



Divorce, Pensions and Retirement Benefits

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THE QDRO GAMBLE (Part One)

Introduction:

A lot of things can happen between the time a QDRO is entered and the time it goes into pay status. How can attorneys advise their clients about the many unanticipated situations that can completely change the nature of the benefit for which they thought they had been negotiating if they don't know how pensions work. In some states, because of really bad case law, a QDRO should be used only as a last resort and the client should be fully aware of that fact. But few attorneys properly advise their clients of potential QDRO hazards or try to mitigate them. For the next couple of months we are going to look at some of the problems that use of a QDRO as the retirement benefit settlement tool can create. In some cases these problems are out of the control of the attorney but if the client (who is relying on the expertise of the attorney) is not made aware of these potential hazards it will be the attorney who will be blamed for any unrealized expectations. This month we are going to look at the effects of inflation on an equitable settlement.

Tip of the Month:

AN OLDIE BUT GOODIE!

The easiest way for an attorney to get into a QDRO problem, if they represent the alternate payee, is to let the opposing counsel prepare of the order.

If you represent the alternate payee it is your responsibility to protect your client and insure that the QDRO that is filed reflects the agreement as negotiated. In the preparation of a QDRO there are always issues that must be addressed that weren't covered in the negotiation but which, if not properly worded, could have a negative impact on the terms of the settlement. Rarely do these issues become "after the fact" problems because their inclusion is usually considered fair and part of the settlement. For example, the alternate payee's share of post-retirement across-the-board passive benefit improvements (COLA's, renegotiated union contracts affecting retirees, etc.) often will not be paid to the alternate payee unless specified in the order. If you don't write the order you might not even think of their existence, much less take issue with your opposing counsel when no mention of them is made. But your client will certainly learn of them sooner or later and you will be blamed for their absence. That is just one example of the many things that can be overlooked if you do not prepare the order. If you represent the alternate payee you have the duty of insuring that an order is drafted and that the client receives every component of the benefit normally paid to an alternate payee. There is no sense of responsibility on the part of your opposing counsel to your client and certainly no sense of urgency. If the participant dies or leaves employment prior to the submission of an order (though not necessarily the approval of the order) your client might get nothing.

THE QDRO GAMBLE- (PART ONE)

The Inflation Nightmare - We still see settlement language that awards the alternate payee "50% of the accrued monthly pension benefit" on the marital property cut-off date. This means exactly what it says. The alternate payee's share of the benefit will not increase one cent between the cut-off date and the date it goes into pay status. Traditional pensions (defined benefit plans) do not have any provisions for paying interest or adjusting the monthly income because there is not an individual investment account backing up the pension income. Pensions are promises to pay a future monthly income based on a formula and backed up by a large investment account based on the actuarially determined amounts needed to fund pension benefits to all the employee participants. Once the alternate payee's share is defined using the previous language that is all that will be paid.

In some states this is the best you can do (see more later) but we see this in states that do allow for an equitable pension distribution. The award should be "50% of the marital portion of the gross monthly benefit paid at the time the pension goes into pay status". The marital portion is defined as a percentage determined by dividing the total number of months married while employed by the total number of months of employment at the time the benefit begins being paid. To illustrate the difference, if a couple were married 20 years and on the cut-off date the participant had an accrued pension benefit of \$1,000.00 per month payable at age 65 the alternate payee would get \$500.00 per month when the participant reached his normal retirement age, 65. Assume each party is 45 years of age on the marital property cut-off date. For the purpose of this example we will forget about the fact that the plan might have supplemented, early unreduced benefits and assume retirement commences at age 65. To keep it simple we will also assume that the alternate payee was also awarded her share of the joint and survivor benefits but limited to the same amount as she would receive if the participant had not predeceased (\$500.00 per month). We only want to isolate the effect of inflation on the settlement.

Assuming a 3% annual inflation, the portion of the actual pension paid to the participant after retiring at age 65, based on the first 20 years of employment, the marital portion, will be \$903.06 per month. The alternate payee's share stays at \$500.00. Based on historical inflation factors, it is probably more realistic to assume an average inflation rate of 6% over the 20 years between the cut-off date and retirement. In that case the participant would receive \$1,603.57 per month as the marital share while the alternate payee still only gets \$500.00 per month. This is because pensions are based on a formula that uses the highest average salaries to calculate the participant's benefit at the time of retirement. This automatically adjusts the accrued pension income for inflation as salary increases generally reflect cost of living increases, unless the employee is on a fast track moving up the management ladder. The participant's total pension is unjustly increased by \$1,103.57 per month, using the 6% assumption, with dollars that really should go to the alternate payee as they were earned during the marriage and should be part of the alternate payee's 50% marital share.

From the previous, you can see how it is possible to structure a totally inequitable distribution while on the surface it appears that the employee's pension was fairly distributed. If your state permits otherwise, never use language that awards "50% of the accrued monthly pension" on the marital property cut-off date. If the correct language was used each party would get the same amount of monthly income for the portion of the pension attributable to the marital period.

Addressing State Statute/Case Law Problems - If you practice in a state that only permits distribution of the accrued benefit determined on the marital property cut-off date (PA, FL, IN, NC, SC, etc.) then, as you can see from the above example, use of a QDRO guarantees an inequitable distribution. Of course, if the participant wants to be reasonable there is nothing in the law to prevent structuring an equitable QDRO but as we all know "reasonable" is more often than not a missing factor in the divorce process. You

will have to be creative to salvage some equity for your client if you are locked into an unfair settlement by statute and/or case law in your state.

One way to protect the alternate payee is to use an immediate offset of property (i.e., a bigger share of the home equity to offset the present value of the pension) combined with making the alternate payee the sole beneficiary of the pension plan's pre and post retirement survivor annuity. The participant's gross pension will have to be reduced by about 10% to fund this benefit but that is exactly the pension that would have been paid if the parties had not divorced so in a way the participant is not giving away anything. You will have to draft a QDRO to lock in this provision.

If the alternate payee is female, and better still younger than the participant, actuarially, she has an excellent chance of reaping the rewards of this option and will be paid the survivor benefits with dollars having the same purchasing power as the dollars that would have been paid to the participant. Even if the alternate payee has to take less than 50% of the present value of the pension, this is still a better settlement than using a QDRO to distribute the pension using the provisions required in your state. If the parties do not have enough marital assets to make the offset, consider structuring an amortized payment (using a realistic interest rate) over as many years as necessary (based on the participant's disposable income) to reimburse the alternate payee for the portion of the present value of the pension that is awarded. This can be an attractive alternative to all involved. With alimony practically dead and buried in many states, additional income following the divorce can be very attractive to the non-participant spouse.

Unless the participant is contemplating an immediate remarriage, giving away the survivorship benefit after he or she dies can be very palatable. Deep down, everybody thinks they are immortal or at the very least that they will outlive their ex-spouse. Because of this many participants sincerely doubt that their ex will see a dime. So, in their mind they are not giving away anything.

[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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