



METHODOLOGY PROBLEMS WHEN IMMEDIATE DISTRIBUTION OF MARITAL PROPERTY DEFINED BENEFIT PENSION ASSETS IS THE SETTLEMENT VEHICLE

Introduction:

This month we are going to examine the implications of the methodology used to identify the marital portion of a defined benefit pension. The methodology used to value a pension has very great bearing on whether a settlement is truly equitable. Unfortunately in some States the judiciary has failed to grasp the implications of the application of incorrect methodology and the nightmares it creates for an attorney trying to get an equitable settlement for a spouse who is not the plan participant. If you practice in one of those States just be aware of the problems attendant and advise your client accordingly. But many attorneys still fail to properly define the marital portion of a defined benefit pension asset when there are no statutory or case law restrictions.

Tip of the Month:

Property settlement language when using a Qualified Domestic Relations Order.

The retirement asset distribution language in your settlement agreement completely controls the language in the Qualified Domestic Relations Order (QDRO) if that is the vehicle to be used for distribution. It is imperative that the settlement language addresses every contingency you want in the QDRO. That means you better define the distribution formula, the award of survivor benefits and how they are to be paid, the timing of payment commencement, etc. A New York Appellate Court recently ruled that if the provision is not in the settlement agreement it cannot suddenly appear in the QDRO. Most other States would probably concur. This means that as a practitioner you better know what the plan will allow and address the plan provisions in the settlement. Language like "the wife will get 50% of the value of the pension attributable to the marriage payable in a Qualified Domestic Relations Order to be submitted to the court for approval" is not going to fly. You better be prepared to define exactly what each party gets and address any payment provisions like early retirement supplements, lump sums in lieu of monthly income, etc.

METHODOLOGY PROBLEMS WHEN IMMEDIATE DISTRIBUTION OF MARITAL PROPERTY DEFINED BENEFIT PENSION ASSETS IS THE SETTLEMENT VEHICLE

As you may recall from my first article, there is a substantial difference between types of benefit plans. Dealing with a defined contribution plan is fairly clear-cut. Defined Contribution plans are like bank accounts and fairly easy to value and distribute. The big problem is in the methodology to be applied to the valuation of a defined benefit plan. Understanding what is at stake when a method of valuation of a defined benefit plan is chosen is critical to an attorney attempting to settle a divorce case. What I am referring to is whether a Deferred Vested pension appraisal or a Matured Full Benefit pension appraisal is prepared.

A Deferred Vested pension appraisal treats the pension plan participant spouse as if he or she stopped working on the marital property accrual cut-off date and only values the benefit earned up to that date. Anything that happens after that date (supplemented early retirement benefits, future change in the benefit accrual rate based on passing a time deadline [i.e. annual pension accrual rate increases from 1.5% per year for all years of employment to 2% per year for all years of employment once you attain 15 years of employment service]) is not considered in the valuation.

A Matured Full Benefit pension appraisal looks at the whole pension plan, considers all of its provisions, assumes continuation of employment and carves out the marital property portion based on a coverture calculation.

To illustrate the problems in dealing with this issue let us look at a current participant in a General Motors - U.A.W pension plan and the problems created by attempts to establish the value of his pension rights incident to a divorce. Hypothetically, let us assume our individual commenced employment at age 20 and is now 49 years of age. Under the provisions of the GM - U.A.W. pension agreement, if he continues to work he can retire with 30 years of service with a supplemented pension. That is, commencing at age 50 (one year from now) he can retire and receive approximately \$32,760 per year until age 62 (when Social Security benefits begin) and then receive approximately \$16,812 per year in pension payments until he dies. This computes to an actuarially averaged annual life income of \$23,646 commencing at age 50 and continuing until his actuarial death. If, on the other hand, he were to leave employment at this time with 29 years service and at age 49, he would only be entitled to his accrued pension of about \$16,257 per year commencing at age 65 and continuing until his death.

Let us also assume he was married prior to beginning his G.M. employment. Now which is the appropriate assumption to use for pension appraisal purposes? Should we cut off his pension accrual on the appraisal date of the marital assets in the case, thereby assuming no additional employment and no entitlement to the "thirty and out" provisions of the plan (Deferred Vested) or should we assume he continues to work and attains eligibility to the early supplemented pension (Matured Full benefit)? This is not a unique dilemma. While maybe not as radical as the GM-UAW plan, most plans have some sort of supplemented early retirement provision as a reward for longevity.

There are minorities of jurisdictions (i.e. Pennsylvania, Indiana, Florida) that require a Deferred Vested appraisal. In some, even if the employee is eligible for a supplemented pension on the divorce date, but was not eligible on the statutory appraisal date in that State, no consideration to the reality of the value of the benefit can be given. Very technical but not very equitable.

Appraisals (copies attached) using the foregoing GM-UAW example clearly illustrate the problem. A Matured Full Benefit pension appraisal considering the 30 and out provisions

of the plan would provide a marital property value of \$321,754.81. Assuming a termination of employment on the marital property cut-off date and preparing a Deferred Vested pension appraisal only values the marital property pension at \$84,964.

As you can see the marital property value of the same pension is worth over \$118,395.20 more to the non-participant spouse (assuming a 50-50 split of marital pension assets) if we assume the employee continues to work one more year. We are not giving the spouse an interest in that additional year's employment because the coverture calculation backs out that additional year before the marital property portion of the present value is identified. It is a fact that the parties were married and operating as a marital partnership during 29 of the 30 years necessary to earn the supplemented pension. Common sense dictates that 29/30 of the value of the "30 and out" pension is a marital asset. How some States miss this is frankly beyond me but, as they do, you are stuck if you practice in their jurisdiction.

There are situations where it is appropriate to use an assumption of immediate termination and deferment of the accrued pension benefit besides those cases when employment with the pension provider terminated prior to the marital property cut-off date. For example, when the employee's position is threatened because of downsizing or permanent lay-off for economic reasons a Deferred Vested pension appraisal makes perfect sense. Or even in the case of a short marriage and relatively young parties a Deferred Vested appraisal might be appropriate. But in the absence of special circumstances the only equitable approach to the valuation of a Defined Benefit pension is a Matured Full Benefit appraisal unless you practice in a State that ignorantly prohibits this approach.

You get a pass if your State requires Deferred Vested appraisals. But if that is not the case and you represent the non-participant spouse you better understand what is at stake and be fighting to get the best deal for your client. Even in States that have had Matured Benefit case law for decades we see practitioners representing the pension participant using Deferred Vested appraisals and attorneys representing the non-participant spouse accepting those values and settling.

I believe that to ignore a critical provision of a pension plan, such as early, supplemented benefits and then provide a settlement based on the assumption that they do not exist can expose the practitioner, if he or she represents the non-participant spouse, to potential liability unless case law or legislation clearly dictates otherwise.

[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.

DEFERRED VESTED APPRAISAL USING PBGC ANNUITY RATES

DATE OF REPORT: 9 / 1 / 2002 ATTORNEY: Paul Collins

PENSION HOLDER: John Johnson MALE DOB: 8 / 1 / 1953

PENSION PLAN: GM-UAW

APPRAISAL DATE: 8 / 15 / 2002 AGE: 49.03

DEFERRED ACCRUED PENSION INCOME COMMENCEMENT DATE: 8 / 1 / 2018

AGE ON PENSION INCOME COMMENCEMENT DATE: 65.00

ANNUAL PENSION INCOME: \$19,857.12

PBGC DATA: INITIAL RATE = 5.4 % YRS: 25
ULTIMATE RATE = 4.25 % PBGC FACTOR: 4.0506
LOADING: 4221 MORT. TABLE: VII

APPRAISAL DATE PRESENT VALUE OF ACCRUED PENSION BENEFIT: \$84,654.00

PRESENT VALUE ADJUSTED TO REPORT DATE (PBGC % Factors): \$84,964.40

MARRIAGE DATE: 7 / 1 / 1973 EMPLOYMENT DATE: 8 / 1 / 1973

MARITAL COVERTURE % OF PRESENT VALUE: 100.000% AMOUNT: \$84,964.40
(Report date value of the pension attributable to the marriage.)

COVERTURE VALUE, ASSUMING 50-50 SPLIT, TO SPOUSE: \$42,482.20

% OF ACTUAL MONTHLY PENSION INCOME TO BE PAID TO SPOUSE BASED ON REPORT
ASSUMPTIONS IF QUALIFIED DOMESTIC RELATIONS ORDER IS USED: 50.000%

The foregoing appraisal is based on objective actuarial data from the Pension Benefit Guaranty Corporation, a U.S. Government agency. The appraisal date value was adjusted using the applicable PBGC interest rate less 1%, 4.4 % , compounded annually up to the date of this report.

This report identifies the present value of a pension plan providing an annual income for life. No actuarial deviations were made. It does not consider any savings (Defined Contribution) plans (401(k), ETC.).

This report reflects the opinion of LawDATA, Inc. as to the pension values involved. It is based on the information submitted with this appraisal request. ANY QUESTIONS? PLEASE CALL BEFORE WRITING.

MATURED FULL BENEFIT APPRAISAL USING PBGC ANNUITY RATES

DATE OF REPORT: 9 / 1 / 2002

ATTORNEY: Paul Collins

PENSION HOLDER: John Johnson

MALE

DOB: 8 / 1 / 1953

PENSION PLAN: GM-UAW

APPRAISAL DATE: 8 / 15 / 2002

AGE: 49.03

RETIREMENT DATE ASSUMING CONTINUED EMPLOYMENT: 8 / 1 / 2003

AGE ON PENSION INCOME COMMENCEMENT DATE: 50.00

ANNUAL PENSION INCOME: \$23,646.84 (This amount was determined by actuarially averaging the annual income paid from age 50 to 62, \$32,760, and \$16,812, the annual income paid from age 62 until the actuarial death of the participant.)

PBGC DATA:

INITIAL RATE = 5.4 %

YRS: 25

ULTIMATE RATE = 4.25 %

PBGC FACTOR: 13.5337

LOADING: 11148

MORT. TABLE: VII

APPRAISAL DATE PRESENT VALUE BASED ON EMPLOYMENT UP TO THE RETIREMENT DATE AS SHOWN IN THIS REPORT: \$331,177.00

PRESENT VALUE ADJUSTED TO REPORT DATE (PBGC % Factors): \$332,391.31

MARRIAGE DATE: 7 / 1 / 1973

EMPLOYMENT DATE: 8 / 1 / 1973

MARITAL COVERTURE % OF PRESENT VALUE: 96.800% AMOUNT: \$321,754.81
(Report date value of the pension attributable to the marriage.)

COVERTURE VALUE, ASSUMING 50-50 SPLIT, TO SPOUSE: \$160,877.40

% OF ACTUAL MONTHLY PENSION INCOME TO BE PAID TO SPOUSE BASED ON REPORT ASSUMPTIONS IF QUALIFIED DOMESTIC RELATIONS ORDER IS USED: 48.400%

The foregoing appraisal is based on objective actuarial data from the Pension Benefit Guaranty Corporation, a U.S. Government agency. The appraisal date value was adjusted using the applicable PBGC interest rate less 1%, 4.4 % , compounded annually up to the date of this report.

This report identifies the present value of a pension plan providing an annual income for life. No actuarial deviations were made. It does not consider any savings (Defined Contribution) plans (401(k), ETC.).

This report reflects the opinion of LawDATA, Inc. as to the pension values involved. It is based on the information submitted with this appraisal request. ANY QUESTIONS? PLEASE CALL BEFORE WRITING.