QDRO OR BUYOUT: PREPARING TODAY FOR A SECURE TOMORROW
BY THEODORE K. LONG JR.

One of the most complex and difficult decisions a divorcing couple faces is the division of the pension rights accumulated during the marriage.

Some 84 million Americans work for companies that maintain Employee Retirement Income Security Act (ERISA)-covered retirement plans that are divisible by Qualified Domestic Relations Orders (QDROs), which guarantee the non-worker spouse (the non-owner, who is usually the wife) a share of her husband's pension. Or the couple can opt for a buyout (sometimes called an immediate offset), by which one spouse trades away pension rights for another asset.

Normally, divorcing couples face a situation where the husband is the pension holder and the wife is the non-owning spouse who is entitled to a share of the pension benefits he earned during the years of their marriage. Sometimes the wife may have her own pension, and her husband may be entitled to share of the marital portion of her pension, but generally, the husband's benefits are larger than those of the wife, who may have no pension at all or much smaller benefits because of years out of the work force.

To start, the decision to draft a QDRO, which gives the non-owning spouse income later in life, or opt for a buyout, which provides money up front, demands good legal advice and requires the services of a professional pension appraiser. Sometimes neither the pension holder nor the non-owning spouse appreciate just how valuable a pension is until it is appraised. The two most valuable assets a divorcing couple divide are the marital home and pension assets, but it is not uncommon for a thrifty couple who lived in a modest home for a long time to discover that the husband's pension may be worth more than the marital home (particularly now in the wake of the collapse of the housing market). Moreover, despite the advances women have made in the work place, the husband's career (and consequently his pension) usually come first in the economics of a marriage, which also enhances the value of the man's pension.

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Sometimes, the non-worker spouse (usually the wife) may be tempted to opt for a buyout far more readily than a QDRO. The woman, faced with near-term problems like keeping a roof over her children's heads and food on the table, fails to consider the long-term problem of retirement income. Sometimes the buyout shortchanges women, particularly those whose marital contributions have been child rearing and homemaking, because it means that they head into their so-called "golden years" without any retirement income other than Spousal Social Security. This consideration should be of particular concern to a woman if she is among half the workers in the labor force without a pension and has been a stay-at-home mother who can only make a claim against her husband's Social Security benefits.

In deciding between the two, both the worker spouse and the non-worker spouse should consider the division in both the short term and the long term. A wife's willingness to take a buyout gives her leverage with her husband who may want to go into retirement with undivided pension benefits. A husband's willingness to agree to a buyout may mean he gives up the marital home but gets to keep his pension.

Very often, divorcing couples, particularly those who divorce *pro se*, may settle on a buyout of the husband's pension interest without a pension professional placing a value on the plan. Moreover, legal fees may seem off-putting, particularly when the value of the pension seems low. Consequently, the buyout price falls short of the present value of the plan. A buyout gives the recipient cash in hand now and up front or in many cases the full ownership of the marital home, but it means that the participant (often the husband) gets all the benefit of the pension in his old age and the nonparticipant (often the wife) gets nothing. And she lives to regret her decision.

GOOD LEGAL ADVICE

The decision to go for a buyout versus a QDRO or vice versa requires good legal advice. Attorneys must be well grounded, not only in the particulars of the pension plan(s) of the divorce case, but also in the subtleties of the ERISA, which is the federal law covering private pensions, and the Retirement Equity Act, which broadened the rights of divorced spouses. Retirement plans and pension rules are very complex, and dividing them challenges both attorney and client.

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As experienced lawyers know, calculating the amount to be paid to each spouse is a challenging task that often goes beyond the simple completion of forms provided by a plan administrator. QDRO preparation and approval can take months, and it involves preapproval by a plan administrator, revisions, approvals by both parties, and final approval as a QDRO. At no point in this routine does any third-party intervene to make certain that the parties are in fact receiving the right amount.

In the back-and-forth of divorce negotiations, a lawyer can easily make mistakes that work against those who opt for a QDRO, including:

1. **Failure to ask for the important information about a spouse's benefits and retirement soon enough.** Pension plans vary greatly about the terms and conditions about when a pension can be paid under a domestic relations order.

2. **Failure to prepare any pension order**. This should be done at time of the divorce. The death of a former spouse, his retirement, remarriage can reduce the benefits a former spouse otherwise would have received.

3**. Failure to obtain information about every retirement benefit that might be marital property.** Many employees have more than one pension plan at the same company. Some people have pensions from companies they no longer work for.

4. **Failure to obtain information about all pension plans provisions.** Benefits vary greatly, and some plans pay more than one type of benefit. For example, some include cost-of-living escalators and others have provisions to encourage early retirement.

5. **Failure to ask for survivor benefit or does not mention none is available.** The death of a worker-spouse may terminate the benefits. A separate interest QDRO assures the recipient benefits even if the owner spouse dies before retirement.

6. **Failure to explain how retirement benefits are usually divided under state law.** State marital and community property laws often specify the division and distribution of retirement and pension benefits. Sometimes couples can use these laws as the basis of negotiation.

7. **Failure to explain what a former spouse might do to reduce or eliminate benefits to the former partner.** Sometimes a former partner may fail to apply for a pension or waives his right to a pension, or become injured or disabled.

8. **Failure to explain how remarriage might affect benefits**. Some federal, state and local government employee benefits terminate if the former wife remarries.

9. **Failure to explore the unusual legal requirements or loopholes that could result in the pension order being rejected by the plan administrator.** Some plans are not required to accept any court order assigning benefits to a former spouse.

10. **Failure to have the proposed pension order preapproved before being sent to the court.** This means that the plan may have to be filed with the court a second time if the administrator rejects it the first time.

11. **Failure to make sure the final pension order is sent to the plan and accepted.** Even when the payout of benefits is years away, the court order should be approved promptly.

12. **Failure to explain Social Security benefits.** These benefits are not marital property. A spouse married at least 10 years may be eligible to apply for them as a divorced spouse.

Moreover, in addition to defined benefit and defined contribution plans, family practice attorneys now must contend with a new type of retirement hybrid called a "cash balance pension plan" as well as the sometimes more daunting challenges of post-divorce pension enhancements.

BUYOUT VERSUS QDRO

After the pension appraisers determine the present value of the pension, the spouses are in a position to make the first big decision: buyout or QDRO.

Care must be taken in making sure that the buyout accurately reflects the value of what is traded off.

In her book *Survival Manual to Divorce,* Carol Ann Wilson describes how a wife took a $12,000 baby grand piano, but passed up her chance for half of her husband's $2,300 per month defined benefit pension, which had a present value of $250,000. "[S]he could have exchanged her half of Frank's pension upfront for $125,000 worth of another asset. … Or she could have waited until Frank retires to obtain her share of the marital portion of his benefit. What seemed to have been a few thousand dollars on the surface proved to be a costly mistake in the end," Wilson writes.

Considerations other than the value of the pension may influence the decision. For example, a childless professional couple may decide to take the pension division off the table, agreeing that both spouses keep their own pensions. A middle-aged homemaker, however, may be very concerned that she faces the prospect of retirement without a pension and opt for a QDRO, which gives her a share of her former husband's pension.

Basically, however, the decision to go for a buyout or a QDRO has benefits and inabilities for both the pension owner and the nonworking spouse.

For the pension owner, a buyout means he enjoys all the benefits earned because of future increases in salary and continued years of service. For the non-owning spouse, a buyout provides cash in hand now.

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On the other hand, for the pension owner, deferred distribution via a QDRO avoids argument over the discussion and analysis involved in the pension appraisal. For the non-owning spouse, deferred distribution via a QDRO means the non-owning spouse may share in future salary and years of service earned by her former husband.

QDRO BASICS: CARE AND PATIENCE

The procedures for obtaining a QDRO may vary from jurisdiction to jurisdiction, but a few basics must be held in mind.

The terms and conditions of the QDRO must be set forth in the marital settlement or divorce decree. At a minimum, the decree should set forth the amount or percentage of the benefit to be assigned from the worker-participant, identify the plan(s) from which the benefits are to be assigned; and also other material facts, such as whether the alternate payee is to be named as surviving spouse for purposes of a joint and survivors annuity, when the benefits are to be divided and whether any post-retirement subsidies are to be included.

Obtaining an approved QDRO, one that is in place and approved by the plan administrator, can take anywhere from a month to a year or more, so a note of common-sense caution here. The worker-participant has no incentive to expedite the preparation of a QDRO, and the alternate payee receives his or her share (usually her) only if and when the QDRO is prepared and executed. Hence, it is in the interest of the alternate payee to move forward with the QDRO as soon as possible (although it is very common to wait before doing so). Needless to say, cooperation between the former spouses — the participant and the alternate payee — is highly desirable because the cost of litigation dramatically increases the expenses associated with QDRO preparation.

Rarely may a single QDRO be used for two or more retirement plans — for example a 401(k) and a defined benefit plan, and one QDRO cannot be used to cover two or more different employers.

Sometimes, a plan administrator provides a model form that can be used because it reduces the time to review the form for approval. Such forms must be used with care, however; the forms may not deal properly with the terms and conditions to which the participant and the worker have agreed. This plan "vanilla" form follows the law, but includes no extras that may be a consideration in particular pension distribution.

The practitioner must determine if the plan administrator preapproves QDROs. Preapproval means that the substance of the QDRO complies with the rules and regulations covering QDROs and the pension plan. QDRO approval is very important. A veto by the plan administrator can stop the process, and the alternate payee has no recourse but to start all over.

The plan administrator is not responsible for the accuracy of the distribution of pension benefits. It is quite possible that the plan administrator could approve a QDRO that incorrectly distributes pension benefits because of a mathematical error made by the practitioner of one or the other spouses.

In writing a QDRO, God and the devil are in the details. A QDRO reflects what the spouses — the worker-participant and the alternate payee, usually the husband and wife — agree to regarding the division and distribution of pension benefits. The QDRO, normally written coincident with or after the divorce is final, is based on the language of the marital settlement agreement. For this reason it is a good idea that the practitioner who writes the QDROs — often the attorney of the alternate payee working from the appraisal of a pension appraiser — to make certain the agreement does what the parties wish it to do relative to the pension and its distribution. Despite this, it is not uncommon for the separation agreement to be unclear about the name of the retirement plan, the method used in allocating benefits, and even the date used in valuing the account balance. Such ambiguities invite difficulties in the preparation of a QDRO.

CASH BALANCE PLAN – NEITHER FISH NOR FOWL

Family practice lawyers are familiar with the differences between the defined contribution plan, such as a 401(k), and the traditional defined benefit plan, the old-fashioned company pension.

Attorneys drafting QDROs now must contend with a new type of retirement plan called a "cash balance pension plan" — a hybrid that is not really the fish of a traditional defined benefit plan, nor the fowl of a defined contribution plan. A cash balance plan features elements common to both. Though technically a defined benefit plan, its individual accounts, which sometimes permit lump-sum distributions upon termination, make the cash balance plan resemble a defined contribution plan. When companies began converting traditional defined benefit plans to cash balance plans, older workers protested that the new routine discriminated against those who were near retirement. Moreover, what was termed a "whipsaw" resulted in the calculation of a participant's account value when different rates — one for compounding and one for discounting — were applied.

In a cash balance plan, Joe the Worker at XYZ Corp. receives "defined" pension credits that are a predetermined percent of his annual salary, for example, 6 percent. In addition, Joe receives what a called "interest credits," which are

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based on the annual investment earnings, for example, 5 percent. But if in investing Joe's account, XYZ's cash balance plan receives a 12-percent return, for example, the 7 percent difference goes to the plan, not to Joe's account. Unlike returns earned in a 401(k), which can have real losses and gains in the market, the interest credits, like the pension credits, of a cash balance plan are preordained and set, and Joe has no say in investments in his account.

Many large older established companies began converting traditional defined benefit plans to cash balance plans several years ago when they began to buckle under the weight of what were termed "legacy costs" that made the traditional company pension plans so expensive. Under the old regime, a worker's pension is based on his or her final average earnings, when he or she is at his peak earning, and on his total years of service. Thus, a worker who retires at 65 with 40 years of service receives a pension based on his average salary times his 40 years of service. By comparison, under a cash balance plan, the worker receives an annual pension credit for each year's actual salary. For example, if Joe the Worker is covered by a traditional defined benefit pension plan, his accrued pension benefit is not based on a percentage of his early years when his wages are low, but based on his annual compensation later in his career when his wages are much higher.

Lawyers dividing pensions must understand the difference between the traditional defined benefit plan and the cash balance plan because the type of QDRO that is appropriate will be different (as may be the entire marital property division strategy). Most attorneys representing Joe the Worker, the participant, lean toward a deferred distribution of the cash balance plan; those representing Joe's wife, the nonparticipant, push for a cashing out with other offsetting assets.

The difficulties in dividing a cash balance pension plan may be complicated even more by the fact that many, if not most, of these plans started as traditional defined benefit pension plans. This means that the plan was converted to a cash balance regime and that, as part of the conversion, the accrued monthly benefit — the amount that would be payable to Joe the Walker on a monthly basis for the rest of his life beginning when he reaches age 65 — must be calculated. However, since the cash balance plans (like the 401(k), contain the individual accounts of all the Joe the Workers covered by the plan rather than the accrued monthly benefit amounts, XYZ Corp. must convert Joe's monthly payment to a lump sum amount. The lump sum amount of conversions has been contested in at least three federal court cases, because litigants have contended that "the participant's stated account balance was not judged to be the actual value of the plan:" hence, the "hypothetical" quality of the account in a cash balance plan.

To deal with this, a lawyer must determine when the company established the cash balance plan and whether it was converted from a traditional defined benefit plan. Then, he can draft a QDRO using one of four basic models. They are as follows:

1. **Percent of Total Account Balance as of the Date of Divorce:** Provides the alternate payee with a specified percent of the total account balance at the time of the divorce. Ideal for a party who was not married when he enrolled under a traditional defined benefit plan.
2. **Coverture Before Conversion and Percent of Account Balance after Conversion:** Works if Joe the Worker was covered under a defined benefit plan before it was converted and married before the conversion.
3. **"Frozen" Coverture as of the Date of Divorce:** Applies a coverture-based formula to the participant's total account as the date of divorce.
4. **"Full" Coverture as of Date of Retirement:** Works if Joe the Worker was close to his retirement when his plan was converted to a cash balance and a majority of his benefits will be earned under the traditional defined benefit plan.

DEALING WITH POST-MARITAL ENHANCEMENTS

Sometimes when couples defer the distribution of retirement benefits, disputes arise later because the non-employee spouse contends she should receive a share of subsequent increases. A well-crafted QDRO insures and protects the parties' rights both pre- and post-retirement, including a Qualified Preretirement Survivor Annuity and a joint and survivor annuity.

While an immediate distribution of pension rights is the preferred route in some jurisdictions because it makes for a clean break between the parties and minimizes court involvement in the future, some courts hold that deferred distribution makes for a more equitable settlement because both spouses can share in future increases if the QDRO provides for them and is drafted that way. "Choosing a deferred distribution via a QDRO instead of offsetting assets may prevent an inequitable result," wrote an Ohio court in one case.

The downsizing of many large corporations through voluntary and involuntary early retirements has created particular considerations for divorce courts. In the past generation, millions of American workers have been squeezed out the work force early. Many longtime employees retire voluntarily but not by their own choice, or they retire involuntarily. Retirements under these circumstances may obscure an easy distinction between types of severance pay and early invol-

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untary retirement benefits, particularly when a person retires early after a divorce. Sometimes early retirement benefits can be seen as compensation to an employee for a specific service, that is, retiring early. Courts face the challenge of deciding what portion of these benefits is separation pay (and separate property) and what portion are retirement benefits earned during a marriage (and marital property).

Courts are divided about the sharing of post-divorce pension increases (e.g., early retirement subsidies and benefit enhancements), particularly for deferred distribution pensions. Predictably, when a dispute arises, the employee spouse (often the man) argues that the increase happened after the marriage, and the sharing spouse (often the women) asserts that the increase happened as a result of years of employment during the marriage.

Courts have taken different positions about the sharing of post divorce separation pay. Generally, separation pay after a divorce as a result of involuntary retirement is viewed as separate property because they are seen as compensation for lost future earnings. Overall, courts may look at early retirement benefits as compensation for past service if the employee is at a high point in his or her productivity rather than a low one.

Voluntary early retirement by the pension-owning spouse creates the risk that he or she may retire for the bad-faith reasons for a larger share of the retirement pie.

In recent years, some workers, particularly those in state and local government, have elected to participate in DROP retirement programs. DROP means deferred retirement option program. Under DROP, the worker no longer accrues service, and he is treated as if he retired while continuing to work. Benefits he has earned are paid into an account in his name, which is paid interest and any cost-of-living increases he would have received if he had been retired. DROP permits an employee to postpone collection of benefits he has earned, and they are classified, in the event of a divorce, in the same way they would have been classified if the DROP route had not been taken.

For obvious reasons, both parties and their lawyers must clearly consider pension benefits. Tempting as it may be to take a buyout, a woman — particularly one going into the golden years on her own — should make certain she understands what she is giving up. More than a few women have lived to regret bad advice and bad decisions about a former spouse's pension. For them, the so-called golden years of retirement can become a grim slog across the rocky terrain of financial hardship, if not poverty. A career homemaker who divorces in midlife often finds herself facing vastly reduced circumstances in the wake of a marital breakup.

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