



Dealing With Troubled Pension Plans

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Tip of the Month:

Delegate as much of the divorce data information gathering process as is practical to your office staff.

Rightly or wrongly, attorneys have the reputation of being procrastinators. It can easily be argued that the nature of the profession keeps many attorneys chasing after statutory and court imposed deadlines and that the luxury of a careful review of all the available case requirements, along with the anticipation of every conceivable step throughout the process, is oft times just not realistically practical. This may be more often the case in a smaller office where the staff may consist of a single assistant. But even one assistant can be better utilized if the attorney puts into place a system whereby much of the data gathering is automatic and timely. Most divorce cases involve the valuation of the various assets accrued by the couple throughout the marriage. With that reality in mind, we can identify what must be put in place to better organize the data gathering process.

The attorney should develop an intake form that the client can fill out on his or her first visit. Allow enough time in the scheduled first appointment for this preliminary information gathering. This intake form, to be completed before meeting with the attorney, should ask for all of the basic personal data on each party and other family members, as well as a request for detailed information on all the marital assets that could possibly have been accrued by the couple. The form should have sections to identify each of the assets the attorney normally would run into in a divorce case (real estate, bank accounts, debts, credit cards, vehicles, business assets, retirement assets, securities, valuable furniture or personal belongings such as jewelry, pending insurance settlements, etc.). If the client has difficulty with the form, the assistant should be available to work with the client to complete as much of the preliminary information requested on the form as possible. This form will instantly tell the attorney what is at issue and what additional information must be obtained.

After meeting with the client the attorney can then delegate to the assistant the task of beginning the process to obtain values on all of the assets. If the other party is already represented by an attorney, the assistant could begin by discussing the case with the opposing counsel's assistant and see if there will be difficulty on agreeing to the use of one objective real estate appraiser to save time and money. If the other spouse has retirement benefits, the assistant can find out if the opposing counsel's client would be willing to sign a release form so that the necessary pension or retirement account information can be obtained or if it will be necessary to file a discovery motion – again with the goal of saving time and money. If you do a good job training the assistant, many of those valuation problems that seem to crop up at the last minute should become rare. You should then be able to structure a much more viable draft settlement agreement and be better prepared to more knowingly and successfully represent your client in the settlement negotiations.

Dealing with Troubled Pension Plans

In the past 20 or so years there has been a quiet (and sometimes not so quiet) revolution occurring in this country. This revolution will have a serious impact on the lifestyle of many of the future retired baby-boomers and is even now impacting present day retirees. The simple truth is that in a competitive world economy, corporate America can no longer afford the generous defined benefit pension plans that workers were counting on to fund a carefree retirement. Every year there are fewer and fewer defined benefit plans than there were in the previous year as companies switch over to retirement savings schemes (401(k), ESOP's, Retirement Savings Plans, etc.) which pass on much of the investment risk to the employee and take it off of the company. And many of the largest of the remaining plans are under-funded to the tune of billions of dollars. The truth is that in the industrial sector these pension plans are just not sustainable.

A traditional defined benefit plan is any of those retirement schemes structured to provide a retiree with an income for life based on a plan-defined formula. Typically, the amount of annual income was determined by utilizing the employee's final average five years of salary, the length of employment (with supplemented early retirement benefits the norm for long tenured employees) and a plan defined multiplier (i.e., \$55,000 X 35 years of service X 1.6% = \$30,800 per year payable for life commencing at age 60). If we prepare an appraisal of this pension to determine its value in the annuity market place, it would have a present value of \$434,365.00 (see attached report). Theoretically, the plan provider should have that amount of money put aside to cover this one retiree's actuarial life.

While, in theory, these pension obligations are funded by the company investing money each year to cover their future pension obligations, the reality is that in many, if not most cases, accounting gimmicks and politically influenced funding rules permit plan administrators to make future pension fund investment return assumptions that are "just pie in the sky" wishful thinking. Many financial analysts believe General Motor's under-funded pension obligations are in excess of \$30 billion.. GM has a total stock market capitalization of about \$15 billion. That is how much the company is currently valued by investors. In addition, there is promised health care coverage to GM retirees that analysts estimate to be almost \$70 billion. There are currently over 1,000,000 GM retirees. GM-UAW employees can retire with supplemented benefits of about \$30,000 per year after 30 years of service. At age 62 the pension is reduced to account for the fact that the retiree can then qualify for early U.S. Social Security benefits. In addition, GM must pay for full medical coverage for retirees. That means, frequently, GM has to pick up full medical coverage from age 50 (when many employees have 30 years of service) until age 65. GM then begins to pay supplemental medical benefits after the retiree reaches 65 and qualifies for Medicare. Retiree medical benefits add about \$1,500 to the cost of every car GM makes and erode any competitive edge that productivity improvements instituted in past years should have provided. The financial figures used in this paragraph come from The Economist (10-15-05).

Most of America's larger airline companies are in Chapter 11 bankruptcy and have dumped their grossly under-funded pension liabilities on the Pension Benefit Guaranty Corporation (PBGC). The PBGC is a public corporation (part of the U.S. Department of Labor) and like the FDIC guarantees bank accounts, it guarantees private defined benefit pensions. This means that the retiree in a plan dumped on the PBGC will get his pension, but usually not all of it. We write Qualified Domestic Relations Orders for PBGC managed plans every week. I know of one retired airline pilot whose early retirement was paying him close to \$100,000 per year until his employer went bankrupt and gave the plan to the PBGC. His income plummeted to less than \$38,000 per year - time for a little lifestyle adjustment.

So how does all this affect family law attorneys? It is just this simple. The problems with corporate pensions in America are no longer a secret and have to be taken into consideration every time you structure a settlement agreement that includes provisions for

a Qualified Domestic Relations Order on a private company pension plan (public employee plans, which, amazingly, are becoming more and more generous, will probably not suffer the same fate in the foreseeable future because taxpayers are there to bail them out).

You cannot, in good conscience, assume that the pension plan that you are addressing will be there 15 years from now. It might, but there is a greater chance that it won't. The company may be there but the pension plan might have been terminated or rolled into a 401(k) and the language in your QDRO no longer has any relationship to the asset that the former spouse now has. These are tough problems that I have been wrestling with for some time now. If the employee takes a big reduction in benefits, the language should have the alternate payee taking a pro rata reduction. That is always the case if you use coverture related language (50% of a fraction (years married while employed \div total years of plan covered employment at retirement) \times the actual retirement income. Try to stay away from terms like "50% of the accrued pension benefit" as of a particular date. Following is some settlement agreement language that addresses a few of these problems (not all) and could be included in a subsequent Qualified Domestic Relations Order. The problem is the plan administrators do not like to see these contingencies in QDRO's so there is much education needed for both attorneys and plan administrators if we are all going to deal with the real world.

A: Private employer – pension only – matured full benefit State – limited survivor benefits

The husband has a pension through his employment with the ABC Widget Company. He was employed and accruing pension benefits for 18.6 years up to the date of filing of a complaint in this divorce action, December 11, 2004 (marital property cut-off date). The wife was married to the husband for 14.8 years during this pension benefit accrual period. The wife is awarded 50% of her fractional interest (14.8 years \div total number of years of pension accrual service credited to the husband at the time the pension goes into pay status) in the actual pension received by the husband at the time the pension goes into pay status. The pension is to be paid in the form of a 50% Joint and Survivor Annuity with the wife named as the beneficiary of the marital portion of the pre and post retirement survivor annuity in the event the husband should pre-decease her (survivor annuity \times (14.8 years \div total number of years of pension accrual service credited to the husband at the time of his death)). Any reductions necessary to pay the pension in this form shall be borne by the husband and wife on a pro-rata basis based on their monthly retirement income. Any passive, post retirement increases (i.e., cost of living adjustments, across the board pension benefit increases, etc.) that accrue to the retirement benefit of the husband shall also accrue to the benefit being paid to the wife on a pro-rata basis.

In the event that this plan is terminated prior to the retirement or termination of the participant, and replaced with a defined contribution plan then the portion of the frozen, defined benefit monthly pension payable to the alternate payee shall be determined using the same formula as previously stated, but in no case will the portion of the pension payable to the alternate payee be less than 23.718% of what the participant's pension benefit, as payable in the form of a 50% joint and survivor annuity, would have been under the previous plan based on his actual average salary (on the earlier of his employment termination date or at age 62 if he continues to be employed until that time) that would have been used to compute his benefit on his normal retirement date, age 62. (This represents 50% of the marital portion of the participant's pension had the participant retired at age 62 under the terminated plan (14.8 years married \div 31.2 years of projected employment at age 62 \times 50% = 23.718%).

In the event that this defined benefit pension plan is converted to a defined contribution plan prior to the retirement or termination of the participant, and the actuarial value of his

accrued benefit at that time is converted into a lump sum and included in the account balance of the new defined contribution plan, then the amount of the new lump sum defined contribution plan payable to the alternate payee shall be determined using the same formula as previously stated, as determined on the date that payment is made to her. The 50% share of the marital portion awarded to the wife will be determined using the husband's credited years of service on the earliest date her share of the defined contribution plan can be paid to her. In most cases this would be immediately after the defined benefit plan is rolled into the defined contribution plan.

In the event that this defined benefit pension plan is converted to a defined benefit cash balance plan prior to the retirement or termination of the participant, then the portion of the cash balance plan payable to the alternate payee shall be determined using the same formula as previously stated, as determined on the date that payment is made to her. The 50% share of the marital portion awarded to the wife will be determined using the husband's credited years of service on the earliest date her share of the cash balance plan can be paid to her on an unreduced basis and distributed to her at that time.

A Qualified Domestic Relations Order will be prepared by the attorney for the non-participant spouse and submitted to court for approval and forwarding to the plan administrator to implement the intent of this section of the agreement.

As you can see, trying to protect your client – whether it be the participant or the alternate payee – is very difficult when you are guessing at possible scenarios. If the plan was terminated and replaced with nothing then the first paragraph would protect both parties. The wife would get her marital share of the reduced pension and the husband would get the balance. It gets real hard when the plan is transferred into another entity to try to protect the wife's marital interest and it is doubtful that the language would be accepted by any plan right now. Still, simply trying to protect your client from some very real possibilities, even if you fail in your attempt, offers you strong protection from any future liability.

Model Property Settlement Language

Download our settlement language form and let the experts at LawDATA, Inc. [draft model property settlement language](http://www.lawdatainc.com/SetLanForm.pdf) (<http://www.lawdatainc.com/SetLanForm.pdf>) that deals specifically with the pension plan to which the order is addressed and the facts of your case.

Mr. Commerford has been active in the valuation of pensions and the preparation of Domestic Relations Orders for his attorney clients since the founding of LawDATA, Inc. in 1984. He has presented Continuing Legal Education programs, dealing with the valuation and distribution of retirement assets incident to divorce cases, for State Bar Associations throughout the country and written many articles on the subject for legal publications.

For any questions or ideas for upcoming articles you can reach Paul Commerford at paul@lawdatainc.com.

MATURED FULL BENEFIT APPRAISAL USING PBGC ANNUITY RATES

DATE OF REPORT: 11/1/2005

ATTORNEY: Marsha Williams

PENSION HOLDER: Joe Smith

DOB: 11/1/1945

PENSION PLAN: The Big Corporation

APPRAISAL DATE: 11/1/2005

Male

AGE: 60

RETIREMENT DATE ASSUMING CONTINUED EMPLOYMENT: 11/1/2005

AGE ON PENSION INCOME COMMENCEMENT DATE: 60

ANNUAL PENSION INCOME: \$30,800.00

PBGC DATA:

INITIAL RATE = 3.7%

YRS: 20

ULTIMATE RATE = 4.75 %

PBGC FACTOR: 13.7268

LOADING: 11581

MORT. TABLE: VII

APPRAISAL DATE PRESENT VALUE BASED ON EMPLOYMENT UP TO THE RETIREMENT DATE
AS SHOWN IN THIS REPORT: \$434,365.00

PRESENT VALUE ADJUSTED TO REPORT DATE (PBGC % Factors): \$434,365.00

MARRIAGE DATE: 6/1/1970

EMPLOYMENT DATE: 11/1/1970

MARITAL COVERTURE % OF PRESENT VALUE: 100% AMOUNT: \$434,365.00
(Report date value of the pension attributable to the marriage.)

COVERTURE VALUE, ASSUMING 50-50 SPLIT, TO SPOUSE: \$217,182.50

% OF ACTUAL MONTHLY PENSION INCOME TO BE PAID TO SPOUSE BASED ON REPORT
ASSUMPTIONS IF QUALIFIED DOMESTIC RELATIONS ORDER IS USED: 50%

The foregoing appraisal is based on objective actuarial data from the Pension Benefit Guaranty Corporation, a U.S. Government agency. If the appraisal date value is different than the report date value, it was adjusted using the initial PBGC interest rate less 1%, 2.7%, compounded annually. You can use the same % factor to adjust the value up to the distribution date.

This report identifies the present value of a pension plan providing an annual income for life. No actuarial deviations were made. It does not consider any savings (Defined Contribution) plans (401(k), ETC.).

This report reflects the opinion of LawDATA, Inc. It is based on the information submitted with this appraisal request. ANY QUESTIONS? PLEASE CALL BEFORE WRITING.