



Divorce, Pensions and Retirement Benefits

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Paul Commerford - President - LawDATA, Inc.

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THE QDRO GAMBLE (Part Two)

Introduction:

Last month we began a series on the problems that attorneys may encounter when submitting a Qualified Domestic Relations Order. Specifically, these articles are targeted to show you how your intentions may not stack up against reality if you do not consider all the things that might occur between the date your order is accepted by the plan and the date it actually goes into pay status. In the past I have pointed out the potential problems that are inherent in defined benefit QDRO's. Those are the orders that deal with traditional post-retirement monthly income pensions. Defined contribution plan orders (401k plans, Retirement Savings Plans, ESOP's, etc.) which provide lump sum distributions can be tricky but are not usually the potential minefields that defined benefit plans can be. Last month, in the first installment of the series, we looked at the effects inflation can have on an order and some tips on how to anticipate these problems and some suggestions on involving your client in the decision making process as to how they can be addressed. (By the way, knowing about the potential problems that may exist because of case law or pension provider distribution provisions, advising the client of these potential problems and getting them involved in the distribution options is the attorney's best protection against future malpractice claims.) This month we are going to look at the evolving nature of defined benefit QDRO's and suggest some property settlement language to protect your client in particular situations.

Tip of the Month:

If you have any doubts about your expertise in understanding the distribution of marital property retirement assets or how a plan actually works and what benefits are available to an alternate payee, get help early in the negotiating process –NOT AFTER THE PROPERTY SETTLEMENT AGREEMENT HAS BEEN SIGNED.

I've been involved in structuring retirement asset settlements and domestic relations orders since 1985 and what was true then is true today. The biggest problem we face in drafting a domestic relations order is trying to craft an equitable order when relying on settlement language that is detrimental to the attorney's own client. In many cases the attorney for whom we are drafting the order also drafted the retirement asset portion of the property settlement agreement. When we call the attorney to point out the problems for his or her client the standard reply is; "I can't go back and get it changed now so just do the best you can do." A 10 minute phone call to us or any other pension consulting company (usually gratis in anticipation of future relationship with the attorney) would have prepared the attorney for negotiations and provided him or her with the knowledge necessary to avoid most of the potential hazards. Even if the attorney was unsuccessful in getting the very best deal for the client at least the client could have been forewarned and involved in the decision to forego something more beneficial thereby eliminating future recriminations.

THE QDRO GAMBLE (PART TWO)

*** The Coming Apocalypse for Defined Benefit Plans?** - There is a developing problem that I believe must be considered when negotiating the settlement language addressing future pension payments. If you use a Qualified Domestic Relations Order as the settlement tool in a State that employs Matured Full Benefit distribution methodology (non-participant's share of the pension is based on actual retirement income of the participant) and you represent the non-participant spouse, you will be facing this problem.

Anyone who has been following the business journals and newspaper articles has to be aware that on-going, and future, defined benefit plan pension obligations are forcing company and public plan providers to rethink how to finance their employees' retirements. With a rapidly aging population, the cost of continuing to provide generous, guaranteed annual pension income, at little or no cost to the employee, is fast becoming too burdensome. Public plans will probably retain their current benefit structure because funding requirements can be met by simply increasing the taxpayers' burden. Also, the government employee workforce is more unionized and much less likely to allow a major cutback in benefits. But that is not the case with private plans. The trend in the nineties of terminating defined benefit plan pension plan accruals and switching to defined contribution plans (401k's, etc.) or defined benefit cash balance plans continues in the early two thousands and will only accelerate in the future.

Matured full benefit pension distributions are crafted with the intent of paying the non-participant spouse with dollars having the same purchasing power as the dollars received by the participant. This is the only way to protect the distribution against the potential erosion of purchasing power due to inflation and an attempt to provide the same benefits (on a pro rata basis) to both parties. It is not a perfect solution to the problem but, unlike deferred vested distributions, it at least attempts to provide an equitable distribution. It is highly likely that in the next 20 years private pension plan providers will replace most pensions with some sort of defined contribution scheme or a defined benefit cash balance plan and the intent of your order (and that of the State's mandate) will be severely compromised. In the sample settlement paragraphs which follow I tried to address this very foreseeable problem in private plan matured full benefit distributions with language that will at least retain most of the original intent.

If the defined benefit pension plan is terminated and frozen prior to the retirement of the participant and the company commences to provide matching contributions to a defined contribution plan, then only the participant will continue to accrue benefits in the new plan. The QDRO cannot address this because that plan will not be marital property. The intent of the settlement agreement was to have the non-participant's share determined using the participant's actual pension income at the time of retirement. To deal with this you can use an estimate of what was expected, without the change in plans, to craft language that will address this possibility. I do not think it is possible to address the potential loss incurred by both parties when supplemented early benefits are eliminated, but the language I use at least protects some of the purchasing power.

If the defined benefit pension plan values are rolled over to a defined benefit cash balance plan prior to the retirement or termination of the participant then it is necessary to instruct the plan to continue the alternate payee's participation in the new plan on a pro-rata basis.

SAMPLE PROPERTY SETTLEMENT LANGUAGE

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, 2002 (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 $14.8 \text{ years} \div \text{total number of years of pension accrual service credited to the husband at the time the pension goes into pay status}$ 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 $\times 14.8 \text{ years} \div \text{total number of years of pension accrual service credited to the husband at the time of his death}$). 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 ($14.8 \text{ years married} \div 31.2 \text{ years of projected employment at age 62} \times 50\% = 23.718\%$). If the accrued benefit of the husband is less than the amount provided by the foregoing formula at the time the plan is terminated then the portion of the pension payable to the wife will be 100% of the accrued benefit as payable in the form of a 50% Joint and Survivor annuity with the wife being named the beneficiary of 100% of the survivor annuity.

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 forwarded to the plan administrator to implement the intent of this section of the agreement.

B: Private employer – pension only –matured full benefit State – no 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, 2002 (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 ($14.8 \text{ years} \div \text{total number of years of pension accrual service credited to the husband at the time the pension goes into pay status}$) in the actual pension received by the husband at the time the pension goes into pay status. The pension to the wife is to be paid in the form of a Single Life Annuity, actuarially

adjusted so it is payable for the balance of her life. The wife can elect to commence payment of her share anytime after the earliest date the husband is eligible to receive his pension, whether or not he elects to do so. If she elects to commence receipt of these benefits prior to the commencement of payments to the husband, then the portion of the pension awarded to her will be determined by dividing 14.8 years by the total number of years credited to the husband at the time she commences receipt of these benefits X 50% X the husband's accrued pension benefit on the date she elects to commence receiving her benefits. If the wife commences receipt of her benefits prior to the normal retirement date of the husband or if elected by the husband, prior to his retirement and receipt of supplemented early retirement benefits, if permitted by the plan, then it is understood that additional reductions, for early commencement of the benefits, shall apply to the portion of the pension awarded to the wife. Any passive, post retirement increases (i.e., COLA adjustments, across the board 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, the 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 single life 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 ÷ 31.2 years of projected employment at age 62 X 50% = 23.718%). If the accrued benefit of the husband is less than the amount provided by the foregoing formula at the time the plan is terminated then the portion of the pension payable to the wife will be 100% of the accrued benefit as payable in the form of a single life annuity.

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 forwarded to the plan administrator to implement the intent of this section of the agreement.

[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.