



HOW TO AVOID UNEXPECTED SURPRISES WHEN USING A QDRO AS YOUR SETTLEMENT TOOL WITH A DEFINED BENEFIT MONTHLY INCOME PENSION

Introduction:

Last month we examined the implications of the different methodologies used to identify the marital portion of a defined benefit pension when making an immediate offset settlement. The same problems relating to how the pension income is defined are also inherent in any settlement involving a defined benefit pension using a Qualified Domestic Relations Order (QDRO). Again your choices might be limited by the case law in your state but knowing what is the right thing to do will serve you and your client well no matter what the case law might be. Unless the participant is already retired, the amount of the pension income payable to the non-participant spouse is never really known until the pension goes into pay status, misunderstandings in this area of your practice might not reveal a potential problem until many years in the future. The best way to avoid those problems is to make it absolutely clear to your non-participant client exactly what was bargained for and what to expect in the future when the income commences.

Tip of the Month:

The Individual Retirement Account (IRA) and Qualified Domestic Relations Orders.

Most attorneys know that the best source of a substantial amount of money for the non-participant spouse is the immediate distribution of the marital share of a lump sum retirement account such as a 401k or an ESOP. They are also aware that a Qualified Domestic Relations Order must be filed with the plan to effect the immediate distribution to a non-participant spouse. It is not necessary to draft a QDRO to get the funds from an IRA but many custodians of IRA accounts (brokerage firms, banks, mutual fund companies, etc.) will not pay the money to the non-participant spouse without a QDRO if only the participant's name is on the account. The tax implications of early payment to a non-participant spouse, even if a trustee to trustee distribution is requested, and the potential of becoming involved in the divorce litigation, make the plans wary of distributing funds without a court order. While law does not require a QDRO, many plan attorneys take the position that this is the surest way to avoid problems. Using a QDRO makes it easier all around and avoids putting the participant in the position of controlling the distribution. Build the cost into your fee when you encounter this situation.

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The awarding of deferred defined benefit marital pension benefits is usually stated in a property settlement agreement in one of three ways.

1.) The wife (or husband) shall receive 50% of the accrued pension benefits as of (date).

or

2.) The wife (or husband) shall receive 50% of a fraction of the pension the participant spouse receives at the time of his/her retirement. This fraction shall be determined by dividing the total number of months the participant accrued during the marital period up to the marital property cut-off date by the total number of months credited to the participant at the time the pension goes into pay status.

or

3.) The wife (or husband) shall receive 50% of the marital portion of the pension.

For the purpose of this discussion I am going to assume that in each case the non-participant spouse is named the beneficiary of the marital portion of the survivor annuity. Survivor benefits are another issue that we shall look at in-depth at another time.

Using the language in example # 1, the alternate payee will receive 50% of the accrued pension as of the marital property cut-off date. Assume the participant had been employed for 15 years and the marriage preceded his employment. So, if on the marital property cut-off date the participant had accrued \$1,000.00 per month in pension benefits commencing at age 65, the non-participant will get \$500.00 per month when the participant turns 65. If we assume the parties are both currently age 40 then the non-participant spouse will have to wait 25 years to get her share of the pension. This is a defined benefit plan and as such there is no account in the name of the participant on which to earn interest. The amount that was awarded in the QDRO will not increase one cent over the years. The pension is simply a promise on the part of the plan provider to pay a future monthly income. The income is usually determined by a formula such as the average high salary based on your highest five salaries at the time of retirement times a multiplier (i.e. 1.5%) times the years of credited service at retirement. This is how most (U.S. Civil Service, IBM, GE, state and local government, etc) defined benefit pensions work.

In all probability, over a twenty-five year period, inflation alone will have increased the participant's income by at least 250%. That means that instead of \$1,000 per month in pension income attributable to the marital period (remember the pension is based on the five highest salary years) the participant will be getting \$2,500 per month. Based on the language in the property settlement agreement and its reiteration in the QDRO the former spouse will only get \$500 per month for the same period (\$500 with a substantially reduced purchasing power). The participant retains \$2,000 per month for the marital period accrual plus \$4,166 per month in additional pension income earned after the marital period; up to his retirement at 65. The language in example #1 precludes any other outcome.

The language in example #2 provides a completely different scenario. The non-participant alternate payee will get 18.75% (180 months married while employed divided by 480 months of total employment times 50%) of the participant's full pension of \$6,166.66 per year or \$1,250 per month. This is exactly 50% of the portion of the pension attributable to the marriage and truly represents the intent of community property or equitable distribution.

The language in example # 3 should be avoided at all costs because it is vague in its intent and will invite more negotiation at the time the QDRO is prepared. This language cannot be used in a QDRO as no plan can be sure of the intent of the parties. You will have to spell it out in the QDRO and create new problems when you thought the case was all wrapped up.

Some states (unenlightened to say the least) require settlements based on the example in # 1. Most do not. It is up to you to be familiar with the ramifications of the settlement language you choose, to insure you are getting your client the marital share. If you represent the non-participant spouse, this is critical. In most cases this means 50% of the pension that is attributable to the marital period determined at the time of retirement. The mandate under community property and equitable distribution is to fairly distribute the marital assets. Only the settlement language in example # 2 will achieve this when you are dealing with a defined benefit pension plan.

[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.

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