



ADDRESSING A CHANGING ECONOMY: SETTLEMENT LANGUAGE AND DEFINED CONTRIBUTION PLAN QDRO'S

Introduction:

As the economic world changes around us, it is hard to ignore that there will be an ultimate effect on how the legal community must address retirement benefit issues. At LawData, we feel that it is time to begin to focus on the areas of divorce settlement that are vulnerable to liability due to the foreseeable (and unforeseen) changes ahead.

We are initiating a series of newsletters, each addressing a specific issue that has recently arisen in the course of our business.

Our first newsletter will address settlement language and how its nuances can change the division of a defined contribution plan when a Qualified Domestic Relations Order (QDRO) is anticipated. A *defined contribution plan is a retirement benefit plan with a specific account balance rather than a monthly annuity*. Two commonly referenced types of defined contribution plans would be 401(k) or investment plans.

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In every case involving a defined contribution plan, remember that the portion of any such plan awarded to the alternate payee spouse is considered that party's sole and separate property as of the marital property cut-off date, whether or not it has actually been transferred to a separate account in the name of the alternate payee spouse.

Because of the nature of the beast, the funds in a defined contribution plan cannot be "put on hold", so to speak. This means that after the parties arrive at an agreement concerning the division of the defined contribution plan, the alternate payee spouse's share, sitting in the account of the account holder spouse's account, is subject to gains and losses.

Also keep in mind that, on a regular basis, while the parties are or were "happily married" such assets are subject to market fluctuations. While, during the course of the marriage, market fluctuations can impact the value of such assets, it is not the fault of one or the other party that such accounts lose money, if said losses are solely due to market fluctuations.

When the alternate payee's portion is transferred to an account in his/her name, that account is also subject to market fluctuations.

An alarming number of property settlement agreements are not acted on in a timely manner. It is sometimes months, and even years, before the initiation of the QDRO process is begun. In the past, this was usually not a problem when dealing with a defined contribution plan. But, of course now, due to the downturn in the economy, those agreements, considered in light of the above considerations, are now cause for alarm on the part of the alternate payee spouse.

Most of those kinds of agreements simply state the award to the alternate payee in terms of a percentage as of a past date ("marital property cut-off date"). The QDRO drafter will, rightfully so, based on sparse language as stated herein, assume the QDRO to be drafted as awarding the alternate payee spouse, lets say, 50% as of (insert marital property cut-off date) subject to gains and losses from that date to the date of distribution to the alternate payee.

Indeed, that was probably the intent of the parties' when the agreement was reached. However, the reality is that the alternate payee's share has shrunk, as has that of the account holder spouse's share. But, hindsight being what it is, the alternate payee spouse now wishes to ignore the realities of the market place and receive what he/she thought was available at a prior date.

If the alternate payee's share, after the fact, is awarded to him/her as if time had stopped, the same cannot be said of the account holder spouse's share. Absent the existence of fraud, on the part of the account holder spouse, such a distribution circumvents the intent of "equitable distribution."

However, going forward, we offer some advice we hope will help to avoid the pitfalls associated with defined contribution plan QDROs.

When addressing a defined contribution plan that is to be divided by a QDRO, the most important factor to consider is that utilizing a percentage in conjunction with a dollar amount in the settlement language, exposes your case to subsequent dispute.

EXAMPLE:

“The wife is awarded 50.00% of the husband’s retirement account or \$75,000.00.”

In this rapidly fluctuating economic culture, what amounts to 50% today may amount to 80% by the time the order is executed. Under that scenario, either the wife ends up with \$45,000.00 when she is expecting \$75,000.00 or the wife receives the \$75,000.00 she is expecting and the husband retains a mere \$15,000.00. Both scenarios have the potential to destroy the intent of equitable dissolution. Not to mention headaches for the legal counsel.

Another factor to consider is that in difficult economic times, it is much more prevalent to see individuals borrowing against their defined contribution plans. Thus, it is important to investigate the existence of any outstanding loans and address them properly.

EXAMPLE:

Pursuant to discovery, the Plan provides a statement indicating an outstanding loan balance in the amount of \$10,000.00 on the above-cited husband’s retirement account. What is the date of the loan? Was it during the course of the parties’ marriage, therefore making it a marital debt? Or was it after the marital cut-off date, but before the agreement was reached? That would make it the sole property of the husband.

It is usually a requirement that the QDRO provide the plan administrator with a provision pertaining to the computation of the alternate payee's award in relation to any outstanding loans.

The plan considers the account to consist of two balances. There is the "total account balance" (inclusive of any outstanding loan balance), and there is the "available balance". Think of it in terms of a checking account when some of your deposit is readily available, and some is on hold.

A QDRO addresses this issue by stating that:

In computing the award to the alternate payee any outstanding loan balances (will/will not) be included in the total account balance.

Let's say the account's total balance is \$100,000. There is a \$10,000. loan balance. The available balance is \$90,000. The alternate payee's share is 50%. By including the loan balance in the computation the alternate payee spouse is awarded 50% of \$100,000. By not including the loan balance the alternate payee spouse is awarded 50% of \$90,000.

Generally speaking, if the alternate payee spouse is not responsible for the loan (the account holder took out the loan for his/her own purposes) the loan balance should be included in the computation. If the loan was marital, it should not. In any case, in the eyes of the plan, the account holder spouse is responsible for re-payment of the loan. The QDRO cannot assign responsibility for loan re-payment to the alternate payee.

A third factor that relates to every instance where a defined contribution plan is being distributed by a QDRO is whether or not the non-participant spouse will be entitled to the gains and losses attributable to his/her portion of the benefit he/she is awarded. The quickest way to answer this question would be to ask whether the intention of the agreement is to offset other asset(s) or to provide an equal distribution.

EXAMPLE:

Assume our sample couple has no offsetting assets; the intention of the parties is simply for the wife to be allocated her marital portion of the husband's retirement benefit. Thus, the intention is to give the wife her marital share plus or minus any loss or growth from the date of marital cut-off up until the date that funds are segregated and a separate account is established under her name. Alternatively, should our sample couple wish to simply ensure that the wife is entitled to \$75,000.00 representing the husband's purchase price of another asset; there would be no need to utilize the language allowing the wife to share in any gains and / or losses.

Keep in mind though that, even when stating the award in terms of a flat dollar value, when the plan establishes a separate account in the name of the alternate payee, the alternate payee's award cannot be made immune to market fluctuations.

The settlement language shown below represents a template thoroughly addressing most issues.

THE HUSBAND / WIFE (INDICATES PENSION HOLDER) HAVE AN INTEREST IN AN XYZ EMPLOYEE SAVINGS AND INVESTMENT PLAN. THE HUSBAND / WIFE (INDICATES ALTERNATE SPOUSE) IS AWARDED (INSERT MARITAL PERCENTAGE) % OR \$ (INSERT DOLLAR AMOUNT) OF THE ACCOUNT BALANCE AS OF (INSERT MARITAL CUT-OFF DATE), INCLUDING / EXCLUDING (CHOOSE APPLICABLE) ANY OUTSTANDING LOAN BALANCES AND ALLOWING / NOT ALLOWING (CHOOSE APPLICABLE) FOR ANY GAINS OR LOSSES ON THAT PORTION ATTRIBUTABLE TO HIS / HER (ALTERNATE SPOUSE) ALLOCATED PORTION FROM (INSERT MARITAL CUT-OFF DATE) THROUGH THE DATE THAT THE FUNDS ARE DISTRIBUTED TO THE HUSBAND / WIFE (ALTERNATE SPOUSE).

Contact us at Info@LawDATAinc.com to assist you in preparing your settlement language. Allow our *25 years of experience* to assist you in minimizing both your liabilities and your headaches in your next marital dissolution case.

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