



AVOIDING FUTURE PROBLEMS

Introduction:

Since its initial issue, the purpose of this newsletter has been to help attorneys avoid unforeseen problems. If you have been reading them monthly, you are aware of the many issues that arise when attempting to settle a divorce case where retirement benefits are a distributable marital asset. What I thought I would do this month is go over some of the situations you will encounter and some possible solutions. Most are tips I have mentioned in the past but I am realistic in my expectations that you all read and remembered everything I have written. I know there is a lot of jargon and that many of the concepts that have been addressed are rather complicated and deal with situations that you may not encounter on a regular basis. But, if you continue to include family cases in your practice many of those issues will become very important when they are a component of the case with which you are dealing at that time. To help you get a handle on those issues I have listed a few tips that I am sure will come in handy when you really need them. These are not in-depth discourses on the issues but rather tips that you can consult to be sure you are not going off the wrong direction.

Tip of the Month:

The answer to all my QDRO problems today – KNOWLEDGE

I received an e-mail this month from an actuary who has been involved in implementing the provisions of QDRO's years after they have been reviewed and approved by a company employee working in the benefits department. He wanted me to be aware that when it comes time to determine the monthly pension for each of the parties, real problems can be revealed. It often becomes obvious at that time that many attorneys who use boiler-plate language have little or no understanding of some of the terms used in QDRO's. As an example, he wrote that the oft used phrase "the actuarial equivalent of" when awarding a lifetime annuity to a former spouse can have many meanings to an actuary. Actuarial equivalent can be determined many ways but unless the attorney uses a phrase such as "using the plan's actuarial assumptions" the actuaries can apply any assumptions they can justify (and there are many sources of legitimate data that can be used in making actuarial assumptions) that will be more beneficial to the employee/plan participant if they are instructed by the company to do so. Dealing with that same phrase in the QDRO; many alternate payee's are furious when they find out that the "actuarial equivalent" might provide a monthly benefit 50%, or more, less than the amount they thought they were going to get. Never were they informed of this at the time of the settlement. The "actuarial equivalent" is based on the present value of the pension at the time it goes into pay status subject to myriad economic and mortality factors. If you have any doubts as to the impact of language in the settlement agreement learn more before you allow your client to sign off on it. These are unpleasant surprises that can be avoided.

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1. We can begin with the information in our "Practice Tip of the Month". If you are not sure of the meaning of a term as it relates to a retirement benefit you should find out everything you can about the term, advise your client of the implications and only then should your client sign off on it. It is a good idea (and many attorneys do it) to provide your client a written, jargon-free, explanation of the terms of the settlement and have them sign that before they sign the agreement. This forces the attorney to also get the needed information so that the "jargon-free explanation" can be put into writing. Any advice or options you give to a client should also be put into writing with your client acknowledging receipt of the information in writing. Remember we are trying to avoid future problems.

2. Never get into a situation with dueling QDRO's. If you represent the alternate payee, and anticipate a QDRO as a settlement tool, always put language in the settlement agreement to the effect that you will draft the QDRO and your opposing counsel can review it before it is finalized. If each attorney drafts their own QDRO, or each has an expert prepare one for their client, the case can go on forever. The terms of the QDRO should be spelled out as specifically as possible in the settlement agreement. When that does not happen and both attorneys submit drafts of the order you will never settle the case without litigation. There are numerous choices to be made when a QDRO is drafted that can be beneficial to the participant or the non-participant spouse. When an agreement is silent on these choices and each side prepares an order, you will never be able to negotiate and resolve each of the possible choices. The chasm will not be breached without lengthy, and costly, litigation.

3. Unless you are a board certified tax attorney, do not give out any advice as to the tax implications of the retirement asset distribution. Have your client discuss these issues with an accountant. The reality is that retirement benefits can be distributed on a tax-deferred roll-over basis but not a tax-free basis. Many clients are unsophisticated in these matters. Even though you might know the answers to the tax questions that arise with marital property distributions, always advise that the client consult with a tax accountant before negotiating the settlement. If he or she should elect not to see the accountant then that is their call. If the client elects to take a large lump sum distribution from a 401(k), and he or she will be presented with that option once the QDRO is approved, and it throws them into the 36% tax bracket in the year of receipt, you don't want to be the expert who advised that this would be a tax-free distribution. Many attorneys have found this out the hard way. Again, we are trying to avoid future problems.

4. Don't over-promise! Equitable distribution or community property distribution is pretty much the law of the land. Your client should understand that only property attributable to the marital period is in play and that in all probability the settlement will be around 50% of the present value of those assets. Your job is to see that these assets are fairly valued and distributed. Advise them that debt is also a marital asset subject to distribution and in all likelihood will be a component of the settlement. If you create expectations for more than that, the case is going to be very difficult to finalize and you will be guaranteed to have a very unhappy client.

5. Don't rely on a judge's decision to settle the retirement asset issues in the case, especially those that are pension related. This might be a little controversial but the reality is few judges have any more understanding of retirement benefit issues than family law attorneys. This is true even if your district has a Family Law Bench. The judges usually rotate on a regular basis so rarely do they develop real expertise in this area. I read case law from all over the country and I do not often see any real insight on pensions and equity on the appellate level and the summary of how the case was handled on the local level often shows the presiding judge had little or no understanding of how pensions work and

what is equitable. Try your best to settle the retirement asset questions in negotiations. Persuade your client to have some flexibility. Going to court on this issue is more often than not a crapshoot. I always advise attorneys to argue the intent of your community property or equitable distribution statute in negotiations rather than case law. In most states the statute tries to guide the practitioner to equity. The case law that follows is often all over the place and can create nightmares for attorneys who understand retirement assets and are attempting to negotiate an equitable settlement.

6. If you represent the non-participant spouse and the marriage is lengthy and you settle using a QDRO then you have to fight for the pension to be paid on the basis of a joint and survivor annuity with the former spouse being named the beneficiary for at least that part of the survivor annuity attributable to the marital period. If not, payment will be made to the former spouse on the basis of a single life annuity in private plans or only for as long as the participant survives in public plans. In either case the alternate payee is not getting an equitable distribution of the marital asset. If paid in the form of a single life annuity and if the alternate payee is female, she could receive as little as 25% of the pension attributable to the marital period while the husband receives 75% of the pension attributable to the same period. This is because her share will be based on the actuarial equivalent of the lump sum value, subject to actuarial interest and mortality factors at the time the pension commences while his will be based on the formula the plan uses to determine the pension (i.e., $2\% \times \text{Final Average Salary} \times \text{years of service at retirement} = \text{annual benefit}$) which does not take into account real market or actuarial factors. If she is named as the beneficiary then payment is made on a "sharing basis" and the actual pension he receives becomes the starting point for computing her share. This form of payment requires an approximate 10% reduction in the monthly pension to fund joint and survivor benefits but that reduction is pro-rated on each party's share of the monthly benefits. This is the normal form of payment for married participants and the actual asset they were accruing during the marital period. If it is a public plan than all payments to the alternate payee stop if the participant predeceases without survivor benefits. The alternate payee won't get a dime if the participant in a public plan dies prior to retirement if there is no joint and survivor annuity. If the marriage is short in duration (less than five years) normally an immediate offset or cash payment based on the present value of the marital portion of the pension is the most equitable.

7. Use an expert to avoid future problems. Unless you are extremely knowledgeable about retirement assets always use an expert to value the benefit and to draft the settlement language dealing with retirement assets and the QDRO. I say this without feeling like I have conflicted interests because our company does that stuff. I don't care whom you use but get some distance between you and your liability in any area of your practice with which you might have some trepidation as to your expertise.

[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.

For any questions or ideas for upcoming articles you can reach Paul Commerford at paul@lawdatainc.com.