QDROs Keeping You Up at Night?

Sleep Tight by Getting it Right

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Introduction

- **Problem**: Hundreds of different retirement plans, each with their own unique pitfalls and hidden treasures
  - No presentation of this length could adequately prepare an attorney for every issue that will conceivably need to be addressed when dividing retirement benefits
- **Purpose of Today**: Roadmap
  - Basic differences and similarities of the various *types* and *classes* of plans you are likely to encounter in your daily practice
  - Common and/or default provisions that may come into play (and may also keep you up at night unless you properly address in the negotiations or litigation, and any subsequent agreement or order)
- **Remember**: It isn't a pitfall if you discover it pre-decree

Introduction

- **Nutshell: What is a Qualified Domestic Relations Order (QDRO)?**
  - A state domestic relations order, including an approved property agreement, that relates to child support, spousal support, or marital property rights; and
  - Which creates or recognizes the existence of an alternate payee's (spouse, former souse, child, or other dependent of a participant) right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a plan participant.
- **4 Dos:** Plan name; Parties' names & addresses; Amount of assignment; Payment period or number of payments
- **3 Do Nots:** Form of benefit; Increased benefit; Benefits due to another alternate payee

Introduction

- 3 ways to ‘divide’ retirement plans
  - **Offset**
    - Must have sufficient assets; must make tax equalizations; net present valuations
  - **Direct Payment**
    - Immediate or deferred (“if, as, when”); must mitigate tax liabilities and contingencies
  - **Deferred Distribution** (QDROs or other marital property division order)
    - Plan pays non-participant spouse by assignment pursuant to QDRO or similar order
    - Non-taxable event for participant / defers tax for non-participant
    - QDRO avoids 10% tax penalty

- For purposes of today, QDROs are an attorney’s best friend
  - “You had me at QDRO”
    http://you-had-me-at-hello.urbanup.com

Introduction

- Today we are going to focus on two TYPES of ‘local’ plans, and the issues to consider when negotiating, litigating, and drafting QDROs*****
  - **Qualified ERISA Plans:** Lexmark, Toyota, Kroger, etc.
  - **Non-ERISA Plans:** Kentucky / Kentucky Teachers’ Retirement Systems
  - Non-Qualified / Deferred Compensation Plans
  - Individual Retirement Plans

*****QDROs as used herein = Qualified Domestic Relations Orders (QDROs) & similar orders to divide and assign marital property rights (*e.g.*, COAP)

Spotting & Solving QDRO Issues Pre-Decree: A Plan Based Strategy

EZ 3 Step Approach: DO IT EVERY SINGLE (EXPLETIVE DELETED) TIME

To avoid pitfalls, you must characterize the retirement plan at the outset of EACH AND EVERY case in order to properly frame the QDRO-related issues

- **ASK** – What is the best method to divide this Plan?
  - Identify the Plan TYPE
- **ASK** – What QDRO-related issues must I look out for?
  - Identify the Plan CLASS
- **ASK** – Where do I look to solve QDRO-related issues?
  - Go to the SOURCE

EZ 3 Step Approach: Step #1
What is the best method to divide this Plan?

You must identify the Plan TYPE to make sure a QDRO is an option

<u>Not</u> all TYPES of plans will make a property assignment via QDRO, for instance

- Individual Retirement Accounts or Annuities (IRAs), established by 26 USC § 408(a)-(b) are non-qualified non-ERISA-based plans
    - QDROs are inapplicable. However, 26 USC § 408(d)(6) allows for an IRA transfer, incident to divorce, without immediate tax consequences, so long as certain requirements are met
- The Cincinnati Retirement System (a defined benefit pension plan), established by Chapter 203 of the Cincinnati Municipal Code, is exempt from ERISA requirements pursuant to 29 USC § 1003(b)(1) and 29 USC § 1002 (32); Chapter 203 does not authorize QDROs
- The City Employee's Pension Fund (CEPF), established by Chapter 6 of the Code of Ordinances, Lexington-Fayette Urban County Government, is exempt from ERISA requirements pursuant to 29 USC § 1003(b)(1) and 29 USC § 1002 (32); Does Chapter 6 authorize QDROs? (*See* §§ 6-65, 6-91)

EZ 3 Step Approach: Step #1
What is the best method to divide this Plan?

What TYPE of Retirement Plan?

<u>Qualified ERISA</u>

- Think: Private Employer-Sponsored Plans
  - 401(k), ESOP, Profit Sharing, Money Purchase, Traditional Pension, Cash-Balance, "Savings Plan"
- Established by IRC § 401(a)
- What is the best method to divide this plan?
  - A QDRO may assign benefits to a former spouse without penalty
  - *See* IRC §§§ 401(a)(13)(b), 402(e)(A); 414(p); ERISA § 206(d)

EZ 3 Step Approach: Step #1
What is the best method to divide this Plan?

What TYPE of Retirement Plan?

<u>Non-ERISA</u>

- Think: Government-Sponsored Pension Plans
  - Federal Civil, Military, Railroad, Kentucky Retirement System (3), Kentucky Teachers' Retirement System, Lexington-Fayette Urban County Government (3+)
- Definition IRC § 414(d); ERISA § 3(32)
- What is the best method to divide this plan?
  - Exempt from QDRO rules, see ERISA § 4(b)(1)
  - Must look directly to authorizing federal & state law, and municipal codes to see if the plan can be divided by similar court order

EZ 3 Step Approach: Step #1
What is the best method to divide this Plan?

What TYPE of Retirement Plan?

Non-ERISA continued

- Kentucky Retirement Systems & Teachers' Retirement System = Yes, via statutory QDRO form
- Ohio = Yes, via statutory Division of Property Order form (DOPO)
- Military Retired Pay = Yes, via Uniformed Services Former Spouse ACT ("USFSPA") "10/10 Killer Rule"
- Federal Retirement Plans = YES, via COAP for FERS, CSRS; RBCO for TSP; Partition Order for Railroad Tier II

EZ 3 Step Approach: Step #2
What QDRO-related issues must I look out for?

You must identify the Plan CLASS to properly frame the issues

- There are only two classes of plans
  - Defined Contribution
  - Defined Benefit
- Fundamental difference: Who bears the investment risk?
  - Employer versus the employee
  - The “difference” explains the decline in defined benefit plans in the private sector

EZ 3 Step Approach: Step #2
What QDRO-related issues must I look out for?

Defined Contribution Plan

- Think: 401(k) Type Plan
  - The contributions are defined, but the final benefits payable are not (know what goes in, not what comes out)
  - Individual accounts are maintained on the employee's behalf
  - The value of the retirement benefit is the account value (what you see is what you get)
  - Employee receives the vested account balance at termination or retirement

EZ 3 Step Approach: Step #2
What QDRO-related issues must I look out for?

Defined Contribution Plan

- Examples of QDRO-related issues
  - Effective date
  - “Magic” date
  - Gains/Losses
  - Delayed employer contributions
  - Loans
  - Vesting
  - Tax basis
  - Immediate lump sum
  - Beneficiaries
  - Passive appreciation on pre-marital contributions

EZ 3 Step Approach: Step #2
What QDRO-related issues must I look out for?

Defined Benefit Plan

- Think: Traditional Pension Plan
  - The plan is defined, but the contributions are not (know what goes out, not what goes in)
  - Generally, no account balances; benefit calculated using a formula that often employs years of credited service and final average salary
  - A lifetime benefit is typically paid when the employee reaches normal retirement age

EZ 3 Step Approach: Step #2
What QDRO-related issues must I look out for?

Defined Benefit Plan

- Examples of QDRO-related issues
  - Effective date
  - Time rule/Coverture
  - Duration of benefits (i.e., Separate vs. Shared Interest)
  - Survivorship rights & annuities (QPSA, QJSA)
  - Reversion
  - Pay-Status
  - Pre-decree retirement with Single Life Annuity (SLA) or QJSA election
  - COLAs
  - Early retirement subsidies & supplements

EZ 3 Step Approach: Step #3
Where do I look to solve QDRO-related issues?

You must go to the SOURCE – no shortcuts

- Not all plans play by the same QDRO rules
  - Authorizing Laws
  - Plan Documents
  - State Domestic Relations Law

EZ 3 Step Approach: Step #3
Where do I look to solve QDRO-related issues?

- **Laws that authorize the plan, as applicable**
  - IRC & ERISA
  - Other Federal, State, or Municipal Law
- **Plan documents, as applicable**
  - Plan Document, Summary Plan Description (SPD)
  - Employee Benefit Handbook
  - Attorney Guidance Manuals (Kentucky, Ohio, Military, Railroad, Federal)
  - Written QDRO Procedures (Fidelity, Hewitt)
  - Account Transfer Forms (IRAs)
  - Contracts

EZ 3 Step Approach: Step #3
Where do I look to solve QDRO-related issues?

- **State domestic relations law, as it may affect classification, valuation, or division**
  - Valuation Dates
  - Coverture
  - Vested Benefits
  - Survivor Benefits
  - Cost-of-Living-Adjustments (COLAs)
  - Early Retirement Benefits

Transition: Putting the Roadmap to Work

- **Let's look at two TYPES of plans**
  - Qualified ERISA: Local Company
  - Non-ERISA: County Employees Retirement System (KRS/CERS)
- **Let's look at one CLASS of plans – Defined Benefit Plan**
  - Qualified ERISA: Local Company Traditional Pension Plan
  - Non-ERISA: KRS/CERS Traditional Pension Plan
- **What issues might arise?**
  - COLAs
  - Maximum Benefit
  - Duration of Benefits
  - Defining "Marital Portion"
  - QPSA
  - QJSA
  - Post-Retirement QJSA
  - Administrative Fees

Putting the Roadmap to Work: COLAs
Local Company Pension Benefit

BACKGROUND

- New case, you represent Husband (non-participant / former spouse)
- Wife (participant spouse) has a Local Company Pension

Putting the Roadmap to Work: COLAs
Local Company Pension Benefit

- **Step #1**
- **ASK,** “What is the best method to divide this plan?”
  - TYPE
    - QUALIFIED ERISA Employer-Sponsored Plan = Divisible by QDRO
- **Step #2**
- **ASK,** “What QDRO-related issues must I look out for?”
  - CLASS
    - Defined Benefit – COLAs
    - COLA Benefits explained (see next slide)
    - Include in Husband’s award?

Putting the Roadmap to Work: COLAs
Local Company Pension Benefit

Post-retirement Cost-of-Living (COLA) Increases

- Under some defined benefit plans, the plan will from time to time, after the parties begin to receive benefits, increase the monthly benefit to adjust for inflation. These are small incremental increases that keep retiree's benefits in line with inflation. A COLA is often based upon the increase in the Consumer Price Index. *See* http://www.bls.gov/cpi

- For a good explanation of the importance of pension COLAs, see the National Institute of Retirement Security's AARP brochure at http://assets.aarp.org/www.aarp.org_/articles/work/pension-colas.pdf

Putting the Roadmap to Work: COLAs
Local Company Pension Benefit

Step #3

- **ASK**, "Where do I look to resolve this QDRO-related issue?"
  - Laws that authorize the plan
    - IRC / ERISA – recognizes the existence of an alternate payee's right to receive all or a portion of the benefits payable with respect to a participant under a retirement plan (*See* IRC § 414(p)(1)(A)(i)) & ERISA § 206(d)(3)(B)(i))

Putting the Roadmap to Work: COLAs Local Company Pension Benefit

Step #3 continued

- State Domestic Relations Law
  - The argument for inclusion of COLAs provides that COLAs are part and parcel of "accrued benefit" and should be considered marital property to the same extent that the pension itself is marital. Any increase in the marital portion of the retirement benefit that is not a direct result of the efforts of the employee after the divorce would be considered marital property. (*See generally* KRS § 403.190(3)-(4))
  - *See Brown v. Brown,* 456 S.W.3d 823 (Ky. App. 2015)(assessment of defined benefit plans may also require consideration of COLA increases); *Poe v. Poe*, 711 S.W.2d 849, 851 (Ky. App. 1986)(court-approved formula includes COLAs)

Putting the Roadmap to Work: COLAs Local Company Pension Benefit

GOOD RESOLUTION

- You look at Plan's QDRO Procedures
  - Procedures state that "if QDRO is silent regarding COLAs, COLAs shall not be allocated to the alternate payee's award"
- You decide to include COLAs in settlement language and submit for negotiation
- Parties agree & Court enters Decree incorporating Separation Agreement
- You expressly include proportional COLAs in QDRO language

Putting the Roadmap to Work: COLAs
Local Company Pension Benefit

BAD RESOLUTION

- You ignore COLAs in the settlement language and the QDRO. So what's so bad??
  - Participant/Wife retired & divorced in 1996. At the time of retirement, the total accrued pension was $1,000/mo. Because the entire pension was marital, Former Spouse/Husband was awarded 50% ($500 in 1996).
  - The COLA average between 1996-2016 was 2.2%.
  - You used the Model QDRO Form, and did not affirmatively address COLAs.
  - In 2017, the Participant/Wife would be receiving **$1,031.77** per month, while Former Spouse/Husband would still be receiving **$500** per month.

Putting the Roadmap to Work: COLAs
CERS Pension Benefit

BACKGROUND

- New case, you represent Husband with KRS/CERS pension
- Your client tells you he doesn't want to share COLAs
- You remember your last case with Local Company pension, and that COLAs are negotiable
- But before you make promises to your client that he won't have to share COLAs, you shimmy through the EZ 3 Step Approach

Putting the Roadmap to Work: COLAs
CERS Pension Benefit

Step #1

- **ASK**, "What is the best method to divide this plan?"
  - TYPE
    - Non-ERISA = Not Governed by QDRO Rules
    - Must find out if plan can be divided by similar court order
      - Where to go? State Law
        - KRS § 61.690
        - 105 KAR § 1:190
        - QDRO STATUTORY FORM FOR MARITAL PROPERTY (Rev. 5.2011)
          - https://kyret.ky.gov/All%20Forms/form6434.pdf
          - https://kyret.ky.gov/All%20Forms/form6435.pdf

Putting the Roadmap to Work: COLAs
CERS Pension Benefit

Step #2

- **ASK**, "What QDRO-related issues must I look out for?"
  - CLASS
    - Defined Benefit – COLAs
      - Beginning with the 2013 Fiscal Year, COLAs will be given to retirees only if the retirement system in which the retiree has service is funded over 100%, and giving the COLA will not reduce the funding level of that system under 100%. Additionally, a COLA may be given only if the General Assembly provides funding.
      - Include in Wife's award?

Putting the Roadmap to Work: COLAs
CERS Pension Benefit

Step #3

- **ASK**, "Where do I look to resolve this QDRO-related issue?"
  - Laws that authorize the plan
    - KRS § 61.690(9)(a) provides that a percentage award <u>will</u> include COLAs.
    - KRS § 61.690(9)(b) provides that a set dollar award will include COLAs <u>only</u> <u>if</u> <u>expressly</u> <u>stated</u> in the QDRO.
    - *See also* QDRO Statutory Form – Paragraph #10

Putting the Roadmap to Work: COLAs
CERS Pension Benefit

GOOD RESOLUTION

- Thankfully you properly identified the pension plan’s TYPE and CLASS and figured out pre-decree that COLAs were mandatory because this was a percentage-based assignment (so you didn’t have to renegotiate settlement terms)

Examples of QDRO-related Issues Defined Benefit Plan	Government Non-ERISA Defined Benefit Plan (Martial Property)	Private Qualified ERISA Defined Benefit Plan (Martial Property)
COLAs	**KY** – Automatic for %; must expressly allocate for $ **TRS** – Automatic for %; must expressly allocate for $	Generally negotiable (exceptions in some plans, *e.g.*, for Separate Interest)
Maximum Benefit	**KY** – 100% **TRS** – 100%	100%
Duration of Benefits	**KY** – Participant's lifetime (Shared Interest) **TRS** – Participant's lifetime (Shared Interest)	Negotiable* Participant's lifetime (*i.e.*, Shared Interest), or Alternate Payee's lifetime (*i.e.*, Separate Interest) *If in pay-status, then generally Shared Interest only
"Marital Portion" Percentage Formula	**KY** – Fixed coverture fraction (50% of service overlapping with marriage / total service) BUT can also do percentage that may or may not be based on the marital service **TRS** –Fixed coverture fraction (50% of service overlapping with marriage / total service) BUT can also do percentage of monthly benefit that may or may not be based on the marital service	Negotiable

Examples of QDRO-related Issues Defined Benefit Plan	Government Non-ERISA Defined Benefit Plan (Martial Property)	Private Qualified ERISA Defined Benefit Plan (Martial Property)
Pre-Retirement Survivorship Annuity (QPSA) through QDRO	**KY** – Not available* *Consider term-life insurance policy **TRS** – Not available* *Consider term-life insurance policy	Negotiable (not applicable to "Severed Interest")
Post-Retirement Survivorship (QJSA) through QDRO	**KY** – Not available* *Consider term-life insurance policy **TRS** – Not available* *Consider term-life insurance policy	Negotiable (not applicable to Separate Interest)
Divorce Post-Retirement & Election of QJSA	**KY** – Divorce automatically revokes beneficiary designation **TRS** – Beneficiary designation remains unchanged unless revoked by Member (60 days)	Generally annuity vests with non-employee spouse (limited exceptions exist)
Administrative Fees	**KY** – Yes $50 original /$25 amended (one check) **TRS** – Yes $300 original /$150 amended (one check)	No, prohibited for defined benefit plans

“QDRO” is Not a 4 Letter Word

- **It isn’t a pitfall if you discover it PRE-DECREE**
- To avoid post-decree headaches, you must characterize the retirement benefit at the outset of each and every case in order to properly frame the QDRO-related issues for negotiation or litigation
    - Identify Plan TYPE
    - Identify Plan CLASS

Thank You

My practice focuses on the division of retirement assets in divorce, and includes providing consultation, litigation support, and drafting services to family law attorneys on issues related to retirement benefits

Feel free to contact me if you have any questions

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