Divorce, Pensions and Retirement Benefits

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THE QDRO GAMBLE (Part Three)

Introduction:

This is the third installment in a series on the problems that attorneys may encounter when submitting a Qualified Domestic Relations Order. This series, for the most part, deals with 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. In the first installment of the series, we looked at the effects inflation can have on an order and offered some tips on how to anticipate these problems and some suggestions on involving your client in the decision making process. Last month we looked at the evolving nature of defined benefit QDRO's and suggested some property settlement language to protect your client in particular situations. This month we are going to explore the problems you may encounter when dealing with a plan that refuses to honor an order that complies with ERISA and IRS regulations or simply creates unnecessary problems to discourage the use of a QDRO. The second example applies to lump sum Defined Contribution orders.

Tip of the Month:

Time is critical if you are using a QDRO and represent the alternate payee.

1. Until the plan receives a signed QDRO they are under no obligation to honor the terms of the final decree if the participant were to die in the interim. This could mean the former spouse gets nothing if after the divorce is finalized the participant has removed the alternate payee as the beneficiary for the survivor benefits and dies with no survivor benefits. We have seen cases where the participant has remarried and died, with the new spouse getting the survivor benefits, while the attorney for the alternate payee never got around to submitting an order that named the former spouse as the survivor. Clients always think they are protected because the final decree awards them a share of the pension and/or names them as a beneficiary for payment of survivor benefits. Without a signed QDRO there is no protection. The signed order does not have to have been approved by the plan before the death of the participant but it must have been submitted to them.

2. If the participant has accrued a highly valued defined contribution plan (401(k), ESOP, Retirement Savings Plan, etc.) he or she has every right to quit their job, withdraw all of the proceeds from the account, and move to Costa Rica. The plan has to pay the participant his or her vested interest immediately under those circumstances. Without a QDRO on file, the plan has no idea that a portion of the account has been awarded to the former spouse.

THE QDRO GAMBLE- (PART THREE)

*** Some plans do not play by the rules!** - The Retirement Equity Act of 1984 and the amended IRS sections make it pretty clear as to what the plan's obligations are upon the receipt of a Qualified Domestic Relations Order. But I have run up against plan attorneys who just refuse to comply. The law does not cite a specific distribution formula but simply states that the amount payable to the alternate payee must be easily determined by the plan with either a dollar amount, a percentage or an easily understood formula.

A couple of years ago, I ran into a plan in a matured full benefit state (usual formula = 50% of the marital portion of the actual monthly pension paid when it goes into pay status with the marital portion determined by dividing the number of months married while employed by the total number of months of employment at the time of retirement). In this case the parties were married for 14 years and the participant could retire in 16 years at age 55. If the participant elected to retire at age 55 and begin receipt of his supplemented early pension he would get $2,500.00 per month in today's dollars or $4,011.77 assuming a 3% annual inflation factor for the next 16 years when it would actually go into pay status. Most defined benefit plans are structured to maintain parity with inflationary growth at least until they go into pay status. In this plan, the benefit amount would not increase if the participant were to work past 30 years and the nature of his employment was physically taxing. It was easy to foresee that he would probably retire at age 55 with 30 years of service.

The plan rejected the proposed QDRO and said that they would only accept orders awarding the alternate payee an interest in the accrued benefit up to the marital property cut-off date (date of filing of a complaint for divorce in the subject state) payable to the alternate payee on the plan's "normal retirement date" (participant's age 65). This meant that the alternate payee would only be awarded 50% of the participant's accrued benefit, $1,166.50 per month on the cut-off date, or $583.25 per month when the participant reached age 65 while the participant was going to get $4,011.77 per month at age 55 and beginning at age 65, he would get $3,428.52 per month after payments to the alternate payee commenced. (There was also a 50% survivorship involved which would have reduced all the amounts payable to the wife and the husband by about 10% but for the sake of simplicity we will forget that for the moment.) It is obvious that the alternate payee is not getting 23.33%, the actual marital award of the participant's pension and the portion that represented 50% of that part of the pension that was attributable to the marriage. If that was the case she would have been getting $935.44 per month commencing on the husband's 55th birthday assuming he were to retire with his supplemented early pension. This is what the original language in the order would have provided.

I called the plan's attorney who told me that this was how the plan interpreted the Retirement Equity Act of 1984 (the "Act") and this was what the plan's members wanted (it was a union plan). He said that if the alternate payee wanted redress she would have to go into federal court and challenge the plan's interpretation of the "Act". Off the record, he told me that nobody had ever taken up the challenge because few divorcing spouses had the funds necessary to pursue a federal ERISA case. All I could do was report the situation to the attorney for whom we were preparing the order. He later advised that his client was not going to pursue the issue and would settle for what the plan would allow. Over her lifetime, she would be receiving over $160,000.00 less than she was awarded because of the position taken by the plan. If you consider the actuarial implications of her having to wait until his age 65, while he got full benefits at age 55, the inherent disparate distribution was compounded.

If you run into a situation like the foregoing your only option is to advise your client of what they are up against. It has to be their decision but very few clients will have the resources and the inclination to pursue the matter even though, in all probability, they

would prevail. The bottom line is that if the plan will not play by the rules they have very little liability exposure and they know it. The Retirement Equity Act of 1984 makes the plan administrators the final arbiters of interpreting the rules as they apply to their plan's bylaws. Their decisions would have to be challenged in court.

* How to make a defined contribution plan distribution really difficult! Usually, Defined Contribution plan Qualified Domestic Relations Orders are much easier to draft than orders addressing Defined Benefit plans. But in the past couple of years we have encountered a real problem in trying to make the QDRO language address the correct amount to be paid to the alternate payee in a lump sum from a defined contribution plan. Usually language such as the following is sufficient:

The alternate payee is awarded 50% of the participant's account as of May 30, 2001 (or the closest plan valuation date to May 30, 2001 if valuation on that date would require the plan to incur additional expenses) plus or minus any earnings, gains or losses thereon, up to the actual date of distribution to the alternate payee. If permitted by the plan,, payment to the alternate payee shall be made immediately upon receipt and approval of this order.

Now, many plans are taking the position that they will not compute the gains or losses on the portion of the account awarded to the alternate payee and will only accept an order that states a final dollar amount. That dollar amount figure can be very difficult to determine in these days of wildly fluctuating equity accounts. If the participant has kept all of his quarterly statements the figure can be arrived at by backing out all post cut-off date contributions made by the plan and the participant and isolating the actual quarterly percentage gains or losses so they can be applied to the alternate payee's share. But this can be a time consuming and costly exercise, especially if a number of years have transpired between the cut-off date and the preparation of the QDRO, which is often the case. Very few plans will provide duplicate statements if the participant did not retain his or her statements. The plan usually claims that they do not keep copies and generating new ones is too time consuming and costly. Rarely will a participant have all of his or her statements so even when they are available you often have to impute some figures.

When the records are not available, you are left with no alternative but to go back to the negotiating table and get the parties to agree on a figure for the distribution. If you anticipate a QDRO on a Defined Contribution plan check with the plan before you commence negotiations to be sure they will compute the balances. If they won't you will at least know early on that you have a problem and hopefully can get it resolved during property settlement negotiations rather than after the divorce has been issued and additional legal fees become difficult to collect.

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.