

## QDRO Drafting Strategies and Divorce Judgments

Avoiding Pitfalls That Result in Unintended Loss of Retirement Plan Benefits

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THURSDAY, SEPTEMBER 19, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

Matthew L. Lundy, Esq., **Matthew Lundy Law - QDRO Law**, Tampa, Fla.

Darren J. Goodman, Founder, **The Law Offices of Darren J. Goodman**, Westlake Village, Calif.

Louise Nixon, President, **QDRO Counsel**, San Marino, Calif.

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# QDROs: An Overview

By: Matthew L. Lundy, Esq.  
Tampa, Florida and Atlanta, Georgia  
Matt@MLundyLaw.com

# Overview

- A brief history of pensions: Looking at the Studebaker Case
- What are the issues that must be addressed in a marital settlement agreement and/or final judgment when it comes to dividing a retirement account?
- What is a “QDRO”?
- How long does a plan have to review a QDRO?
- What are your client’s remedies if the Plan does not carry out its duties?

# Defined Benefit Plans: Best Practices

Matthew L. Lundy, Esq.

# What is a defined benefit plan?

- Defined Benefit Plan: The Internal Revenue Code defines these plans as any qualified plan that is not a defined contribution plan (see IRC § 414(j)); think of this as a pension plan; the plan is generally only funded by the employer and employees earn credits based on years of service and other factors that vest on a pre-determined schedule; they have titles such as “Company X Pension Plan” or “Company X Retirement Plan” or “Company X Retirement Income Plan”
- More and more frequently private sector employers are offering a lump sum cash payout, and when they do, these pensions are sometimes referred to as hybrid pensions

# Defined Benefit Plan Ancillary Economic Benefits

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- 1) Survivor Benefits (See Louise's presentation)
  - a) Qualified Joint and Survivor Annuity
  - b) Qualified Pre-Retirement Survivor Annuity
- 2) Duration and Benefit Commencement
  - a) Shared Interest b) Separate Interest c) Lump Sum
- 3) Amount—Valuation
  - a) How do you get a valuation?
- 4) Cost of Living Adjustments
- 5) Early Retirement Subsidies
- 6) Social Security Reductions
- 7) Effect of plan merge (into another plan with different rules, such as a disability pension)  
buyout, PBGC takeover

# Military Pensions

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- All military members earn service credit toward a pension
- Pensions differ for active duty members versus reservists
- The military does not accept QDROs per se, but they do accept orders for the division of military retirement pay
- These orders divide disposable retirement pay, which is the base retired pay, less:
  - (A) are owed by that member to the United States for previous overpayments of retired pay and for recoupments required by law resulting from entitlement to retired pay;
  - (B) are deducted from the retired pay of such member as a result of forfeitures of retired pay ordered by a court-martial or as a result of a waiver of retired pay required by law in order to receive compensation under title 5 or title 38;
  - (C) in the case of a member entitled to retired pay under chapter 61 of this title, are equal to the amount of retired pay of the member under that chapter computed using the percentage of the member's disability on the date when the member was retired (or the date on which the member's name was placed on the temporary disability retired list); or
  - (D) are deducted because of an election under chapter 73 of this title to provide an annuity to a spouse or former spouse to whom payment of a portion of such member's retired pay is being made pursuant to a court order under this section.

# Military Pension Continued

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- Only shared interest available, plus COLAs
- 10/10 Rule: Must be married for 10 years of creditable service in order to direct DFAS to make direct payment to a former spouse as property division; can only take 50% for property division purposes
- 20/20/20 rule: full entitlement to medical, commissary (store for provisions)
- 20/20/15 rule: one year of transitional medical benefits
- SBP: 55% of base pension; cost of 6.5% of base amount
- Deemed election-DD 2656-10

# Federal Government Pensions

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- FERS v. CSRS
- Court Order Acceptable for Processing (“COAP”): this is the QDRO-like order used to divide federal employee pension annuities and associated benefits
  - Self-Only Annuity: Annuity based on the lifetime of the employee spouse
  - Gross Annuity: self-only annuity less survivor annuity cost
  - Net Annuity: gross annuity, less amounts: owed to government, deducted for health benefits, deducted for life insurance, deducted for Medicare, deducted for state and federal taxes
  - Refund: for employees who separate, they can receive a refund of their contributions to the federal pension. The refund can be divided by COAP
  - Under a COAP, if the non-employee spouse pre-deceases the employee after benefit commencement, the amount payable to the non-employee can pass to their estate and not revert
  - This plan only offers a shared interest payment; it also offers a COLA, a post-retirement survivor annuity, and each plan has a pre-retirement employee death benefit
- Spousal Equity: Former Spouses are eligible to enroll under Spouse Equity provisions if:
  - they are divorced from a Federal employee or annuitant during his/her employment or receipt of annuity;
  - they were covered as a family member under an FEHB enrollment at least one day during the 18 months before their marriage ended (Note: This requirement is also met when both the former spouse and the Federal employee or annuitant have FEHB enrollments);
  - they are entitled to a portion of the Federal employee's annuity or to a former spouse survivor annuity; and
  - they have not remarried before age 55.

# Defined Contribution Plans

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# Considerations

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- Identifying a defined contribution plan
- Valuing a defined contribution plan
- Offsetting with other retirement plans
- QDROs for defined contribution plans
- Self-Administered Plans
- Distribution Issues
- Language for Judgments and Settlement Agreements

# Identifying Defined Contribution Plans

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- 401(k), 403(b), 457, profit sharing plans, money purchase pension plans, and ESOPs
- Employee contributions through salary deferrals
- Employer contributions in form of matching contributions or discretionary contributions
- Individual Accounts with Investment Options
- Lump sum distributions eligible for tax free rollovers
- Loans and Hardship Withdrawals

# Valuation Issues

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- Tracing contributions for marital period and earnings/losses thereon
- Premarital account balance and accounting for separate property can be difficult
  - Historical Account Statements
  - Salary Deferral Election Forms
  - Plan Entry Date
  - IRS Contribution Limits
  - Assumed Interest Rates
  - Coverture (Time-Rule) Method of Allocation

# Valuation Continued...

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- Post Separation Contributions and Earnings/Losses
- Contributions related to prior Plan Year
- Plan Loans/Withdrawals - Characterization

# Offsetting With Similar Plans

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- Comparing Values of Defined Contribution Plans with other retirement plans/IRAs
- Using Identical or Similar Valuation Dates
- Fixed Awards
- Eliminating risk associated with market fluctuation
- Dividing plans in-kind via QDRO
- Equalization adjustments/Valuation Date

# QDROs for Defined Contribution Plans

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- Award to Alternate Payee
  - Fixed Award or Percentage
  - Valuation Date Issues
  - Treatment of Loans
  - Handling Pre-Marital Balance
  - Post Separation or Post-Dissolution Earnings/Losses
  - Employer Contributions for prior Plan Year

# QDROs continued...

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- Segregated Accounts
- Distribution Options
- Death of Participant/Alternate Payee
- Plan Administrator Calculations
- Plan Administrator Headaches
  - Delay in Approval
  - Calculations
  - Review Fees

# Self Administered Plans

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- Accounting Issues
  - 5500s
  - Account/Participant Statements
  - Multiple Participants
  - Pooled Accounts
  - Limited Valuation Dates
  - Alternative Investments and Valuation/Liquidity Problems

# Self Administered Plans Continued...

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- QDRO Administration Issues
  - Plan Administrator is Plan Participant
  - Failure to Process QDRO
  - Calculation of Earnings/Losses

# Distribution Issues

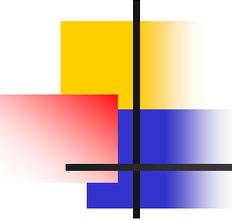
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- Lump Sum/Rollover
- Exception - 10% Early Withdrawal Tax
- Transfer cash versus shares/units of specific holdings
- Tracing assets after rolled over to IRAs

# Judgments and MSAs

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- Identification of Plan
- Recognition of pre-marital and/or post- separation contributions
- Fixed Award/Percentage of Account must be tied to Valuation Date
- Investment Earnings and Losses
- Equalization with Other Plans/Accounts/Assets
- Broad Language versus Specific Allocation Formula

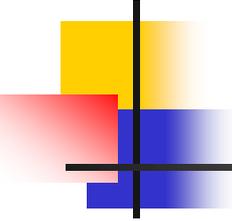


Pension Division –  
How to Protect Survivor Benefits/Drafting Issues

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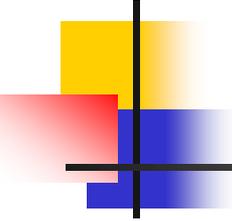
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## How to Protect Survivor Benefits

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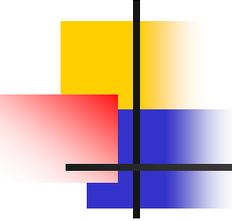
- Federal law (ERISA) protects certain rights of spouses and surviving spouses
  - ERISA § 205(a)(2), 29 USC 1055(a)(2) – Qualified Preretirement Survivor Annuity (QPSA)
  - ERISA § 205(a)(1), 29 USC 1055(a)(1) – Qualified Joint and Survivor Annuity (QJSA)



## How to Protect Survivor Benefits

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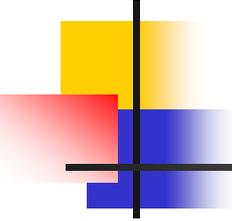
- ERISA and Same-Sex Couples
- IRS adopts Rule 08/29/2013 recognizing lawful Same-Sex Marriages regardless of couple's state of residence as "spouse"
- Revenue Ruling 2013-17



## How to Protect Survivor Benefits

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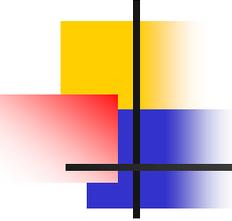
- Are any spouses not entitled to this protection?
  - Legally separated spouses (Treas. Reg. § 1.401(a)-20, Q-27)
  - Married less than one year (29 USC 1055)
  - Registered domestic partners are not spouses
  - Important to review plan documents



## How to Protect Survivor Benefits

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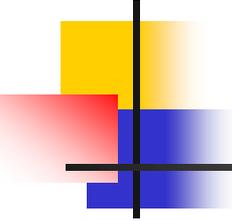
- To obtain spousal rights for former spouses, a QDRO is needed.
  - ERISA Section 206(d)(3)(F)(i), 29 USC 1056(d)(3)(F) permits a QDRO to designate a former spouse as the surviving spouse, and the actual spouse is not treated as the surviving spouse.



## How to Protect Survivor Benefits

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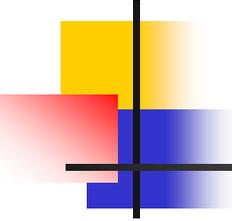
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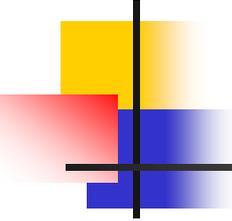
- Generally, designate former spouse as surviving spouse in the QDRO to the extent of marital/community interest
- Qualified Preretirement Survivor Annuity (QPSA) and Qualified Joint & Survivor Annuity (QJSA) – 50% of monthly benefit minimum payment required under ERISA



## How to Protect Survivor Benefits

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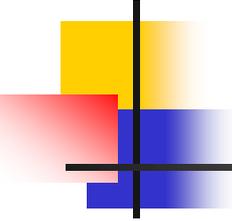
- If employee dies before retirement
  - QPSA
  - *Hamilton v. Plumbers & Pipefitters National Pension Fund*, 433 F. 3d 1091 (9<sup>th</sup> Cir. 2006), cert denied, 127 S. Ct. 86, 166 L. Ed. 2d 32
  - *Trustees of DGA Pension Benefits Plans v. Tise*, 234 F.3d 415 (9<sup>th</sup> Cir. 2000)



## How to Protect Survivor Benefits

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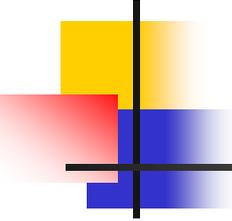
- If employee dies after retirement
  - QJSA
  - Irrevocability of retirement election
  - *Carmona v. Carmona*, 603 F.3d 1041 (9th Cir. Nev. 2010) which followed *Hopkins v. AT&T Global Solutions Corp.*, 105 F.3d (4<sup>th</sup> Cir. 1997).



## How to Protect Survivor Benefits

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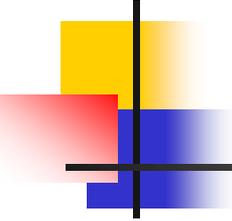
- Limit on ability to get survivor benefits for former spouse after death or retirement if Judgment does not specifically award survivor benefit and participant died or retired with a second spouse.



## How to Protect Survivor Benefits

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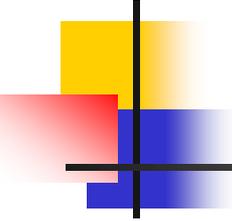
- For ERISA plans, often only former spouse qualifies as survivor for QPSA if unmarried participant dies preretirement. If a QDRO is not filed and no award of survivor benefits in Judgment, many plans will not allow payment to former spouse with a post death QDRO.



## How to Protect Survivor Benefits

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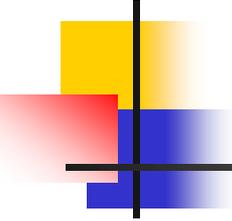
- Designation of spouse as beneficiary remains valid even if Judgment of Dissolution revokes the beneficiary designation and awards all benefits to participant. See *Kennedy v. Plan Adm'r for Dupoint Sav. & Inv. Plan*, 129 S. Ct. 865; 172 L. Ed. 2d 662 (2009), in which participant failed to change the beneficiary designation.



## How to Protect Survivor Benefits

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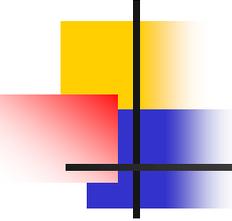
- Under what circumstances might P's heirs have a state law claim against the former spouse for the distribution proceeds?
  - *Kensinger v. URL Pharma, Inc.*, 674 F.3d 131 (3<sup>rd</sup> Cir. 2012)
  - *Andochick v. Byrd*, 2013 U.S. App. LEXIS 5327 (4<sup>th</sup> Cir. 2013)



## How to Protect Survivor Benefits

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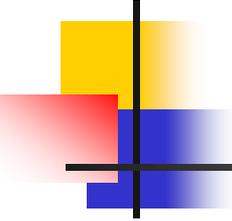
- Participants should be advised to contact the plan administrator and complete a new beneficiary designation form as soon as allowable.



## How to Protect Survivor Benefits

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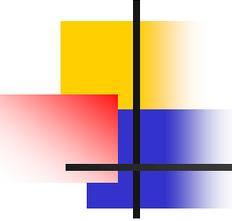
- Use a certain type of QDRO to ensure lifetime benefit.
  - Separate interest payable over AP's lifetime
    - Effective when QDRO approved even if payment delayed
    - Most common form of division when P not yet retired.



## How to Protect Survivor Benefits

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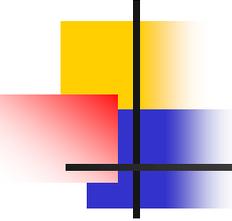
- Shared payment payable over P's lifetime with QJSA to AP on P's death.
  - Right to share in stream of income
  - AP's designated beneficiary must be successor alternate payee
  - Usually required when P retired
  - Issues when P retires with 2<sup>nd</sup> spouse before QDRO done



## How to Protect Survivor Benefits – Public Plans

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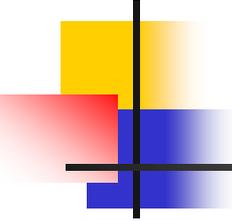
- Major issues with Military Plans [Survivors Benefit Plan (“SBP”)]– Draconian effect for failure to award survivor benefit in Judgment if employee retires or dies before division order served on those plans.
- Need proper forms also timely served for military SBP.
- Need domestic relations order (“DRO”)



## How to Protect Survivor Benefits – Public Plans

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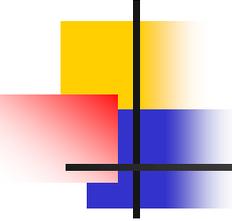
- Military Plans –
- Former Spouse should file a “deemed election” request per 10 U.S.C. §1488 DD Form 2656-10) to protect his/her interest in the SBP
- Member’s form for SBP - DD Form 2656-1



# How to Protect Survivor Benefits – Public Plans

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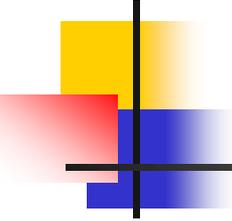
- Military Plans -
- Maximum Base amount for SBP is 55%
- Cost of SBP is generally 6.5% and comes off the top of the pension
- Allocation of costs



## How to Protect Survivor Benefits – Public Plans

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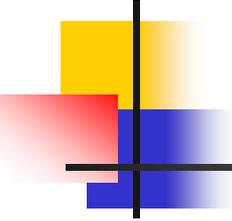
- Federal Employees Retirement System (“FERS”) and Civil Service Retirement System (“CSRS”)
  - <http://www.opm.gov>. Go to handbook for attorneys preparing domestic relations orders.
  - Amount - 55% (CSRS) or 50% (FERS)
  - Need DRO.



## How to Protect Survivor Benefits – Public Plans

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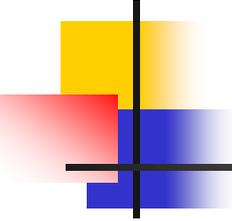
- FERS and CSRS:
- Major issues with Former Spouse Survivor Annuity (“FSSA”)] – Draconian effect for failure to award survivor benefit in first court order (usually the Judgment of Divorce) if employee retires or dies before division order served on those plans.
- Cannot file nunc pro tunc Order to fix



## How to Protect Survivor Benefits – Public Plans

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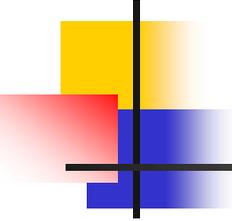
- Different options for FSSA regarding amount to allocate to former spouse
- Different definitions for pro rata share by OPM (Section 838. 922 of Title 5 of the CFR – 50% of marital fraction vs. Section 838. 922 of Title 5 of the CFR – 100% of the marital fraction)



## How to Protect Survivor Benefits – Public Plans

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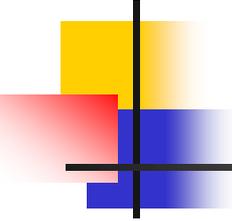
- Employees under FERS, CSRS, and Military also likely to contribute to the Federal Thrift Savings Plan often called “TSP” (defined contribution plan)
- Need DRO for TSP



## Drafting Issues

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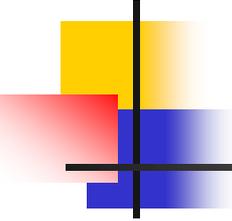
- Common Drafting Issues for MSAs, Judgments and QDROs.
  - Defined Contribution Plans
    - If division is 50% of community/marital interest – state 50% of that interest and identify the interest (date of marriage and date of division) in the Judgment.



## Drafting Issues

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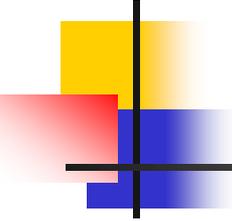
- Defined Contribution Plans (continued)
  - Always state whether investment gains/losses should be included especially when amount awarded is an equalization payment.



## Drafting Issues

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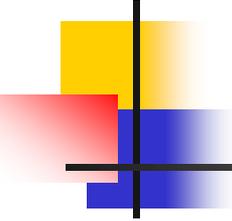
- Defined Contribution Plans (continued)
  - If different division date than normal division date in your state (i.e. in California the date of separation), clearly identify that date or if future date put i.e. “through date of judgment of dissolution” or “through date of implementation by the plan.”



## Drafting Issues

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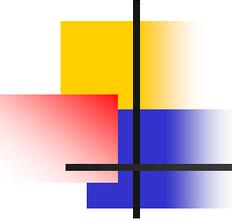
- Defined Contribution Plans (continued)
  - Know if there is a premarital contribution to the DC plan. Most plans will not calculate out of the community/marital interest participant's premarital contributions and gain/losses thereon through date of division.



## Drafting Issues

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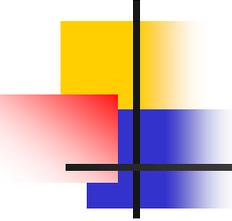
- Defined Contribution Plans (continued)
  - Loan issues - whether that loan value should be included or excluded in QDRO.
  - Fees to review DC Plans
  - Only use time rule formula as last resort if premarital separate property interest cannot be otherwise valued.



# Drafting Issues

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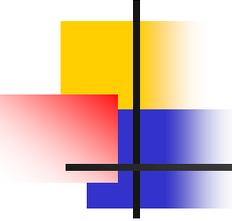
- Defined Benefit Plans
  - Know the earliest retirement date and if P is retired.
  - When to use a shared payment QDRO vs. separate interest QDRO.



## Drafting Issues

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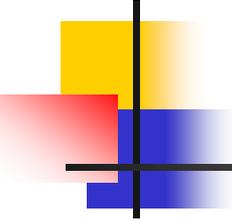
- Child or Spousal Support
  - Yes for defined contribution plan
  - Yes for defined benefit plan if P in pay status (and sometimes when P not in pay status but eligible to retire)
  - Tax considerations (gross up)



## Drafting Issues

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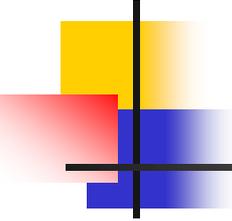
- Disability Retirement
  - Different rules apply in determining community/marital interest. Depends on state but usually -
    - Amount in excess of service retirement = SP; Amount paid prior to retirement eligibility = SP
    - Tax benefit for disability benefits = SP



## Drafting Issues

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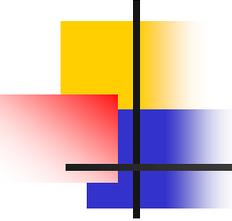
- **WHAT ABOUT IRAS?** - IRAs do NOT need a QDRO but may need DRO
- What about SEP IRAs? SEP part is subject to ERISA, but the pension is funded by an IRA, which is not. ERISA Opinion Letter 75-14 , 09/30/1975.
- IRC Section 408 Order as DRO.



## Drafting Issues

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- QDRO Procedures
  - Plans must have reasonable written procedures, but form QDROs not mandatory
  - Form orders should not be trusted: Drafted first to benefit the plan, then the participant and last the alternate payee. Many pitfalls in model QDROs.



## Final Thoughts

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- Send filed Judgment to plan. Most will treat it as a DRO to be reviewed and place a hold if QDRO not yet filed and served on the plan.
- Can get attorney's fees related to at least support pursuant to *Trustees of The Directors Guild of America-Producer Pension Benefits Plans v. Tise*, 234 F.3d 415 (9<sup>th</sup> Cir. 2000).