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DISPOSITION OF RETIREMENT PLANS IN DIVORCE: A QDRO PRIMER

There are two primary ways to handle retirement plans in divorce—division or offset.

Division: Division merely divides the plan (or marital portion of the plan) in half or in any other agreed to proportion and does not require that a valuation or appraisal be performed to determine a present value. If the parties decide initially to divide retirement benefits, which intent will need to be expressed in the judgment of divorce or marital settlement agreement, the expense of actuarial valuation can be avoided. QDROs or other similar division orders are also generally necessary to effect division. Because the pension and retirement area is highly specialized and complicated, most divorce attorneys choose to have a specialist prepare draft versions of all necessary QDROs or other division orders.

Offsetting: Offsetting requires an actuarial to determine the present value of the marital pension benefit so that other marital assets can be apportioned to achieve the desired result. Offsetting sometimes takes the form of “I’ll keep my pension but you’ll get the house, etc.” Offsetting requires that the parties agree upon a present value of the marital pension benefit and sufficient other marital assets exist to offset retirement benefits.

To explain the difference to our clients, we generally use a “loaf of bread” analogy. The size of the loaf is usually irrelevant in division. Typically, the parties simply agree to disagree about what the pension is worth and instead decide to split the loaf often 50/50 through the date of divorce (with adjustments, if applicable, for pre-marital service). Offsetting often entails analyzing competing views of the value of a pension. Because offsetting typically requires more than one valuation, it is frequently more expensive than a division by QDRO or other domestic relations order. Also, in cases where valuations are performed and no agreement is reached, a QDRO may become necessary and expenses can greatly exceed the cost of a QDRO alone.

Although we are well equipped to perform an actuarial valuation to assist with offsetting, we almost universally recommend against it. The value of pension benefits, even if they are fully vested, are contingent on a number of factors, including how long the party or parties live.

We usually discourage valuations because they require various actuarial assumptions, some of all of which may not hold true in a particular case. Someone could die many years before or after actuarial tables suggest. Actuarial tables are based on the law of large numbers and do not take into account individual factors like health conditions or every day risks, including occupational risks. Second, some assumptions (future interest rates, future tax rates, etc.) make actuarial valuations inherently inaccurate. Two properly performed valuations may, and often do, differ materially. Only one could ultimately

turn out to be correct or both could turn out to be incorrect. Accordingly, we promote the use of the division method in most cases. Anyone eager to sell you a valuation without cautioning you about the valuation's helpfulness is probably just typing a few numbers into a spreadsheet and charging you a lot of money.

QDROs in Division: As stated earlier, QDROs or other similar division orders are also generally necessary to effect division. We are frequently asked, "What is a QDRO and why is it necessary?"

Most retirement plans in the United States are qualified under ERISA and the Internal Revenue Code. This means that they must comply with certain legal requirements. One of those requirements is that plan participants are not permitted to assign their retirement benefits. This prevents the diversion of funds intended for retirement and protects those funds from attack by creditors. This non-assignment rule used to mean that a divorced participant could not assign the former spouse retirement benefits even though those retirement benefits accumulated during the marriage and possibly represented a major portion of the couple's assets.

In recognition of the inequities the non-assignment rule imposed on spouses of plan participants, Congress passed the Retirement Equity Act of 1984 ("REA"). REA generally required that surviving spouses be protected in the event vested participants died. REA also created a limited exception to the non-assignment rule by permitting divorcing participants to assign a portion of their retirement benefits to spouses or former spouses (called "alternate payees"). However, the vast majority of retirement plans cannot honor such assignments unless they are in the form of a qualified domestic relations order ("QDRO").

A QDRO is a special court order that contains certain required provisions but cannot contain certain prohibited provisions. There are a number of optional provisions that a QDRO may include and there are a variety of ways the benefits assigned to alternate payees may be specified. Although QDROs are not supposed to increase the actuarial cost of benefits to the plan, if a QDRO so provides, the alternate payee may be permitted to begin to receive benefits any time after the participant is eligible to receive benefits even if the participant has not yet retired. In addition, a QDRO may provide that the alternate payee be treated as the surviving spouse of the participant for survivor benefits in the event the participant dies. The extent of the participant's benefit awarded to the alternate payee, the extent of survivorship rights, the inclusion or exclusion of various other benefits and optional provisions vary from case to case. Thus, each QDRO must be custom tailored to the specific case. ***Although the judgment of divorce may state in general terms the parties' intent with respect to the division of retirement benefits, it does not meet the technical requirements to be a QDRO. This is why a separate QDRO is generally needed for the parties to share retirement benefits.***

Combined QDROs: We are often asked if multiple retirement plans can be divided by one QDRO. Although there's nothing in the law that prohibits including more than one retirement plan in a QDRO, most retirement plans insist on separate QDROs for each

plan. Every plan has its own set of QDRO rules and combining provisions from two or more plans is simply an exercise in futility.

Government Employees: REA does not generally apply to governmental retirement plans which, therefore, do not generally honor QDROs. However, most states have enacted laws to afford alternate payees of public plan participants in those states many of the same or similar rights to those provided under REA. In Michigan, the analog to a QDRO for state and local employees is called an Eligible Domestic Relations Order or “EDRO.”

Other DROs: There are some circumstances where, for technical reasons, a QDRO or a state authorized DRO is not permitted or feasible. This does not necessarily mean that retirement benefits cannot be assigned. Often the plan will accept and honor a plain “DRO” (a domestic relations order other than a QDRO or a state authorized DRO) that may assign retirement benefits but cannot grant alternate payees certain other rights (such as the right to begin benefits before the participant has retired or the right to be treated as the participant’s surviving spouse) that are permitted under QDROs and state authorized DROs. In cases where plans will not honor QDROs or plain DROs, a DRO which requires the Participant to directly pay the Non-Participant is often appropriate.

The Retirement Benefits Division Process: After drafts of the appropriate domestic relations orders are prepared, they must be reviewed by the parties and their attorneys. The orders are not valid court orders until they have signed by the judge. (For more information, see our article entitled “*The QDRO Process Steps.*”) In many cases, retirement plans will review a draft order, *i.e.*, an order that has not yet been entered with the court. Generally, QDRO Professionals PLLC attempts to obtain plan “pre-approval” of draft orders unless we are instructed otherwise. Some plans do not allow for pre-approval; for those plans, the order must be entered with the court prior to its submission to the plan. Please note that a plan’s pre-approval has no legal effect whatsoever. A pre-approved order must be entered with the court to have legal effect.

Court entry of the orders (before or after pre-approval) is handled by one of the divorce attorneys or one of the divorcing parties after they have been signed by the divorcing parties and their attorneys. For orders that are not pre-approved, the mere fact that orders have been entered with the court does not guarantee that plan administrators will accept them as valid orders and will honor them. Our fees include all work necessary for the order to ultimately be approved by the plan. We guarantee a complete refund of your fee if we are unable to obtain plan approval of a QDRO we draft.

This article is not a substitute for legal advice. If you need legal advice, please contact Jon Mallin at 248.865.4700 or by e-mail at JON@QDRO.PRO.