



HOW TO IDENTIFY THE MARITAL PORTION OF A DEFINED CONTRIBUTION PLAN

(See next page for this month's article)

Practice Tip of the Month:

What to do to protect yourself when your client is less than candid.

Nobody likes to think that their client is a liar but it happens more often than one would expect. Maybe liar is too strong of a term, but many clients present the facts surrounding the case very differently from reality; either because of an emotional obsession to hurt their spouse, to hide their own indiscretions or a deliberate attempt to make things look more favorable to their own position. In some cases it is simply an attempt to get you "on their side".

In any event, unless you conduct some initial due diligence, you can find yourself filing an action that is replete with falsehoods easily exposed by your opposing counsel, immediately embarrassing you and putting you on the defensive. As an attorney you are a trained interrogator and those skills should be used even if this is a divorce case and the party being questioned is your client. The first thing is to ask who can verify any facts being alleged. If there is no way, then you have a he-said-she-said situation and weak case. You have to ask your client about his or her contribution to the marital breakdown. Few things happen in a vacuum. Review the tax returns if that is possible. If you represent the wife and she alleges there are hidden funds, ask how she can prove it. If she "just knows" you are facing a very expensive forensic accounting exercise and your client better be able to pay for it if it is a wild goose chase.

Many wives are kept in the dark about the actual retirement benefits that are available on the date of the divorce. They hear the husband say things like "we will have over a million dollars when I retire" not realizing that assumes continued employment with anticipated raises and promotions, an expected substantial future defined contribution plan growth rate and the continuation of a defined benefit plan that might already be in jeopardy. Get the information directly from the plan provider.

Statistically, most American families would be in severe financial jeopardy if they miss 3 or 4 pay checks and your client's situation is statistically probably no different. Base your petition for the divorce on what you can establish beforehand and not the representations of your client. You can always amend the petition if additional assets surface during the action but you won't weaken your case by making initial allegations that are patently false.

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HOW TO IDENTIFY THE MARITAL PORTION OF A DEFINED CONTRIBUTION PLAN

In most states the defined contribution account balances (401(k), Retirement Savings Plans, ESOP, etc.), and the passive growth thereon, that were accrued prior to the marriage are separate property and must be subtracted from the account balances on the marital property asset cut-off date. This is rarely an easy task. Fortunately, it only applies when the participant came into the marriage with pre-existing plan balances, which is not the usual case. Unfortunately, with the proliferation of defined contribution plans beginning in the 1980's, it is becoming more common.

The Ideal Situation

Ideally, either the participant or the plan can provide every quarterly statement going back to the date of the marriage. How the account grew prior to that date is of no consequence for the purpose of the divorce. If the records pertinent to the marriage are available you must hire a pension expert or an accountant (usually more expensive) to determine the passive growth in each quarter and apply it to the original separate property balance on a quarterly compounded basis. All contributions commencing the date of the marriage, and the passive growth thereon, are marital property.

Determining the passive growth is a simple mathematical calculation where you take the quarterly opening balance plus contributions and average the ending quarterly balance with the opening balance, plus contributions, subtract the average balance from the ending balance and divide that amount by the ending balance to determine the passive growth rate. Once that is known you simply apply it, on a compounded basis, to the separate property portion of the account to date, to identify the non-marital portion of the account.

While it sounds like a simple excise, doing it 60 times over the period of a 15 year marriage is very tedious and time consuming. We have computerized the actual calculations but even that does not really simplify the process. Companies change investment plan managers who present the information in a different format; and even when they don't the investment plan managers change their report format themselves every couple of years. Just getting the correct information off the reports can be a real task. Some plans do not show the actual contribution but rather run a continuing contribution account

so you have to make these calculations also to identify the quarterly contributions and growth.

Once you identify the marital portion by subtracting the separate property portion on the marital property cut-off date, you have to continue to do a similar calculation only this time to bring the non-participant's separate property up to its value on the current date. You now have the figure to be used in the settlement agreement.

But what I have described is the ideal situation and rarely encountered. Most participants do not have all of their quarterly statements and few, if any, plans will provide them to you. If there are actually statements available, often many are missing. We can either interpolate the figures if the numbers missing are few and far between or simply advise the attorney that it is impossible to make a credible calculation, if not. Frankly, it is a nightmare to come up with a number in many cases.

The Reality

Unless the plan participant is an obsessive-compulsive who has saved every statement since commencing plan participation, you will probably be unable to provide all the statements an analyst will need to provide a credible evaluation. Few plans will provide duplicate statements. If the marriage is short of duration (less than 5 years) you are more likely to find the participant has sufficient data to provide the necessary data to prepare an analysis but, it is unlikely that will be the case in a marriage of 10 or 15 year duration. In these cases you are left with two alternatives.

1. Apply a coverture calculation to the ending account balance. In other words, if the plan participation lasted 20 years and the marriage 15, then the parties would divide the account by dividing the total months married while accruing benefits (180 in this case) by the total number of months of plan participation (240 months). And divide the results (75%) by 2 (37.5%). The non-participant spouse would get 37.5% of the final balance. This is not very precise, but often the only way to resolve the issue, in the absence of available data.
2. If the opening balance at the time of the marriage is known, the parties could agree upon a reasonable growth factor, say 5%, and apply that to the opening balance on an annual compounded basis to determine the non-marital portion to be subtracted from the final account balance. Don't forget that while we saw some spectacular investment growth in the late 1990's, we also saw some spectacular losses in the early 2000's.

The truth is, while not 100% accurate, neither method will be severely harmful to either party. They just will not be as correct as they could be if the documentation was at hand.

What is required is legislation requiring plan providers to keep and furnish duplicate statements for divorce purposes. As defined contribution accounts become more prevalent, the need for this will only grow. Plans can provide the exact accrued benefit amount anytime during the marriage for defined benefit plans and are required to be able to do so by ERISA. There has to be similar requirements for defined contribution plans.

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.

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