Divorce, Pensions and Retirement Benefits

Number: 49 Paul Commerford - President Emeritus - LawDATA, Inc. December 2006

SOME IDEAS FOR ADDRESSING PLAN TERMINATION CONTINGENCIES

(See next page for this month's article)

Practice Tip of the Month:

Dealing with Plan Administrators who refuse to honor and approve a properly written Qualified Domestic Relations Order.

Over the years we have encountered many situations wherein, we drafted an order that was definitely in compliance with The Retirement Equity Act of 1984 (the law that created private pension QDRO's), and its revisions over the years, only to have it rejected by a plan reviewer. The order drafted met the terms of the agreement and was in total compliance with the law but the reviewer, backed by the plan attorney and/or administrator, would not approve it unless it was written to the plan's exact specifications, which, if we complied, in one way or the other, would do financial damage to one of the spouses and be contrary to what was agreed upon by the parties or ordered by the judge.

Naturally, we try to reason with the powers that be at the plan, and occasionally prevail, but often it is to no avail. In cases like this we have no choice but to go back to the attorney who requested the order and advise her or him that their client, and the opposing counsel's client, will have to decide to accept the plan's decision, and we will redraft the order, or take the plan into federal court in an attempt to enforce the order as written. Issues such as this are federal and come under the jurisdiction of the ERISA laws. We have encountered this more with labor union managed plans than private companies but both entities have taken this position over the years.

Going into federal court against a well funded labor union or corporation is not going to be cheap. In every case that I am aware of, the clients relented and took the order acceptable to the plan.

I am telling this to you so you can advise your client that it is always the retirement plan that has the last word on the validity of a Domestic Relations Order and on whether or not it is qualified, and that sometimes, life just isn't fair.

Introductory Special!

Free Pension Appraisal

If you are an attorney who has never used our services, then let us prepare a free pension appraisal (a $150.00 value) so that we can demonstrate to you the outstanding support and expertise we provide to every one of our attorney/clients. We make this offer knowing that once you try us you will become a regular client.

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SOME IDEAS FOR ADDRESSING PLAN TERMINATION CONTINGENCIES

Last month I discussed the more than likely demise of many private company defined benefit plans (monthly pension schemes). This month I am going to throw out some ideas on how the practitioner can attempt to address these contingencies, which are very real. The solutions, in many cases, are unwieldy and will be refined as we learn more about how plans are redefining their retirement plans and what will be acceptable to their administrators. But for the time being there is no easy, one method fits all, solution to address every possible contingency. Remember, none of this language can find its way into a Qualified Domestic Relations Order unless it is in the settlement agreement or final decree.

I am going to repeat much of what I have written in previous newsletters when things were more speculative. Frankly, the speculative nature of the problem is diminishing as more and more realities emerge. The airlines and auto industries are only the tip of the iceberg. All manufacturers with defined benefit plans will eventually wind up in the same boat. Hospitals, banks and other local service businesses will maintain their defined benefit plans for a while longer but eventually succumb to the lure of lower cost retirement benefits. Only government (taxpayer) funded plans seem secure for the foreseeable future, even though many of these are seriously under-funded. Some of these suggestions will work in most of the cases you will encounter but there are unknowns that can only now be imagined as plans try to get a handle on their financial retirement and medical benefit burdens while still trying to provide some kind of future security for their employees. New retirement schemes will probably be proposed and approved in the coming years, and those will be impossible to address, other than vaguely, at the present time.

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 is 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 for a 60 year old male about to retire, to determine its value in the annuity market place, it would have a present value of $434,365.00. Theoretically, the plan provider should have that amount of money put aside, or some methodology to establish that there will be that much money available, 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 managers to sometimes 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, alone, 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. This is just one example of what U.S. manufacturers face in a multi-national economy where their foreign competitor's retirement and health burdens are a fraction of ours. This is unsustainable.

Most of America's larger airline companies are, or have been, 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 and often see higher paid employees who retired early with supplemented benefits have their pensions cut by 50% or more. A properly drafted QDRO will insure that both parties share proportionately in the unfortunate financial reversals suffered. PBGC does not honor supplemented benefits, which most private plans provide.

Every time you structure a settlement agreement that includes provisions for a Qualified Domestic Relations Order on a private company pension plan (many public employee plans, funded of course by taxpayers, are amazingly, becoming more and more generous) you must take these realities into consideration if you are trying to protect the non-participant spouse, or for that matter, the participant from bearing the burden of the restructured plan.

You cannot, in good conscience, assume that the pension plan that you are addressing today, 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 the attorney needs to consider for the protection of the client as well as him or her self. 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 ÷ total years of plan covered employment at retirement) X the actual retirement income. Following is some settlement agreement language that addresses a few of these problems (but not all) and could be included in a subsequent Qualified Domestic Relations Order. The present difficulty is that plan administrators do not like to see 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. I know many plan administrators and actuaries read these newsletters and I would love to hear of some of their ideas on how to deal with these problems.

The other major difficulty caused by these economic changes will be in States where the sharing method is used to prepare a pension valuation and distribution is made by immediate offset against another asset (house, stock portfolio, etc.). The sharing method assumes the employee continues employment and receives all the benefits that would accrue to such an employee, including early, supplemented benefits but bases the appraisal on the salary currently being received with no assumption of future wage increases. The appraised value therefore takes into consideration the future supplemented benefits if they are part of the present pension plan. If the employee believes his or her future pension is in jeopardy they will be very reluctant to settle on an immediate offset basis if the value of their pension is predicated upon benefits they no longer have confidence in receiving. That will leave the practitioner no choice but to use a QDRO for settlement purposes, which can address these contingencies. I anticipate that will eventually become the norm when attorneys are dealing with defined benefit pensions in States that use Matured Full Benefit Methodology (sharing method) to determine the present value of the pension when addressing private company pension plans. In States using deferred vested methodology, the problems are not as looming but are still substantial. We will deal with their situations in an up-coming newsletter

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

The husband has a pension through his employment with the Jones 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, 2005 (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 ÷ 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 X (14.8 years ÷ 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% (or 100% if that amount is more than available in the frozen benefit) of the actuarial value 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 ÷ 31.2 years of projected employment at age 62 X 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 paid to the alternate payee immediately after the defined benefit plan is rolled into the defined contribution plan. She will remain the beneficiary for her share of the restructured plan until such time as payment is made to the former spouse.

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 by using a coverture calculation (number of months married while employed ÷ total number of years of employment on the earliest date the former spouse is entitled to receive unreduced benefits) and distributed to her at that time. She will remain the beneficiary for her share of the restructured plan until such time as the lump-sum payment is made to her.

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 is 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 really difficult, when the plan is transferred into another entity, to try to protect the parties' 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**) that deals specifically with the 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.

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