

QDRO PROFESSIONALS PLLC  
30300 Northwestern Hwy.  
Suite 260  
Farmington Hills, Michigan 48334

Telephone: 248.865.4700  
Fax: 248.865.4705  
JON@QDRO.PRO  
WWW.QDRO.PRO

## **SURVIVORSHIP RIGHTS: SHARED PAYMENT AND SEPARATE INTEREST QDROS**

Perhaps the most significant issue in dividing a defined benefit pension plan (a plan that pays a monthly benefit based on a benefit formula) is protecting the alternate payee's award against reduction in the event the participant dies before the alternate payee. There are two primary methods that can accomplish this result: (1) a "shared payment" QDRO with benefits payable for the participant's lifetime and sufficient survivor benefits thereafter for the alternate payee's remaining lifetime and (2) a "separate interest" QDRO where the benefits payable to the alternate payee are converted actuarially to an annuity for the alternate payee's lifetime rather than the participant's lifetime. This article explains the two approaches and discusses their relative advantages and disadvantages.

### **A. Shared Payment QDRO with Survivor Benefits**

Under a Shared Payment QDRO, basic benefits are based upon and payable for the participant's lifetime (as would be typical had there been no divorce). It is called a Shared Payment QDRO because the alternate payee cannot choose a benefit payment option that is different than the benefit payment option chosen by the participant (for example, an annuity payable for the alternate payee's lifetime rather than the participant's lifetime). Essentially, the alternate payee "shares" in the choice of benefit payments option made by the participant rather than being able to independently select a different benefit payment option.

Although the terms "Shared Payment" and "Separate Interest" are commonly used, there are no statutory or universally accepted definitions of those terms. As we use those terms, the principal characteristic of a Shared Payment QDRO is that the alternate payee cannot independently select a benefit payment option different from the participant's benefit payment option. This causes many plans, but not all, to adopt an additional rule that the alternate payee under a Shared Payment QDRO cannot independently commence to receive awarded benefits before the participant's benefits have commenced because the participant's benefit payment form is not then known.

The most common use of Shared Payment QDROs is the division of pension benefits that have previously commenced to the participant. The vast majority of plans consider the benefit payment form chosen at the participant's retirement to be irrevocable. Accordingly, the alternate payee in such situations cannot typically elect a benefit payment option that is different than the one previously elected and cannot typically elect to have awarded benefits actuarially converted from an annuity payable for the participant's lifetime to an annuity payable for the alternate payee's lifetime. In addition,

if the participant has already commenced pension payments, then it is impossible for the alternate payee to draw awarded benefits before the participant.

Under a Shared Payment QDRO, if the alternate payee predeceases the participant, before or after awarded benefits commence, then the benefit assigned to the alternate payee (payable for the participant's lifetime) will usually revert to the participant.

A Shared Payment QDRO does not, by itself, protect the alternate payee's award against reduction in the event of the participant's prior death. A Shared Payment QDRO with no survivor benefits is a gamble that the participant will outlive the alternate payee. To avoid that gamble, the Shared Payment QDRO must be coupled with sufficient survivor benefits. Under most plans, survivor benefits are intended only for spouses. However, a QDRO can require the plan to treat a former spouse who is an alternate payee as if the participant and alternate payee were still married. In other words, the alternate payee may be entitled to certain surviving spouse benefits in the event the participant dies before the alternate payee. This is commonly referred to as "deemed spousal treatment." Deemed spousal treatment can protect the alternate payee's award against reduction in the event the participant dies before the alternate payee, before or after the alternate payee begins to receive benefits.

### **1. Pre-Retirement Surviving Spouse Benefits**

Pre-retirement surviving spouse benefits (referred to as a "Qualified Pre-Retirement Survivor Annuity" or "QPSA" for plans that are divisible by QDROs) are generally the only protection available to the alternate payee before awarded benefits commence. Accordingly, most QDROs provide for the alternate payee to receive a QPSA with a survivor benefit at least equal to the awarded benefit (so that the alternate payee's benefit does not reduce due to prior death of the participant). The vast majority of plans impose no charge for QPSA coverage.

### **2. Post-Retirement Surviving Spouse Benefits**

Post-retirement surviving spouse benefits (referred to as a "Qualified Joint and Survivor Annuity" or "QJSA" for plans that are divisible by QDROs) can protect an alternate payee's award after benefits commence. A QJSA is a benefit payable for the participant's lifetime with a survivor benefit (no less than 50% nor more than 100% of the initial benefit) payable to the participant's surviving spouse/deemed spouse after the participant's death for the balance of the spouse's/deemed spouse's lifetime. Plans almost invariably make an actuarial reduction for the QJSA to account for the fact that benefits will continue after the participant's death if the participant is survived by the spouse/deemed spouse.

*Cautionary Note:* If (1) the participant retires after the divorce and prior to the plan receiving a QDRO and (2) the participant elects a benefit payment form without survivor benefits for the former spouse, then such survivor benefits for the former spouse cannot generally be granted to the alternate payee.

### 3. Extent of Deemed Spousal Treatment

The extent of deemed spousal treatment is very important and should be clearly specified in both the Judgment of Divorce and the QDRO. Deemed spousal treatment can apply to the entire divisible benefit--which is typically the benefit accrued at the divorce date or the portion of such benefit that accrued during the marriage--or only to the portion of the divisible benefit that is awarded to the alternate payee. Other intermediate variations are also available.<sup>1</sup> These variations can produce significantly different results and the following examples illustrate their impact. Assume that the participant's accrued benefit at retirement is comprised of the following components:

Hire Date	Marriage Date	2 + 3 = "Divisible Benefit"		Divorce Date
Component 1 (Pre-marital)	Component 2 (Participant Retains)		Component 4 (Post-marital)	
	Component 3 (Alternate Payee Award)			

1. The portion of the benefit accrued before the parties' date of marriage that is usually, but not always, retained by the participant.
2. The portion of the benefit accrued during the parties' marriage that is to be retained by the participant.
3. The portion of the benefit accrued during the parties' marriage that is to be awarded to the alternate payee.
4. The portion of the benefit accrued after the parties' divorce date that is almost invariably retained by the participant.

For the purposes of this example, Components 2 and 3 together comprise the marital benefit (the "Divisible Benefit"). Assume that the alternate payee is awarded 50% of the Divisible Benefit (*i.e.*, Components 2 and 3 are equal). Assuming that the parties intend that deemed spousal treatment apply, clearly the alternate payee will be treated as the participant's surviving spouse with respect to Component 3 in the event the participant dies before the alternate payee. It is also clear that the alternate payee will not be treated as the participant's surviving spouse with respect to Component 4 and, in most cases, Component 1.

The principal issue concerns possible deemed spousal treatment with respect to Component 2—the portion of the Divisible Benefit retained by the participant. Depending on the Judgment of Divorce and the QDRO, the alternate payee may or may not be treated as the participant's surviving spouse with respect to Component 2 in the event the participant dies before the alternate payee. Generally, Judgments of Divorce and QDROs provide surviving spouse coverage on Component 2 or provide surviving spouse benefits "to the extent necessary" to make the alternate payee's benefit unaffected by the prior death of the participant.

<sup>1</sup> Our Request Form includes the most common variations as choices.

#### **4. Impact on the Alternate Payee of the Extent of Deemed Spousal Treatment**

Surviving spouse benefits under most pension plans is a 50% benefit. If deemed spousal treatment is limited to the awarded benefit only (Component 3) and the participant dies before the alternate payee begins to receive benefits, the alternate payee will generally receive only 50% of the awarded benefit instead of the 100% generally considered equitable. Accordingly, if the participant dies before the alternate payee, the alternate payee risks losing half of the awarded benefit.

If deemed spousal treatment applies to the entire Divisible Benefit (Components 2 and 3) rather than the awarded benefit and the percentage awarded is not in excess of 50%, the alternate payee will generally receive the entire awarded benefit even if the participant dies before the alternate payee. In the atypical situation of an award exceeding 50% of marital portion, it may not be possible to fully protect the alternate payee's award by deemed spousal treatment unless a post-retirement benefit option with survivor benefits exceeding 50% is available. Conversely, some automobile plans and some governmental plans have post-retirement benefit payment forms with survivor benefits exceeding 50%. In those situations, deemed spousal treatment for the entire Divisible Benefit will generally result in a survivor benefit that exceeds the awarded benefit.

In many cases, we recommend that deemed spousal treatment apply "to the extent necessary" to preserve the alternate payee's award. This language produces a survivor benefit equal to the alternate payee's award in the event that the participant predeceases the alternate payee and avoids survivor benefits exceeding the awarded benefit that would otherwise result under plans that provide surviving spouse benefits in excess of 50%.

#### **5. Impact on the Participant of the Extent of Deemed Spousal Treatment**

Deemed spousal treatment for the alternate payee with respect to Component 2 requires the participant to accept the same modest actuarial reduction for the QJSA option with respect to Component 2 as the alternate payee incurs with respect to Component 3.

Deemed spousal treatment for the alternate payee with respect to Component 2 effectively prohibits survivor benefits with respect to that component for any subsequent spouse of the participant. A subsequent spouse could still receive survivor benefits with respect to Component 4 and, most likely, Component 1.

#### **B. Separate Interest—Annuity for Alternate Payee's Lifetime**

Under a Separate Interest QDRO, the alternate payee receives a benefit that is converted actuarially to an annuity that is payable for the alternate payee's lifetime rather than the participant's lifetime. Generally, under a Separate Interest QDRO, an alternate payee may commence benefits anytime after the participant attains eligibility to retire even if he has not retired. After benefits commence, the alternate payee's award will continue for the duration of the alternate payee's lifetime.

A very small number of plans do not permit Separate Interest QDROs. The vast majority of plans permit Separate Interest QDROs unless the benefit being divided is already being paid. Under most Separate Interest QDROs, the conversion of the annuity for the participant's lifetime to an actuarially equivalent annuity for the alternate payee's lifetime is considered to occur if and when the participant and the alternate payee both survive to the date the alternate payee's benefits commence. After the conversion to an annuity for the alternate payee's lifetime has occurred, the risk of losing any of the awarded benefit is prospectively eliminated because the participant's subsequent death will not affect the alternate payee's benefits. Accordingly, a QJSA is not necessary in Separate Interest QDROs and would result in total benefits greater than the awarded benefit in the event the participant predeceases the alternate payee after awarded benefits commence.

However, in most instances, a QPSA is still necessary to protect an alternate payee until the conversion is considered to occur. However, some plans consider the conversion to an annuity for the alternate payee's lifetime to be effective immediately upon qualification of the order. In such cases, the participant's death, whether before or after commencement of the alternate payee's benefits, has no effect upon the payment of benefits awarded to the alternate payee and a QPSA is not necessary.

The Separate Interest approach involves an actuarial adjustment to the alternate payee's benefit to reflect any difference in future life expectancies of the alternate payee and the participant. If the alternate payee is younger than the participant, the actuarial adjustment will reduce the amount of the alternate payee's monthly payment, but not the present value of those payments. If the alternate payee is older than the participant, the actuarial adjustment will increase the amount of the alternate payee's monthly payment, but not the present value of those payments. No adjustments are made based on gender.

### **C. Choosing Shared Payment or Separate Interest**

Some plans will accept orders that permit the alternate payee to defer the choice between a Shared Payment and a Separate Interest and to make that decision just prior to the date the alternate payee's benefits commence. Sometimes the preservation of this option is advantageous to one or both of the parties.

As stated previously, alternate payees who elect Shared Payment may forfeit the right to draw benefits before the participant's benefits are paid. Therefore, if the participant intends to continue working after first becoming eligible to retire and the alternate payee would like to begin receiving awarded benefits prior to the participant's retirement, a Separate Interest QDRO may be preferable.

As stated previously, the Separate Interest approach involves an actuarial adjustment to the alternate payee's benefit (a reduction if the alternate payee is younger than the participant and an increase if the alternate payee is older than the participant). This should be weighed against the reduction for the QPSA that is required for a secured Shared Payment. Generally, alternate payees who are older than or no more than three years younger than the participant will receive a higher monthly payment under the

Separate Interest approach than under the Shared Payment approach. The greater the difference in ages, the more the difference in monthly benefits will be. A small difference in monthly benefits may be more than offset by the other factors bearing on this decision.

With some plans, alternate payees who elect Separate Interests forfeit rights to certain ancillary benefits that would otherwise be available to them (*e.g.*, the right to share in post-retirement COLA and to have benefits redetermined as unreduced benefits at the participant's age 62). These ancillary benefits can, in some instances, be substantial and their potential loss should be considered in deciding between a Shared Payment and a Separate Interest.

In situations where (1) the award exceeds 50% (encountered rarely) and (2) the QPSA and QJSA both based upon 50% survivor benefits, a Separate Interest may be the only way to fully protect the alternate payee against loss of awarded benefits due to the prior death of the participant. If that protection is paramount, then a Separate Interest may be preferable to a Shared Payment.

Substantial differences in the future life expectancies of the participant and the alternate payee may affect the choice of a Shared Payment or Separate Interest. For example, an alternate payee with a terminal illness may not wish to choose a Separate Interest (and thereby eliminate the possibility of a reversion to the participant in the event the alternate payee predeceases the participant). This is especially true if the parties have children and the reversion to the participant is expected to ultimately benefit the children.

In many situations, the preceding decision factors may result in opposite effects. Shared Payment may have some advantages and Separate Interest may have other advantages. It may not always be clear as to which alternative is preferable.

***Because the choice of a Shared Payment or Separate Interest has significant implications for both parties and is almost always irrevocable, we strongly recommend that you consult with us before that decision is made. In cases where we are retained to prepare QDROs, we offer this consultation at no extra charge.***

#### **D. Defined Contribution Plans – Not Applicable**

Most defined contribution plans (plans with individual accounts, including 401(k) plans) permit or require that alternate payees receive immediate lump sums. Those that do not pay immediate lump sums generally pay the participant's designated beneficiary the entire account when the participant dies. QDROs dividing defined contribution plans typically specify that the alternate payee's awarded portion of the participant's account is unaffected by the participant's death. Consequently, the alternate payee's award from a defined contribution plan is not generally at risk if the participant dies. Accordingly, the topics discussed in this article are not generally relevant to defined contribution plans.

## **E. Summary and Recommendations**

The portion of the participant's benefit retained by the participant is not at risk in the event the alternate payee dies before the participant. Therefore, we believe that equity dictates that the alternate payee's awarded interest be protected in the event the participant predeceases the alternate payee.

Even after the alternate payee is permitted to begin receiving benefits, electing a Separate Interest may have negative consequences for the alternate payee (for example, the possible loss of certain valuable ancillary benefits) and eliminates the possibility of a reversion of the alternate payee's interest to the participant in the event the alternate payee predeceases the participant. Also, electing a Shared Payment with deemed spousal treatment usually precludes the alternate payee from drawing awarded benefits before the participant.

On balance, in Shared Payment QDROs we believe it equitable that with Shared Payment QDROs deemed spousal treatment apply at least the extent necessary to preserve the awarded benefit rather than just the awarded portion and recommend this almost uniformly. This is especially true for the QPSA.

The following is worthy of repetition: *Because the choice of a Shared Payment or Separate Interest has significant implications for both parties and is almost always irrevocable, we strongly recommend that you consult with us before that decision is made. In cases where we are retained to prepare QDROs, we offer this consultation at no extra charge.*

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**This topic can and does occupy entire chapters in books. This article provides only an overview of the complexities involved. There are many nuances and caveats that we have not included in this article. Plans vary considerably on survivorship rights and benefit payment forms. 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.**