Retirement Plan Asset Sharing in a Divorce

Mistakes That Can Be Costly

BY HOWARD M. PHILLIPS

The first or second largest asset in a marital estate is usually one or both spouses' retirement plans. Therefore, a mistake made in dividing these assets in a divorce could be very costly for one of the spouses, and, possibly, for those involved in the divorce documents (lawyers, plan administrators or their delegates).

Plan consultants, third party administrators and actuaries will be involved in reviewing Domestic Relations Orders (DROs) as a responsibility directed by the plan administrator. That review will evolve to a court entered Qualified Domestic Relations Order (QDRO). Since we live in a litigious world, the reviewing person, committee or firm will need to be both knowledgeable about QDROs, and as certain as they can be that the language in the QDRO accurately reflects the wishes of the divorcing parties.

Following are some of the avoidable mistakes and pitfalls in the preparation and review of a QDRO.

A POORLY WORDED PROPERTY SETTLEMENT AGREEMENT

The Property Settlement Agreement (PSA) sets forth the agreement between the parties with regard to each of the assets in the marital estate. If the PSA provision in connection with retirement plan benefits/accounts is not specific, the implementation of that provision may not result in what was meant by the provision.

For example, if the provision states that the nonparticipant spouse (known as the Alternate Payee or AP) gets 50% of the participant's benefit/account, the interpretation could be:

a. 50% of the benefit/account accrued as of the date of the complaint or separation;

b. 50% of the benefit/account in place when the participant spouse is paid the benefit/account; or

c. 50% of the benefit/account that accrued during the marriage, knowing that a portion of the benefit/account came with the participant spouse into the marriage.

Each of these interpretations can produce vastly different results. For example:

Account at Date of Marriage (D of M): $50,000
Account at Date of Complaint/Separation (D of C/S): $200,000
Account at Date of Distribution (D of D): $250,000

Years in Plan at D of C/S:	25
Years in Plan at D of M:	15
Years in Plan at D of D:	30

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Based on these assumptions, and the ambiguous language in the PSA, the share to the AP could be:

a. $100,000 [(0.5)* ($200,000)], or
b. $125,000 [(0.5)* ($250,000)], or
c. $40,000 [(0.5)* (10/25)* ($200,000)] or $41,667 [(0.5)*(10/30)*($250,000)]

INEQUITABLE DIVISION WHEN A PARTICIPANT SPOUSE CAME TO THE MARRIAGE WITH A RETIREMENT BENEFIT/ACCOUNT

If the participant spouse, his or her advisors or the plan administrator is not aware of the different methods of properly reflecting that premarital benefit/account, the selection of method could be less equitable for the participant spouse. For example, one or more of the methods available to reflect that premarital asset will deliver to the nonparticipant spouse a share of the investment gains earned during the marriage by the premarital benefit/account. If such a method is set forth in the PSA or the QDRO, the participant spouse may get less than an equitable share.

For example, the share to the AP in the example above could be $75,000 [(0.5)* ($200,000 – $50,000)], instead of $40,000. Both methods attempt to reflect that part of the account that accrued during the marriage. There are other methods.

INAPPROPRIATE SELECTION OF THE TIME TO RECEIVE A SHARE OF THE BENEFIT/ACCOUNT

If the participant spouse continues to earn a retirement benefit payable at some future retirement date, the nonparticipant spouse or his/her advisors should test to determine if the sharing should be done now (at the time of the complaint) or at that future retirement date. It is not unusual to find that state law will allow for sharing the benefit in the future. More importantly, the portion of that future benefit (which will be larger than it is now as a result of increased compensation and service in the benefit formula), prorated for the portion of that benefit earned during the marriage, may be larger than the portion of the benefit to be shared now (at the time of the complaint).

For example:

Pension benefit accrued as of D of C/S*: $3,000/month
Pension benefit payable as of retirement date: $6,600/month
Years of Marriage: 20
Years in the Plan: 30

Will the share to the AP be $1,500/month [(0.5)* ($3,000)] or $2,200/month [(0.5)* (20/30)* ($6,600)]?

*All accrued during the marriage.

The calculations above determine a monthly retirement benefit share to the nonparticipant spouse, payable when the participant commences his/her benefit. In some cases, the divorcing parties do not want to wait until that future benefit

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commencement date to fulfill the sharing. In that case, if allowable under state law, a determination can be made as to the value of that shared benefit payable in the future. That valuation is typically done by an actuary, where the actuarial assumptions used by the actuary in the calculation must be agreed to by the parties and their advisors. That value might be paid now or segregated in the plan as the AP's separate share.

INAPPROPRIATE TREATMENT OF SPECIAL ISSUES THAT ARISE WHEN DIVIDING RETIREMENT PLAN ASSETS

1. Community property states — the AP may own 50% of the account/benefit before the sharing is resolved.

2. Same gender marriage (SGM) — as a result of the Supreme Court decision announced in June 2015, SGM spouses in all states have the same rights as spouses in a traditional marriage, and the same rights in a divorce. Special Note: Some state courts have attributed marital rights to domestic partners. The federal courts have not.

3. Handling post-divorce occurrences — such as death of either party, account/benefit increases, or new spouse.

Those involved in making a DRO a QDRO must answer these questions:

a. Do we restrict our review only to a determination that the DRO fits within the terms of the plan?

b. Do we request a copy of the PSA in order to make certain that the DRO matches the terms of the agreement?

c. If we see something, do we say something? In other words, is there likelihood that we may be involved in a future litigation by making the DRO a QDRO when there is something in the QDRO that did not match the wishes of the parties?

d. If one or more of the answers to these questions is yes, do we: (i) fully train a department to handle DRO reviews; or (ii) outsource the review to an organization that is fully experienced in conducting these reviews?

Answers to these questions must be deliberated carefully. Mistakes can be costly.

Furthermore, as part of these deliberations, we must address how, if at all, the DOL proposal redefining who is a fiduciary is applicable to DRO reviewers.

POSSIBLE IMPACT OF DOL PROPOSED FIDUCIARY RULE

Do people involved in the review of DROs expose themselves or their firm to the proposed DOL fiduciary rule? Although the likelihood is "no," there may be "experts" who say "maybe." Why?

- Fiduciaries are "plan administrators" who exercise discretion with the administration of a plan and who discharge their duties prudently and solely in the interest of plan participants and beneficiaries. Note here that DOL has stated that an Alternate Payee is a beneficiary of the plan.
- Fiduciaries must act in the "best interest" of the participants and beneficiaries. Although "best interest" is more likely than not applicable to investments, will the final DOL rule extend that applicability to some non-investment services? In a June 2015 article ("View From Groom: Fiduciary Advice Proposal Signals a Fundamental Shift in the DOL's Approach"), Jennifer Eller, a principal with the Groom Law Group, Chartered, wrote, "… the Department has chosen to reformulate the definition of fiduciary to encompass numerous types of sales activities that are clearly non-fiduciary in nature under current law. Because ERISA imposes legal responsibilities and liability on those acting in a fiduciary capacity, the effect of any revision to the regulation defining who is a fiduciary will necessarily be magnified."
- If the DRO reviewer is a "fiduciary," does that mean he/she must request and review the Property Settlement Agreement (PSA) in order to be certain that the DRO matches the wishes of the parties as described in the PSA?
- If the PSA is ambiguous, is it the job of the DRO reviewer to consult with the parties and/or their advisors to remedy the ambiguity?

When questions arise about "fiduciaries" and the DOL rules on "fiduciaries," the expert most frequently mentioned as the one to consult is Fred Reish, a Partner at the Drinker Biddle law firm. I discussed these questions with Fred, and here is his response:

"In terms of actuaries and TPAs approving QDROs, it could happen one of three ways, and the consequences and status vary. First, if the person reviewing and approving a QDRO is the 3(16) administrative fiduciary for that purpose, then that 3(16) must be prudent in the review and approval. For both that purpose and the duty of loyalty (sometimes called "best interest"), the 3(16) needs to protect the plan and the participant by ensuring that the DRO is Q, or qualified.

"A second scenario is where the TPA/actuary compares the DRO to a checklist and advises the plan sponsor (who in this case is the 3(16)) that the DRO satisfies the requirements to be qualified. In that case, the TPA/actuary is not a fiduciary, but must use reasonable care to avoid professional liability.

"In the third case, the TPA/actuary could actually approve the DRO, but without being a 3(16). In that case, the TPA/actuary has become a functional fiduciary and must adhere to the prudent man rule and the duty of loyalty."

After discussion with other professionals who practice in this area, I believe that most who review DROs do so thinking they fall into Reish's second scenario. However, care must be taken to ensure that the 3(16) fiduciary agrees.

Other Concerns for Reviewers

What other concerns may arise for a DRO reviewer? Here are seven:

1. One or more items required by law to be in the DRO (*e.g.*, names, addresses, Social Security numbers of the parties) may be missing.

2. A provision in the DRO or the PSA which ends with "…per the pre-nuptial agreement executed by the parties."

3. One or more outstanding plan loans, the repayment of which could be addressed in the DRO.

4. The PSA language sets forth the sharing in a defined benefit plan, described as if the Alternate Payee will have a separate account in the plan, and the plan only allows sharing via a sharing of the participant's stream of payments.

5. The reviewer is told the participant spouse is in poor health, and may not survive the time needed to finalize a QDRO.

6. The plan is sponsored by an employer in a community property state.

7. The reviewer may be subject

to actuarial standards of practice; specifically ASOP 34, "Actuarial Practice Concerning Retirement Plan Benefits in Domestic Relations Actions."

When dealing with these concerns, it's important to bear in mind:

a) Easy to fix/verify.

b) While federal law does not allow a change in survivor benefits that belong to the non-participant spouse, state law will need to be consulted in connection with other stipulations in a prenuptial agreement.

c) A determination will be needed as to who is the borrower. Which of the parties (possibly both) enjoyed the loan's proceeds?

d) If a plan amendment is out of the question, this remedy may need a lengthy conversation with the parties and their counsel.

e) An interim "death" DRO may need to be prepared quickly, with a full DRO prepared later.

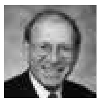
f) Drafting a DRO in a community property state is not as easy as one might think. Court opinions applicable to sharing retirement benefits in a divorce in these states are not consistent. Generally speaking, one might think that the nonparticipant spouse owns 50% of the benefit/account before the sharing discussion begins. Moreover, the sharing process in connection with death of a party before distributions occur is different than the "in life" sharing.

Most of the community property state controversy revolves around the question, "Does ERISA preempt state law as it is applicable to ERISA plans?" The U.S. Supreme Court, in their *Boggs* decision, settled the issue narrowly. That is, the settled issue was only with regard to ERISA preemption of a community property state law in connection with a testamentary (bequeathed by will) directive of a nonparticipant spouse. At issue was the rights of a nonparticipant spouse who provided in her will for her community property portion of her former husband's account to go to her children. Two U.S. Circuits disagreed on those rights — the 9th Circuit said she could not because of ERISA preemption, and the 5th Circuit said she could. The Court reversed the 5th Circuit's decision.

g) An actuary DRO reviewer should consult ASOP 34.

CONCLUSION

It is likely that calls for DRO reviews will only increase, due to the rising divorce rate coupled with the Supreme Court's *Windsor* ruling on same gender marriage. Therefore, TPAs and actuaries must be prepared for that growth. PC



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