Divorce, Pensions and Retirement Benefits

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LOOKING AT A HYPOTHETICAL CASE WHICH INCLUDES THE DISTRIBUTION OF MARITAL PROPERTY RETIREMENT ASSETS

Introduction:

This month I thought it might be interesting to put everything we have written about in the past in context by looking at how an attorney would have to deal with the retirement assets when they are only one of the many that have to be addressed before a case can be finalized. I made up the scenario but it is representative of many cases we have dealt with over the years. It is more common today for both parties to the divorce to have retirement assets than it was 20 years ago, so the hypothetical case I have constructed should represent a situation which attorneys will often encounter in their practice. While private plans are more common in some parts of the country than others, no matter where you practice, you can easily encounter the same situations because of the growth in numbers of public employees (military, federal civilian, state, county, city) and the amazing benefit increases they have enjoyed over the past 20 years. This is an employment sector in which organized labor has rapidly unionized, and with those changes, the attendant improvements in employee benefits that usually follow. In light of the foregoing I think every practitioner will find our hypothetical case of some interest.

Tip of the Month:

Do not delegate your client to deal with the retirement benefit expert to get valuations of the retirement assets in the case.

I guess this is one of my pet peeves and, believe it or not, it happens much more often than you might think. I don't know if it is because the attorney is uncomfortable dealing in this area or simply thinks the client knows more about his or her benefits so it is more practical for them to obtain the valuation information. Frankly, while the client may be more knowledgeable about the retirement assets, they approach it with little objectivity and even less understanding of the law. The attorney needs to be the person who deals with the expert so they can explore their options as to how to resolve any issue if an impasse arises in the case or to discuss the other sides valuation if it conflicts with the report prepared by the expert. We have been involved in cases that required our testimony without ever having any direct attorney contact until we either appeared in court or began telephonic testimony. It was always the client or the attorney's secretary (not legal assistant) with whom we spoke. Discussing the case with the retirement benefit expert is an opportunity for the attorney to become more knowledgeable about retirement assets and can help them put the retirement benefits in prospective in dealing with all of the marital assets in the case. If we need additional information or explanations about the retirement assets the attorney can always make his or her client available to us. But it should always be the attorney who obtains the valuations and, if need be, discusses it with the expert.

LOOKING AT A HYPOTHETICAL CASE WHICH INCLUDES THE DISTRIBUTION OF MARITAL PROPERTY RETIREMENT ASSETS

THE CASE FACTS:

Mary and Tom Jones have been married for 15 years and are now beginning the divorce process. Both are 40 years of age. They live in New York State, which uses the principle of equitable distribution when allocating the value of marital assets between the parties. The assumed starting point is a 50-50 distribution but circumstances can affect the allocation. For the purpose of our exercise we will use a 50-50 split. Both have been employed in their present positions since shortly after the marriage and they have one child who is now 11 years old. Mary works for a county health department in the State of New York as a practical nurse and only took a short leave when their child was born, so all of her pension accruals are marital. She is a participant in the New York State and Local Retirement System and will be eligible to retire with unreduced pension benefits at age 57 with thirty-two years of credited service.

Tom is an electrician and commenced employment shortly after the marriage. He has a union pension and an annuity fund. He has to work until he is 62 to receive unreduced pension benefits. His annuity fund is a lump sum defined contribution account that grows through investments and employer contributions. At the time of his retirement he can either elect to take the lump sum or convert it to a monthly annuity for life. As a defined contribution plan, it may be eligible for immediate distribution incident to a Qualified Domestic Relations Order if the by-laws of the plan have been modified to permit this. In this case it is permitted.

They own a home with an appraised value of $130,000 and an equity value of $40,000 in which Mary and their child would like to continue to reside. Their only other marital assets consist of equities in used cars and household furniture. They have marital debt, other than the cars and the mortgage, of about $7,000.00.

VALUING THE RETIREMENT ASSETS

The first thing that must be determined is the worth of the various retirement assets. Their respective attorneys should provide retirement benefit release forms signed by each of their clients which makes it possible for Tom's attorney to get Mary's retirement benefit information directly from her employer and Mary's attorney to get Tom's from his Union plan administrator. <u>It is very important that each attorney get their opposing counsel's client's retirement information independently to avoid any possibility of hiding any provision, or misrepresenting the value, of the retirement assets</u>.

Once that information is obtained, pension appraisals must be prepared to determine the present value of each pension on the marital property cut-off date; July 15, 2004 in this case. New York is a matured full benefit state so the pension appraisals must reflect their respective values assuming each party works until the earliest date that they can receive unreduced pension benefits.

Tom's defined contribution annuity fund account does not need to be valued as that value is established by the plan providing a statement as to his account's value on the marital property cut-off date, $191,857.90, and then applying a coverture calculation or doing further analysis if there were any accruals prior to the marriage. The balance provided by the plan will also have to be adjusted at the time of disbursement for any passive increases or losses (interest, dividends, changes in the values of stock or other equities, etc.). Any contributions made after the marital property cut-off date, as well as any gains or losses thereon, will remain Tom's separate property. For the purpose of this example I have not included the passive growth amount between the marital property accrual cut-off date (appraisal date) and the projected distribution date in distribution numbers being used.

In preparing the pension appraisals the couple's current incomes are used because the pension appraiser is computing a present value appraisal using the purchasing power of the dollar on the date of the report. Most increases in salaries over the lifetime tenure of an employee simply reflect cost of living adjustments once they reach the top scale of their employment position. Most people reach that plateau after about 10 years of service. Once the pension appraisals have been obtained it is possible to begin the settlement process. Following are the pension appraisals beginning with Tom's.

MATURED FULL BENEFIT APPRAISAL USING PBGC ANNUITY RATES

DATE OF REPORT: 9/27/2004 ATTORNEY: Michael Smith

PENSION HOLDER: Thomas Jones DOB: 2/14/1964

PENSION PLAN: Electrician's Union - Local 1207 Pension Plan

APPRAISAL DATE: 7/15/2004 Male AGE: 40.41

RETIREMENT DATE ASSUMING CONTINUED EMPLOYMENT: 2/14/2026

AGE ON PENSION INCOME COMMENCEMENT DATE: 62

ANNUAL PENSION INCOME: $17,520.00

PBGC DATA: INITIAL RATE = 4.2% YRS: 20
ULTIMATE RATE = 5 % PBGC FACTOR: 4.2973
LOADING: 3964 MORT. TABLE: VII

APPRAISAL DATE PRESENT VALUE BASED ON EMPLOYMENT UP TO THE RETIREMENT DATE AS SHOWN IN THIS REPORT: $79,253.00

PRESENT VALUE ADJUSTED TO REPORT DATE (PBGC % Factors): $79,675.68

MARRIAGE DATE: 6/12/1989 EMPLOYMENT DATE: 9/20/1989

MARITAL COVERTURE % OF PRESENT VALUE: 40.7% AMOUNT: $32,428.00
(Report date value of the pension attributable to the marriage.)

COVERTURE VALUE, ASSUMING 50-50 SPLIT, TO SPOUSE: $16,214.00

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%, 3.2%, compounded annually. You can use the same % factor to adjust the value up to the distribution date.

MATURED FULL BENEFIT APPRAISAL USING PBGC ANNUITY RATES

DATE OF REPORT: 9/27/2004 ATTORNEY: Jennifer Wilson

PENSION HOLDER: Mary Jones DOB: 6/11/1964

PENSION PLAN: New York State and Local Retirement System

APPRAISAL DATE: 7/15/2004 Female AGE: 40.09

RETIREMENT DATE ASSUMING CONTINUED EMPLOYMENT: 11/15/2021

AGE ON PENSION INCOME COMMENCEMENT DATE: 57.43

ANNUAL PENSION INCOME: $21,387.12

PBGC DATA: INITIAL RATE = 4.2% YRS: 20
ULTIMATE RATE = 5 % PBGC FACTOR: 7.0608
LOADING: 7750 MORT. TABLE: VIII

APPRAISAL DATE PRESENT VALUE BASED ON EMPLOYMENT UP TO THE RETIREMENT DATE AS SHOWN IN THIS REPORT: $158,760.00

PRESENT VALUE ADJUSTED TO REPORT DATE (PBGC % Factors): $159,606.72

MARRIAGE DATE: 6/12/1989 EMPLOYMENT DATE: 11/15/1989

MARITAL COVERTURE % OF PRESENT VALUE: 45.82% AMOUNT: $73,131.80
(Report date value of the pension attributable to the marriage.)

COVERTURE VALUE, ASSUMING 50-50 SPLIT, TO SPOUSE: $36,565.90

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%, 3.2%, compounded annually. You can use the same % factor to adjust the value up to the distribution date.

As we can see from the previous reports, Mrs. Jones’ pension has a marital property value of $40,703.80 more than Mr. Jones’ pension. Using a 50-50 split, this means that she owes him $20,351.90 from her pension. Mr. Jones, however, had $191,857.90 in his annuity fund on July 15, 2004. Using a 50-50 split this means that he owes her $95,928.95. When we subtract the $20,351.90 that she owes him from the pension, we have a balance owed by him to Mrs. Jones of $75,577.05. It should be pointed out that even though the marriage spans the total employment up to the appraisal date, the coverture is much less than 100% because New York State uses the Matured Full Benefit pension valuation methodology which carves out the marital portion by projecting employment to the earliest unreduced retirement benefit date under the plan so that all of the plans benefits are taken into consideration and then carving out the marital portion. We can now use the balance of this account to settle the rest of the equitable distribution issues in the case.

THE SETTLEMENT AGREEMENT

Once all the appraisals of the marital property assets are completed, the parties, and their attorneys, are ready to commence settlement procedures. This begins by each attorney explaining to their client what marital assets are involved and their various values. The client then expresses his or her goals for the settlement. If they are realistic each attorney drafts a proposed settlement agreement and a settlement conference is scheduled so a negotiated property settlement can be reached and a costly and prolonged litigated settlement can be avoided. If each attorney has done their job and obtained objective, comparable marital property appraisals and prepared their clients to be realistic in negotiations, the settlement conference should be successful.

In our hypothetical case the parties, having been properly prepared by their attorneys, are realistic in their expectations, understand the law and want to avoid litigation. The settlement conference results in a property settlement agreement that is acceptable to all. Now a final settlement agreement can be drafted which both husband and wife will sign. This is the document that controls the property distribution and all subsequent processes in the divorce.

Following are the terms of the settlement which are incorporated in the agreement:

1. Mr. Jones will keep his Ford Explorer and assume responsibility for the payments owed on it. Mrs. Jones will keep the Volkswagen Jetta and assume responsibility for the payments owed on it.

2. A Qualified Domestic Relations Order utilizing Mr. Jones's defined contribution annuity fund account will be used to make the marital property adjustments. Before other adjustments Mrs. Jones is owed $75,577.05 from the account.

3. There is $7,000.00 in other marital debt so Mrs. Jones' annuity distribution will be increased by $4500 (Mr. Jones' share of the debt, $3500.00, plus the estimated taxes and the 10% early withdrawal penalty that Mrs. Jones will accrue if she actually withdraws $7,000.00 from her IRA after a tax-free distribution to the IRA she opened to receive the trustee-to-trustee transfer of funds) as Mrs. Jones has agreed to pay off the debt once she gets the distribution of her share of the annuity funds. (The use of a Qualified Domestic Relations Order to distribute the annuity funds to Mrs. Jones gives them access to the cash necessary to retire this debt.)

4. Mrs. Jones wants to keep the house with $40,000 in equity plus $6,000 in furnishings. This means she must give Mr. Jones $23,000 for his share. To accomplish this, the $23,000.00 will be deducted from Mrs. Jones share of the annuity.

5. A Qualified Domestic Relations Order awarding Mrs. Jones $57,077.05 ($75,577.05 +$4,500 for her share of the debt and the withdrawal taxes, less $23,000 for credit to Mr. Jones for his share of the house and furnishings = $57,077.05) as of July 15th, 2004. The Order will include passive earnings on the portion of the account awarded to Mrs. Jones between the marital property accrual cut-off date (appraisal date) and the projected distribution date. An Order must be prepared and submitted to the judge and the annuity plan administrator so distribution of these funds can be made to Mrs. Jones.

6. Mr. Jones will keep the $134,780.85 remaining balance of his annuity fund on the marital property cut-off date, July 15th, 2004, as his separate property.

7. The parties have agreed to a semi-joint custody agreement with Mrs. Jones being the primary custodial parent and Mr. Jones having custody on alternating weekends and annually alternating holidays. Mr. Jones will have the right to have the child accompany him on any vacation trips that do not conflict with the child's schooling. Mr. Jones will have to make child support payments of $750.00 per month, plus annual increases based on the published Consumer Price Index (CPI) for each previous year until the later of their child reaching 18 years of age or graduating from high school. If the child quits school and does not graduate it is understood that support payments will then stop at age 18. If the child subsequently decides to go back to school after support payments have terminated, Mr. Jones will not be required to resume support payments.

8. Mr. Jones will furnish medical insurance coverage for the child until the later of their child reaching 19 years of age or graduating from high school. If the child quits school and does not graduate it is understood that support payments will then stop at age 19. If the child subsequently decides to go back to school after medical insurance coverage has terminated, Mr. Jones will not be required to resume medical insurance coverage.

9. Mrs. Jones will pay non-covered medical expenses for the child.

10. The attorney representing the wife shall be responsible for the preparation of the Qualified Domestic Relations Order. Mr. Jones has agreed to pay 50% of the cost of the preparation of the Qualified Domestic Relations Order. The Order will be presented to the judge for signature concurrent with the issuance of the final decree.

All cases should be this easy, and they can be, if each attorney works hard to keep their client's expectations realistic and each attorney works with the other to get all the information necessary to have a successful settlement conference.

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) 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.

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