



## QDRO MECHANICS

### Introduction:

This month we are going to go back to the basics of Qualified Domestic Relations Order preparation. Even if you do not anticipate actually preparing the QDRO document yourself, it is important for you to be familiar with what information is required to prepare an acceptable order so that in the course of preparing your case you gather the necessary data. Also, taking another look at how an order is structured is always helpful when you are about to begin settlement negotiations. Many attorneys address QDRO settlement language with statements along the lines of "the non-participant spouse is to be awarded 50% of the marital portion of the participant's XXXX pension", and leave it at that. Just a cursory reading of this article will tell you why language similar to the foregoing is totally inadequate. Whether you intend to prepare the order yourself or you are going to have a pension consultant prepare it, the failure to properly define the terms of the QDRO to be drafted in the settlement agreement creates problems that will either cause your client to be shortchanged and unprotected, or in many cases, even worse to you as an attorney, require you to go back and renegotiate the retirement asset section of the settlement after all the parties have already signed off. Knowing what points must be addressed to prepare an equitable QDRO beforehand, will go a long way in avoiding future problems and unnecessary embarrassment

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### Tip of the Month:

**Become familiar with defined benefit "Cash Balance Plans" because, if you have not already encountered one, you will be dealing with them in the immediate future.**

**Cash Balance Plan** – These, relatively new, retirement savings plans are being used by companies to replace monthly income, defined benefit pension plans. These plans are cheaper to fund and generally provide less generous retirement incomes. The opening balance of a Cash Balance Plan is usually the present value of the accrued, monthly pension benefit on the date they convert to a Cash Balance Plan. This defined benefit plan is more like a defined contribution plan. In other words, a Cash Balance Plan defines the promised benefit in terms of a stated account balance formula. In a typical Cash Balance Plan, a participant's account is credited each year with a "pay credit" (such as 5 percent of his or her annual compensation) and a compounded "interest credit" (either a fixed rate or a variable rate that is linked to an index such as the one-year treasury bill rate). Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. Thus, the investment risks and rewards on plan assets are borne solely by the employer. This can make them more attractive to employees than traditional, at-risk, defined contribution plans. When a participant becomes entitled to receive benefits it is in the form of an account balance. The plan usually provides a way for this balance to be used to purchase an annuity. The benefits in Cash Balance Plans, as in traditional defined benefit plans, are protected, up to statutory limitations, by insurance provided through the Pension Guaranty Corporation (PBGC).

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If the divorce settlement provides for a deferred distribution (no immediate payment or other asset offset) of the marital property retirement assets provided by a private company covered by ERISA, it is necessary to prepare a Qualified Domestic Relations Order to accomplish this distribution. A Qualified Domestic Relations Order (QDRO) must meet numerous criteria before it can be accepted and implemented by the plan provider. There is specific information that every order must include before it can be considered "qualified". Following is the minimum data that must be addressed:

- Names and last known addresses of the plan participant and the alternate payee.
- Social Security numbers and dates of birth of each.
- The legal name of the specific retirement plan to which the order is directed and its address.
- Citations of the ERISA sections and the IRS regulations that govern the use of Qualified Domestic Relations Orders.
- Reference to the State divorce and marital property distribution statutes that govern the legal action and a reference to the local court that has jurisdiction over the action.
- A paragraph in the order that clearly identifies how the portion payable to the alternate payee is to be determined by the plan administrator. This can be expressed in a dollar amount, a percentage or a formula that can be easily understood and applied to the plan participant's accrued retirement benefit on either a specific date or at the time the benefit goes into pay status.
- When the actual transfer of these retirement assets should occur if it is a lump sum defined contribution plan or when the payment of a pension income stream should commence if it is a defined benefit plan.
- Specific provisions ordering the plan make payment directly to the alternate payee.

In addition to the foregoing the following should be included in every order if there is a meaningful attempt to divide the retirement assets equitably:

- The date (as mandated by State law or by agreement of the parties) to be used as the cutoff for the accrual of marital property.
- Provisions instructing the plan how to compensate the alternate payee if the plan provides for early, supplemented benefits to the participant and the participant elects to retire early and benefit from this provision of the plan (these supplemented benefits are not available to the alternate payee unless the participant elects to receive them).
- Instructions to the plan as to whether the alternate payee should continue to be treated as a beneficiary of all or part of the pre and post retirement survivor benefits and identification of the type of survivor benefit option (50% Joint and Survivor annuity, 75% Joint and Survivor annuity, etc.). As this form of payment usually requires a reduction in the gross pension payable, language advising the plan how this reduction should be allocated to each party should be included in the order.
- Inclusion of the alternate payee in any passive, post-retirement pension benefit increases (COLA adjustments or across the board increases payable to all active retirees) on a pro-rata basis.
- In the event the alternate payee should predecease the plan participant there should be instructions to the plan as to how the portion of the retirement benefits awarded to the alternate payee should be treated if death occurs prior to payment if it is a defined contribution order or how the pension income stream should be paid during the lifetime of the participant if

it is a defined benefit plan. There is a rule in the Retirement Equity Act of 1984 (REACT) that prohibits an alternate payee from naming a subsequent spouse as a beneficiary in the event of the death of the alternate payee, but that is the only exclusion.

- Inclusion of the alternate payee in any passive increases or decreases on his or her portion of the defined contribution account (401k, ESOP, Retirement Savings Plan, etc.) between the marital property cutoff date and the actual distribution date.
- Language addressing the possibility that the plan might be terminated or converted to a different accrual form.
- Provisions stating that the court shall retain jurisdiction to modify the order until it is accepted by the plan administrator and approved as a Qualified Domestic Relations Order.

In addition, the following paragraphs should be included and are required by many plans:

"Nothing contained in this Order shall in any way require the Plan to provide any form, type, or amount of benefit not otherwise available by law or under the provisions of the Plan."

"Nothing contained in this Order shall in any way require the Plan to provide increased benefits determined on the basis of actuarial values."

"This Order does not require payment of benefits to the Alternate Payee that are required to be paid to another Alternate Payee incident to an order that had previously been determined to be a Qualified Domestic Relations Order."

"Each party shall promptly notify the Administrator of any future changes in his or her address."

"Except as set forth herein, all rights in and to benefits from the (legal name of defined benefit plan) Pension Plan and (if applicable) the (legal name of the defined contribution plan) Plan are awarded to Plan Participant."

A QDRO is a specific legal document that must incorporate the terms of the parties' settlement and address the provisions of the retirement plan to which it is directed. The order must be signed by the judge and filed with the local Clerk of Court before it is submitted to the plan. Some, but very few, plans will review a draft QDRO before a judge signs it, and pre-approve the order. While this might look like an attractive option it is fraught with risk. If the participant or the alternate payee were to die during the period the order is being reviewed, the plan is under no obligation to honor the order. Only a court certified order, signed by a judge, preserves the rights of the parties to the order. The order does not have to be approved by the plan at the time of death to preserve the intent of the settlement. The plan can even require subsequent rewrites, after the death of the participant, to bring the order into compliance with the plan's provisions. But that can only legally happen if there is a signed order on file with the plan.

A property distribution QDRO can only be accepted by a plan after a divorce decree has been issued. That is why "time is of the essence" when filing the order. Prior to the final decree the alternate payee is still the automatic beneficiary of all of the participant's survivor benefits (unless a former spouse had been awarded a portion of the survivor benefits in a previously approved QDRO). This is not the case once the divorce is finalized. To avoid any unanticipated losses, it is best that the attorney present the finished QDRO to the judge at the time the final decree is signed, immediately file it with the Clerk of Court and send a certified copy to the plan. An untimely death can wreak economic havoc on a former spouse if the submission of the order is delayed. Also, an attorney runs the risk of incurring a malpractice suit if procrastination results in the provisions of the QDRO being

unenforceable. If the participant dies prior to the receipt of a signed order by the plan, the plan has no obligation to accept an order and probably won't.

In addition to addressing the provisions of the marital property settlement dealing with the retirement benefit assets, a QDRO has to be written to be in conformance with the bylaws of the targeted benefits provider and comply with the ERISA and IRS rules that govern Qualified Domestic Relations Orders. It can legally only be prepared by a licensed attorney in the jurisdiction of the divorce action or by one of the parties to the divorce action. Companies, like ours, that specialize in the preparation and drafting of QDRO's can only prepare these orders for attorneys. We cannot write them for individuals because to do so would constitute our practicing law without a license in the jurisdiction involved and subject us to possible criminal legal penalties. There are paralegal services and attorney forms books that claim to have forms that can be used in every QDRO situation but that is just not true. Unlike a lease, which can address a few standard contingencies, a QDRO must be tailored to deal with both the property settlement and the plan specific contingencies. A boilerplate document can't begin to protect the interests of the parties involved in a deferred property settlement of retirement assets while correctly addressing the plan's bylaws at the same time.

Attorneys use services like ours because of the complexity of drafting an equitable order that will satisfy the QDRO reviewers at the retirement plan provider. Under REACT, the plan administrator is the final arbiter as to whether the QDRO meets the requirements of the law and their own plan provisions. If you disagree with a plan's interpretation of the law you have to pursue a remedy in the federal system. If they accept an order that falls short of the proscribed criteria, they jeopardize the tax-deferred status of their plan. Retirement plan QDRO reviewers tend to err on the side of caution. This is the primary reason getting an order approved by the plan is so problematic. Also, the review of pending Qualified Domestic Relations Orders is obviously not a profit center for any company. Over the years many have tried to save money by downgrading the required skill criteria of the individuals who do the initial review of orders.

Retirement plan QDRO reviewers usually work off of a checklist provided by the legal department. If the language in the proposed order does not meet the language on their check sheet, many do not have the legal and actuarial skills needed to interpret the language in the proposed QDRO even though it may be in strict compliance with their plan and meets ERISA and IRS guidelines. This causes the initial order to be rejected and requires personal follow-up on the part of the individual who wrote the order. At that point the first choice of the QDRO writer is to change the language in the proposed order to bring it into compliance with the language for which the reviewer is looking while retaining the intent of the settlement. If that is impossible, the QDRO writer must contact someone with more authority and understanding of Qualified Domestic Relations Orders (usually the company's ERISA attorney) to get the necessary approval. This can be a time consuming and difficult process but is absolutely necessary to insure that the order remains in conformance with the provisions of the marital property settlement.

These complexities constitute the primary reasons why many knowledgeable attorneys will not attempt the preparation of a Qualified Domestic Relations Order. It is only natural for any attorney to try to avoid a process where their expertise is limited and the potential for hours of uncompensated labor is always a possibility. With constant new interpretations, by appellate courts, of state divorce laws, a family law attorney can be overwhelmed just staying current in his or her field. To expect them to also be experts in the federal ERISA and IRS regulations governing retirement benefits, and also comfortable with the actuarial jargon used by plan providers that can significantly impact a deferred settlement, is a little unrealistic.

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## **[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.

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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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