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WEALTH MANAGEMENT

Change Your Beneficiaries After Divorce

Remember to modify beneficiary designation forms for retirement assets after splitting from your spouse

Catherine Romania and Rachel Ianieri, New Jersey Law Journal

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Divorce is a time of change. One change that should not be overlooked is the need to modify your beneficiary designation forms for your IRA and other retirement assets.

Most couples enter into a Property Settlement Agreement (PSA) as part of their divorce. Included therein is generally a division of assets as well as a waiver of a claim or right to certain assets such as life insurance or retirement benefits.

Although it is recommended that you amend your will after a divorce to either exclude your former spouse or otherwise include provisions required under the PSA, New Jersey, as well as many other states, such as New York and Florida, has enacted legislation addressing the rights of a former spouse named in a will. As amended effective in 2005, N.J.S.A. 3B:3-14(a) states in part that unless otherwise specifically provided in:

[A] governing instrument, court order, or a contract relating to the division of the marital estate ... a divorce or annulment ... revokes any revocable ... dispositions or appointment of property made by a divorced individual to his former spouse in a *governing instrument* and any disposition or appointment created by law or in a *governing instrument* to a relative of the divorced individual's former spouse. (Emphasis added.)

Pursuant to N.J.S.A. 3B:3-14 (a)(1)(c), the nomination of your former spouse or former spouse's relative as the executor, trustee or other fiduciary is also revoked.

For example, assume your will executed prior to divorce leaves everything to your spouse, should your spouse be surviving, otherwise to the siblings of both you and your spouse equally, and also names your spouse as executor and a sibling of both you and your spouse as the successors. Upon your divorce (absent the PSA otherwise providing) the disposition will go entirely to your siblings, as the dispositions to your spouse and your spouse's siblings are revoked, and your sibling will be appointed as executor, as the nominations of your former spouse and his/her sibling are revoked by the statute without you doing anything more.

A will, however, does not govern the disposition of nonprobate assets. Non-probate assets include assets passing by operation of law, such as when you own property with a right of survivorship. N.J.S.A. 3B: 3-14(a)(2) specifically severs the interest of a former spouse as joint tenants with rights of survivorship or as tenants by the entireties by converting the interest to tenants in common.

Nonprobate assets also include assets that pass by beneficiary designation, such as life insurance, IRAs and 401(k) plans. In fact, a large portion of a person's wealth may be found in

retirement accounts passing not under a will, but based on a beneficiary designation. N.J.S.A. 3B:1-1 defines a governing instrument (referenced in N.J.S.A. 3B:3-14(a)(1)(a)) as including an insurance policy, account with the designation "pay on death" (POD) or "transfer on death" (TOD), pension, profit-sharing, retirement or similar benefit plan. If that is the case, then why must you change your beneficiary designation upon divorce?

A qualified retirement plan or 401(k) is administered through an employer under the provisions of the Employer Retirement Income Security Act (ERISA). Relying solely on federal law, the United States Supreme Court, in *Kennedy v. Plan Administrator for Dupont Savings & Investment Plan*, 555 U.S. 285 (2009), held that ERISA plan benefits were to be paid to the designated beneficiary, regardless of whether a former spouse had waived the rights as part of the PSA in the divorce. In part, the court's reasoning referenced the need of a plan administrator to rely upon the plan documents in administration of the plan, as well as the desire to avoid the potential of subjecting the plan administrator to double liability (potential lawsuit by either the named beneficiary or the estate). The holding did not preclude the possibility of an estate or the beneficiaries of the estate bringing suit against the decedent's former spouse who had waived the benefits under a PSA; the opinion specifically noted that the court expressed no view on the issue.

In *Estate of Kensinger v. URL Pharma*, 674 F.3d 131 (3d Cir. 2012), the parties entered into a PSA which provided in relevant part as follows:

[T]he parties mutually agree to waive, release, and relinquish any and all right, title and interest either may have in and to the other's IRA account(s), or any other such retirement benefit and deferred savings plan of like kind and character, and neither shall make any claim to possession of such property as it is presently titled. (Alteration in original.)

Nine months after the divorce, the husband died intestate, never having changed the beneficiary designation of his 401(k), which still named his former wife as a beneficiary. Relying upon *Kennedy,*the Third Circuit Court of Appeals held that under federal law there is no dispute that the 401(k) plan benefits are to be paid to the former spouse who was the named beneficiary on the beneficiary designation, notwithstanding the waiver in the PSA.

However, in this case, the court also addressed the issue left unresolved in the *Kennedy* case. The Court of Appeals found that under New Jersey law, the former spouse had waived her rights to the pension benefits in the PSA, which constituted a binding contract under state law. As a result, once the proceeds were paid to the former spouse, the estate could bring suit against the former spouse to recover these benefits under contract law principles. Such a right did not undermine the concerns expressed in the *Kennedy* case because: (1) the plan administrator would be able to make a timely payout of the plan benefits to the named beneficiary in reliance upon the beneficiary designation; and (2) the plan administrator would not be potentially subject to costly litigation or double liability to the named beneficiary and the deceased's estate. Instead, a suit against the named beneficiary in reliance on the PSA would "simply require a court to determine the rightful recipient of the plan proceeds as a matter of contract law." *Kensinger,* 674 F.3d at 136.

Although in *Kennedy,* the court was concerned with subjecting the plan administrator to double liability, the New Jersey statute provides protection to the payor. N.J.S.A. 3B:3-14(d) provides as follows:

A payor or other third party making payment or transferring an item of property or other benefit according to the terms of a governing instrument affected by a divorce or annulment is not liable by reason of this section unless prior to such payment or transfer it has received at its home or

principal address written notice of a claimed revocation, severance or forfeiture under this section.

Moreover, the *Kennedy* decision is not binding where only state law governs. In *Hadfield v. Prudential Ins. Co.*, 408 N.J. Super. 48 (App. Div. 2009), *certif. den.*, 200 N.J. 472 (2009), the New Jersey Appellate Division held that where the former spouse remained as the named beneficiary of a life insurance policy following a divorce, N.J.S.A. 3B:3-14 applied; therefore the beneficiary designation was revoked by operation of law. Notwithstanding that the former wife was found to have no interest in the policy and that the statute states that "provisions of a governing instrument are given effect as if the former spouse ... disclaimed all provisions revoked by this section," the court made no determination as to whether the policy proceeds should be paid to the decedent's estate or the decedent's sister, who was the designated contingent beneficiary, holding that such issue was not before the court.

In the case of both a traditional IRA and Roth IRA, the outcome remains uncertain. IRAs are retirement accounts with beneficiaries named on a beneficiary designation form delivered to the IRA custodian (much like 401(k) plans). However, IRAs are not governed by ERISA. Should the IRA custodian, like the plan administrator, be able to rely upon the documents on file, specifically a beneficiary designation form naming a former spouse, and pay pursuant thereto regardless of whether the former spouse waived the right to payment of such benefits under the PSA? Can the contingent beneficiary or the estate of the IRA owner demand payment directly from the IRA custodian upon delivering the PSA to the custodian demonstrating a valid waiver under state law pursuant to N.J.S.A.3B:3-14? Can the contingent beneficiary or estate recover the proceeds from the former spouse if the custodian (without notice of the waiver) pays pursuant to the beneficiary designation? Based on the express terms of the statute and cases cited, the answer to all of these questions appears to be yes, but until the courts have opined on the matter, there can be no assurance.

The best way to avoid any uncertainty following a divorce is to change all beneficiary designations naming a former spouse. What if you still want to provide for a former spouse who is named on the beneficiary designation form prior to divorce? In that case, it is still best to execute a new beneficiary designation form, post-divorce, naming the former spouse to ensure there is no confusion as to your intent. •

Romania is a member with Witman Stadtmauer in Florham Park, N.J. Ianieri is an associate at the firm.
