



## Divorce, Pensions and Retirement Benefits

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### **PUBLIC DEFINED BENEFIT PLANS - COMMON, UNIQUE AND TRICKY**

#### **Introduction:**

Many companies have abandoned pension plans because of the costs and liability attached. This is not the case with public (federal, state or local) plans. If anything, these plans continue to be improved and made more generous. This might be based on the truism the "inmates are running the asylum". That is the individuals making the improvement recommendations are also participants in the same plan and the costs do not really have to be justified because public accounting never deals with contingent liabilities. Most attorneys are dealing with more public plans than private (ERISA covered) plans in divorce cases because public employees, as a group, are the fastest growing segment of the work force.

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#### **Tip of the Month:**

##### **Defined Contribution Plans - try to avoid using specific dollar amounts.**

Defined contribution accounts (401k, ESOP Retirement Savings Accounts, Deferred Income schemes, etc.) are often identified by the dollar value of the account on the marital property cut-off date. This amount is often incorrect because the plan publishes values either at the end of a quarter or at plan year-end and, unless your cut-off date coincides, the amount you are using will probably be an estimate. Because these accounts are subject to daily changes based on the investment vehicle elected by the participant or mandated by the plan provider. Get an agreement or court order ASAP requiring the participant, if permitted, to transfer the spouses' estimated portion of the accounts into a conservative investment vehicle to protect the values until distribution by use of a QDRO.

ESOP's and all equity investment accounts, should be identified by the number of shares to be transferred. The value of the stock will be automatically adjusted and can go along way toward protecting the investment and assuring an equitable distribution. For non-stock based accounts use of the term "50% of the marital property portion of the account (identified by a coverture calculation) as of (date) plus any passive losses or gains on that portion of the account up until the actual distribution to the alternate payee" can also protect your non-participant client and avoid future problems. This, too, can insure an equitable distribution. If you use a dollar amount with no consideration for investment performance, and the plan incurs gains and losses during the pending divorce, there is an excellent chance the non-participant spouse will be awarded substantially more or less than he or she should have been entitled to receive if the proper distribution language had been used. If you had obtained an agreement requiring the funds be placed in the most conservative investment vehicle available and the participant failed to do so, then it may be possible to get the non-participant spouse substantially more than would have been paid out if no directed investment request had been filed or negotiated.

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## PUBLIC DEFINED BENEFIT PLANS – COMMON, UNIQUE AND TRICKY

Pension plans covering public employees differ from private (ERISA) based plans in a number of ways. It is hard to generalize because as no federal legislation applies to them which would result in continuity. Public plans can do whatever they want and they do. This is particularly true when you use a Domestic Relations Order (DRO) as the settlement tool. Some states (i.e. Indiana) do not permit Domestic Relations Orders on a state pensions. The term Qualified Domestic Relations Orders doesn't apply to public plans because "qualified" refers to domestic relations orders that comply with Section 414(p) of the U.S. Internal Revenue (IRS) Code as spelled out in the Retirement Equity Act of 1984 (REACT). As public plans are not governed by ERISA they do not have to comply with REACT so IRS rules do not apply.

Following are some common differences between public and private plans. These generalizations apply to most, but not all, public plans. Obviously, as an attorney involved in dissolution and distribution cases, it is incumbent on you to at least familiarize yourself with the rules governing local, state and federal plans in the jurisdiction in which you practice.

1. Public plans have no provisions for awarding a non-participant spouse a separate life annuity (as permitted in REACT). In order to provide income for life the non-participant spouse must be named the beneficiary for survivor benefits in the event the participant should predecease.
2. Many public plans provide post-retirement cost of living adjustments (COLA) increases. These increases (federal, military, NJ, etc.) are usually based on changes in the Consumer Price Index (CPI). Some are a fixed % amount (3% in Florida, 3% in Michigan, etc.) Some of these adjustments are compounded based on the previous years pension amount and some are non-compounding; that is, the increase is always based on the amount of pension awarded to the participant at the time of retirement. Private plans do not provide post-retirement COLA increases because they cost a fortune. As COLA increases are passive in nature and an integral part of the pension plan, any DRO written should award the alternate payee his or her pro rata share of these annual increases. COLA increases are always included in the computed present value of the pension if you are trying to settle the case with an immediate offset settlement against other marital assets.
3. Public employees usually make contributions to their defined benefit pension plans (private employees do not). This create problems for attorneys negotiating a settlement involving a pension plan. The attorney for the plan participant wants to divide the contributions and call that equitable. The reality is that at the time of the retirement of the participant the portion of the pension value attributable to contributions rarely exceeds 20% of the total value. A pension scheme contemplates an annual income for life. That is the asset to be distributed. The contributions have little or no relationship to the value of the pension. The pension is usually determined by a formula such as final average salary X 2% X years of service at retirement. The contributions are not even factored into the equation. In some states (i.e. Pennsylvania) you can have all the contributions you have made over the length of your employment paid to you in a lump sum at the time of retirement with only a very small (and non-actuarially computed) reduction in the monthly lifetime income you will collect.
4. In some states the plan will honor the DRO while the participant is alive but refuse to allow a former spouse to be named as a designated beneficiary in the event the participant should predecease.

5. Many states and/or cities (and the federal government) have different plans based on the specific employment category of the participant (teacher, police department, fire department, judges, sanitation, FBI, State Department etc.). New York City is the classic with every city job seemingly covered by a different pension scheme. When requesting a pension appraisal or a DRO on a public employee always include information as to the specific employment of the participant when submitting the information to the pension consultant.
6. Military pensions fall into a category of their own. There is no vesting (entitlement to receive a pension if you leave employment prior to your earliest retirement date) until the participant completes 20 years of service. The portion of the pension attributable to an injury (it can be non debilitating and not even work related) is not divisible marital property as per a U.S. Supreme Court Case so it may be that only 80% of the actual pension is marital property because at some time during their military service the participant may have broken his or her leg and is entitled to a 20% disability. Any injury incurred by military personnel during their years of service entitles them to a portion of the pension paid as a tax-free disability. Many states ignore this ruling when it comes to an immediate offset distribution but if you use a military DRO (Uniformed Services Former Spouses Protection Act Order) only the non-disability portion will be distributed by the military. In order to do a military DRO the parties must have been married at least ten years 10 of those years covering the period the participant was in active in the military. If the parties were married for at least 20 years, with 20 of those years being active military service for the participant, the alternate payee will be eligible for guaranteed free medical benefits for life. Reservists also have specific rules for DRO's. Their pension amounts payable are based on the accrual of points and do not commence until age 60. You have to get a points statement before any valuation or distribution of a military active reservist's retirement benefit. There are no guaranteed health benefits available to retired reservists.

Because every state has it's own rules, make it a point to obtain an employee handbooks on local, county and state pensions so you know what you are confronting before you make any assumptions as to how the case will be settled. Rely on your experts to insure you do not make any representations to your client that can't be fulfilled. Public pensions can be tough but as they are impossible to avoid if you practice family law, try to educate yourself of their ramifications.

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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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