she was permitted to receive the $1.15 million. In making this claim Jeff's estate then had to prove that his continued designation of Margaret as his designated beneficiary was a mistake, noting: *"there is nothing concrete in the record to suggest that [Jeff] had any misconceptions who his paper designation was."*

In sum, the only thing that mattered was what was on Jeff's beneficiary designation form.

Random Observations: A couple of 'off-topics' come to mind when reading the claims made by Jeff's 'last' girlfriend and his estate.

Common Law Marriage: While Jeff's 'last' girlfriend never made it to the appellate court on her 'common law' marriage claim, it is important to remember the different rules that deal with a spouse as a designated beneficiary. We know that Michigan has a 'revocation-on-divorce' statute that automatically revokes an IRA owner's beneficiary designation of a spouse after their divorce. [MCL 700.2801; MCL 700.2806(a).] But those statutes do not apply to an ERISA covered retirement plan, like a 401(k) account. Federal law preempts state law when it comes to qualified plans and the rules that govern them; state revocation-on-divorce statutes do not apply. If Jeff had married Margaret and they then later divorced, Margaret would have remained Jeff's designated beneficiary since he had not formally changed the beneficiary designation. If Jeff had married Margaret and they later divorced, and Jeff had rolled his Plan account balances into an IRA, then Margaret as a former spouse would have been automatically removed as the designated beneficiary of Jeff's rollover IRA.

Estate as Default Beneficiary: If Jeff's estate had prevailed in its capacity as the primary default beneficiary under the P&G Plans, the distribution of those inherited retirement funds would have been accelerated, since Jeff died prior to his required beginning date (RBD.) When an account owner dies prior to his RBD then the 5-year distribution rule applies. If Jeff had died after his RBD, then the distribution to Jeff's estate of his retirement Plan balances would have been over Jeff's single life expectancy, had he lived, in other words, Jeff's *ghost life expectancy.*

Roth IRAs: Equally important to remember is that it is very important to name a designated beneficiary for a Roth IRA. A Roth IRA owner does not have any lifetime required minimum distributions (RMDs.) A Roth IRA owner is always considered to have died prior to his/her RBD. Consequently, the 5-year distribution rule will always apply if the Roth owner's estate becomes the default beneficiary.

Conclusion: Anytime there is a marriage, death, divorce, or birth of a child or grandchild, it is important to review existing beneficiary designations to avoid the possibility that someone other than the account owner's intended beneficiary will receive their retirement funds.