



Divorce, Pensions and Retirement Benefits

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CLIENT EXPECTATIONS AND QDRO'S

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Practice Tip of the Month:

Gather specific retirement plan information to avoid preparing a Domestic Relations Order that will not be accepted by the plan provider.

After a lengthy and difficult series of settlement negotiations, the parties have finally agreed to resolve the divorce related financial issues. A large part of the settlement is dependent upon immediate distribution of the husband's 457(b) defined contribution retirement savings plan funds to the wife to pay marital debt and equalize the settlement. A 457(b) plan is similar to a 401(k) plan but is only available to employees of non-profit organizations. The husband is a State employee and has a public pension. He is a police officer and required to retire at age 55. They have been married for 30 years, and have lived well, but have few assets and substantial liabilities in credit card debt, auto loans and a second mortgage on their home. The wife works in a physician's office and only has health benefits. They owe more than the book value on both family vehicles and have outstanding mortgages on their home totaling 85% of its market value.

The settlement provides the wife will receive \$155,000 from the husband's \$210,000 457(b) account balance and will use \$42,000 of that amount to retire all of their credit card debt. The husband reaches his retirement age in 5 years. A domestic relations order will be filed awarding her 35% per month of his projected \$4,000 monthly pension and she will be his beneficiary for the 50% survivor's annuity if he should predecease her, either before or after his retirement. The husband will pay alimony of \$850 per month until he retires so the wife can afford to reside in the marital home and build equity. At his retirement the house will be sold and the proceeds split between the two. Each will keep the vehicle they now use and make their own payments.

The agreement is signed and the attorney for the wife prepares the order and submits it to the judge for signature at the time the decree is issued. It is then sent to the plan for approval. The plan reviewer rejects the order. 457(b) defined contribution retirement savings plans are not "qualified" plans under IRS rules and are only subject to domestic relations orders at the discretion of the plan. The State will not accept 457(b) domestic relations orders. Also, a former spouse is not eligible to receive any of the pension's survivor benefits. Only a current spouse is eligible, so the wife gets nothing if the husband dies. Public plans are not governed by the Retirement Equity Act of 1984 and can write their own rules. The settlement is now worthless.

Before entering into any agreement involving retirement benefits, the attorney should determine what is acceptable to the plan. It is a huge waste of time and money to fail to do this. One phone call would have informed the attorney of the need to develop a different settlement strategy.

CLIENT EXPECTATIONS AND QDRO' s

As every attorney knows, a client often hears only what he or she wants to hear. We are well aware of this when a non-participant spouse calls our office asking about a Qualified Domestic Relations Order we are preparing and submits a question indicating they don't have a clue about what they have bargained to receive from the pension. In many cases they think they are going to get the lump sum present value of the spouse's future monthly pension income paid to them immediately. This lack of understanding can't help but create problems for the attorney. Even if the attorney is unaware of the disappointment on the part of the client, the client is not going to say anything positive about the attorney to friends and family if the settlement they receive is different from the settlement they expected.

This is especially true when the asset involved is a share of a monthly pension that is going to be distributed by means of a Qualified Domestic Relations Order. The biggest problem for a non-participant spouse, who is awarded 50% of the marital share, either identified as 50% of an accrued monthly amount on a particular date or by coverture formula, is the actuarial reductions that will be applied if he or she is not named as beneficiary for the survivor benefit. In private plans the alternate payee can receive his or her share for life without being named as survivor, but subject to actuarial reductions. This is not true with most public plans.

To give an example, let us assume you practice in a State that only allows the portion of the pension accrued up to the separation date to be treated as marital property. On the marital separation date the plan participant husband, after 25 years of service, had an accrued monthly pension income of \$1,000.00 per month payable at age 65 based on his final average salary (\$30,000) on the separation date and a multiplier of 1.6% for each year of employment. The wife is awarded an interest of 50% of this amount. At the time of the divorce the husband is 50 years old and the wife is 45. The pension will continue to grow as the husband accrues more service and as his income increases. These are both factors that determine the pension he will receive when he retires. The portion awarded to the wife will never increase even though her share is losing purchasing power each year as the dollar loses purchasing power due to inflation. The share the husband retains will constantly be adjusted for inflation as this is reflected in his future wage increases.

If the husband retires at age 65 and his final average salary increases at an average of 3% per year over the next 15 years it will be \$46,739.02 and yield him a pension of $(\$46,739.02 \times 1.6\% \times 40 = \$29,912.97$ per year or) \$ 2,492.74 per month. The amount he receives for the 25 years of employment attributable to the marital period will be \$ 18,716.08 per year or \$1,559.67 per month. The plan requires the wife to commence receiving her share of the pension at the time the participant/husband commences receiving his share. So his pension will be reduced by \$500.00 per month to provide the ex-wife with her share. His pension comes down to \$ 1,992.74 per month but she only gets the actuarial equivalent of \$500.00 per month. Using the December 2005 PBGC valuation factors, the wife would receive about \$375 per month for the balance of her life based on the fact that she is 5 years younger than the husband and female. Adjusting for the 3% inflation over the 15 years, her \$375.00 monthly income would have an actual purchasing power of \$240.70. Unless this has been clearly explained to the wife at the time of the divorce, I doubt she will be very happy with the results of the pension portion of the settlement. If she had been named as beneficiary of the 50% survivor's benefit, she would have received about \$450 while the participant was alive and about \$1,121.40 per month if he were to predecease her.

If you practice in a State where the alternate payee receives 50% of a coverture fraction as applied to the actual pension at the time of the retirement of the participant (the majority of States) and you negotiate for the alternate payee to be treated as the beneficiary with both parties sharing the cost of the survivor benefit (usually about 10%) on a pro-rata basis, you will have achieved an equitable distribution. In the aforementioned case, the alternate payee would receive $\$46,739.02 \times .90\%$ (reduction for survivor annuity) $\times 1.6\% \times (25/40) \times 50\% = \$8,413.02$ per year or \$701.09 per month while the participant was alive and \$1,121.40 if he predeceases after retirement.

Rarely have we spoken with clients that have any idea about how actuarial reductions and inflation will impact the benefit they are expecting. And the example I used did not include any supplemented early retirement benefits, which, if not addressed in the settlement agreement and the Qualified Domestic Relations Order, will only magnify the inequity as the participant retires at age 50 with supplemented benefits, while the non-participant spouse has to wait until age 65 for actuarially reduced benefits.

Clearly, it is in the best interest of any attorney with a family law practice to discuss the ramifications of the settlement language with an expert if they are not clear on how actuarial, and other financial factors can impact a settlement. Once that is done they should put into writing what the terms of the agreement mean to the client and have him or her sign it so there can be no misunderstandings in the future.

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.

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