AVOIDING COMMON MISTAKES WHEN DOING QDROS

• Thoroughly Understand the Type of Retirement Plan You Will Be Dividing – Is It a DB or a DC Plan? Know the plan type and the benefit that can be divided. Will it be a lump sum now? A lump sum later? A stream of income? When will those payments begin and end? Knowing the plan type and how the benefit can be divided can substantially affect how you may choose to negotiate a resolution regarding the retirement plan. Include the plan type in your agreement. The plan type is not always clear from the name of the plan. Determine and state who will draft the QDRO, and which client the QDRO attorney represents. Check whether you must use the plan administrator’s forms. Take the time to determine how the QDRO fees will be paid.
  ■ Defined Contribution (“DC”) Plan. An employee and/or employer make contributions into an account maintained in the employee’s name. This is an account-based plan and the value of the account on the statement reflects the value of the participant’s interest in the plan.
    ○ Examples: 401(k)/403(b)/457 plans, PERS Individual Account Program (IAP) accounts, federal Thrift Savings Plan (TSP) accounts.
  ■ Defined Benefit Plan (“DB”). An employee accumulates credits towards their retirement based upon years of service to an employer, and often based on their earned compensation. Typically, the benefit is expressed as a monthly payment beginning at a specified age (e.g., $2,000/mo. beginning at age 65 years). Also typically, this type of plan does not have an account (and if it does, the account may not reflect the true value of participant’s interest).
    ○ Examples: Teamsters, PERS OPSRP, FERS/CSRS, military.
  ■ Hybrid Plan. Some plans are a hybrid of the two basic types.
    ○ Examples: PERS Tier One/Two, cash balance plans.
    ○ Tip: Do not rely on the PERS Tier One/Two account balance, which almost always does not reflect the true value of the member’s interest.
  ■ IRAs. IRAs are not a qualified retirement plan and are not subject to QDRO rules. Rather they are divisible under a different section in the tax code, specifically IRC §408(d)(6), by a transfer from one party’s IRA to the other.

• Double Check that You Are Using the Correct Name of the Plan. Federal pension law requires that a QDRO identify the accurate name of the plan. Remember that often parties have multiple plans because they have had multiple employers over the years, or their employers have offered different types of retirement plans. Being specific about the plan type(s) and name(s) eliminates confusion. For example, if you list the plan name, and upon receipt of a statement that identifies additional plans, it will be clear that these additional plans were not previously listed and a division was not previously negotiated for them.
  ■ Research the exact name of the plan by reviewing the statement and discussing the plan with the client, and with the plan administrator named by the human resources or the accounting department at the employer’s company.
  ■ Check with former employers and be specific about the plan name.
  ■ Get an account or benefit statement, and if possible, also a Summary Plan Description (SPD) and the plan’s QDRO procedures, if any, for each plan.
  ■ Contact all former employers to discover any plans not disclosed or even known by the parties. Parties may not even know they are entitled to a DB plan.
  ■ Get contact information for the person who will implement the QDRO for the company, who may or may not be the plan administrator.

• Watch Out for Non-Divisible Plans. A qualified domestic relations order (QDRO) means that the plan is covered by the Employee Retirement Income Security Act of
1974 (ERISA). This federal law set minimum standards for pension plans in private industries. Not every type of retirement plan is governed by ERISA. Some plans are not qualified. The types of non-ERISA plans that are not divisible plans are often called supplemental, non-qualified, or excess benefit plans, or may be referred to as a “Golden Parachute” plan for high-level executives. Most federal, state, and local government pension plans are not required to follow ERISA guidelines. However, most of these plans are subject to parallel state law and are divisible by a domestic relations order (DRO). Remember, no matter what your agreement may dictate, plans that are not going to be governed by ERISA might not be subject to division by a QDRO. Many non-qualified plans do not offer survivor benefits. If you find that the plan will terminate upon the death of the employee, it will be critical to identify this in the agreement and address it during negotiations. Consider the appropriateness of obtaining permanent life insurance coverage to protect the recipient spouse.

- Check whether your clients have any non-ERISA plans.
- Find out if there are any options for division provided by the non-ERISA plan.
- Check whether the plan has a survivor benefit option.
- If division is not an option, try to negotiate a credit against other assets.
- You may want to consider setting up a constructive trust or using alimony as a means to equalize the non-ERISA plan benefits.
- Hiring a QDRO expert will help in crafting a resolution that can be implemented.

- **Set a Clear Date of Division.** Be clear on what is to be the date of division to avoid arguments about which date was intended. Some common dates to set the division include the date of filing for the divorce, the date the agreement was signed, the date of the final judgment, or the date of retirement.
  - Be sure to come to an agreement upon the date to be used for the QDRO.
  - Simplify the implementation of the QDRO by using a date that is the first or last date of the month.

- **Address Both Gains/Losses and Loans for a DC Plan.** DC plans will have market fluctuations that will affect the balance in the account. Specify in the settlement agreement whether earnings and losses affect the balance that will be divided. Be clear about what should happen to the amount of the benefit to be received during the pendency of the division. For example, consider that it may take several months before the terms in the signed settlement agreement are conveyed in a QRDO, approved by the plan administrator, signed by the judge, sent to the plan administrator, and finally, before the plan administrator will dispense the funds. Be sure to indicate if the award should remain frozen or fluctuate. Because the stock market is subject to great fluctuations, one party will be unhappy if gains and losses are not addressed.
  - Never include any references for earnings or losses in a DB plan QDRO.
  - Conversely, in a DC plan, always include a reference to whether the award does or does not include an adjustment for gains and losses. Do not leave it silent.
  - For DC plans, always investigate whether there is a loan balance and address it in your settlement agreement. Read the statement carefully to see if there is an outstanding loan – it can be buried in the later pages of the statement. Moreover, the account balance shown on page 1 may or may not include the outstanding loan balance as a receivable in the total shown for the participant; statements vary. If there is a plan loan, specify whether the outstanding loan balance, which is an asset receivable of the plan whether or not included in the account balance shown on page 1 of the statement, should be included in determining the alternate payee’s share of the account.
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- Always notify the plan administrator that a divorce is pending to prevent new loans against the plan from being obtained.

- **Address any Surviving Spouse Issues in a DB Plan.** All DB plans will have specific rules and elections regarding how benefits will or will not be paid if the participant dies before retirement. These are called survivor benefits. They may be different during employment, at termination, or upon the commencement of benefits. A major malpractice trap is to neglect how a survivor benefit election has been or will be made.
  - Retired participants. Determine what form of benefit election the participant made upon retirement. If the participant did elect a survivor annuity, you must address what happens to upon divorce. A QDRO may still be necessary to preserve that election for the now-divorced spouse. If the participant elected a single life annuity, then there is no survivor annuity and typically a survivor annuity cannot now be instated, even if both parties agree to it.
  - Pre-retirement. Is there an option for a separate interest? If so, it will allow the alternate payee to have their own pension benefit completely dissociated with the participant. This may be the best option because it disentangles the parties and it may eliminate the need to address survivor benefits.
  - Consider electing a shared interest survivor annuity election if one party has a shortened life expectancy (“shared payment” approach).
  - Determine whether any pre-retirement survivor annuity (QPSA) elections are available; if so, agree upon how these will be handled.
  - Determine if an early retirement subsidy might be paid to the participant and whether it should be divided proportionally with the alternate payee.

- **Handle the Equalization of Multiple DC Plans Carefully.** Many people will have multiple IRAs and 401k plans. The settlement agreement may dictate how each individual plan is to be divided. Instead, plan balances can be offset against each other. A settlement agreement that has an objective to equalize all of the retirement accounts will reduce the complexity and costs that would result from dividing each plan. To equalize the plans, a date when the calculation should take place must be agreed upon by the parties. Then, address the earnings and losses from this date of valuation forward. Be aware that some plans, including Employee Stock Ownership Plans (ESOPs), are only valued annually. Either choose the valuation date of the ESOP or specify that the ESOP value will be based on the prior valuation.
  - Caution equalizing Roth accounts with non-Roth accounts. Calculations may be appropriate to gross-up the Roth to its pre-tax equivalent. (The calculation is not as simple as multiplying the Roth account balance by one plus the combined federal and state tax rate; rather, the Roth account balance must be divided by one less the combined federal and state tax rate, e.g., $x + (1-y), where $x = Roth account balance and $y = the combined federal and state tax rate).
  - Clearly identify which plan will be subject to the equalizing QDRO.
  - Clearly state if the amount will be adjusted for gains or losses.
  - Whenever possible, satisfy the equalizing award with a QDRO from a DC plan, not with a transfer from an IRA plan (for the reasons stated below).
  - Never equalize DB plans, unless: (a) a present value calculation has been prepared (note that this may disadvantage the alternate payee from benefitting proportionally from future increases in salary); (b) multiple DB plans for the same participant may be offset against each other if the normal retirement ages under the plans are the same (or other present value calculations are prepared).
Consider whether the risks of plan insolvency justify the convenience of the offset.

- **IRAs Are Divided by a Transfer Between IRAs, Not by QDRO; Also, a 10% Penalty Applies If Under Age 59½ Years.** IRAs are not divided by a QDRO, but rather are done by a transfer from the IRA that is to be divided to an IRA held by the recipient spouse. The award cannot be paid to the recipient spouse directly; it first must be transferred to the recipient spouse’s IRA. Further, there is no exception to early withdrawals from the IRA if the recipient spouse is under age 59½ years like there is for distributions from a “qualified plan” pursuant to a QDRO. IRAs are not “qualified plans” for tax purposes.
  - The parties do not need a QDRO attorney. The general judgment should identify the IRA by the name of the custodian and a redacted account number, and it should specific a fixed dollar or a percentage award. Contact the IRA custodian to inquire what forms will be necessary and complete them with the parties.
  - The recipient spouse typically will need to open an IRA with the same custodian that holds the IRA to be divided.
  - Most IRA custodians will not adjust for gains and losses. Again, specify a fixed dollar award or a percentage – and if a percentage is used, the IRA owner should not make any contributions or withdrawals in the interim.
  - To avoid the 10% penalty if the recipient spouse is under age 59½ years, and if a DC plan exists of sufficient size, consider equalizing the IRA with and dividing the DC plan by QDRO instead of dividing the IRA.

- **Special Considerations for Oregon PERS Benefits**
  - **Tier One and Tier Two.** Determine whether the retiree will retire under the “money match” or the “full formula.” This will dictate how the benefit should be divided. Most PERS members will retire under the “full formula,” which is a traditional defined benefit formula and which should be divided on the “time rule.” In those cases, the account balance is irrelevant and not reflective of the actual value of the benefit. Dividing the account when the full formula applies will short-change the former spouse. However, a long-serving Tier One member may still retire under the “money match” in which case the account balance is the determinative factor and it is appropriate to divide the account. Avoid the term “account” and instead describe PERS as a “benefit.”
  - **OPSRP** (for members first employed after August 2003). This is a pure defined benefit plan. There is no “account” as such. OPSRP should always be divided based on the “time rule.”
  - **IAP.** This is an extra defined contribution account funded by employer contributions equal to 6% of the member’s salary (but see EPSA below). The IAP account is “cash” and can be awarded and distributed to the former spouse immediately on divorce even if the member is still working and not eligible to withdraw. However, the IAP fund is a giant pooled fund that is balanced out to individual participants only once/year as of each December 31. It is not “daily valued” like most 401(k) plans. So by PERS rules, all divisions must tie to a previous December 31 valuation date. If the parties intend to divide current year contributions, they must be calculated by hand and added to the prior December 31 balance, and then awarded as a dollar amount or percentage of the prior December 31 balance. PERS will not honor an IAP award of more than 100% of the prior December 31 balance.
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- **EPSA.** This is a new account effective July 1, 2020, created to help fund a member’s pension benefit under Tier One/Two or OPSRP. For Tier One/Two members, 2.5% of the 6% IAP contribution is diverted to the EPSA account, leaving 3.5% to go into the IAP account going forward. For OPSRP members, .75% of the 6% IAP contribution is diverted to the EPSA account, leaving 5.25% to go into the IAP account going forward. The EPSA account will be available to the members at retirement only if the PERS fund is at least 90% funded at the time of retirement (the current funding rate is 78% and not projected to reach 90% until the mid-2030’s). Otherwise, PERS will retain the EPSA and use it to offset the cost of the member’s Tier One/Two or OPSRP pension. As of this writing, proposed PERS regulations provide that the EPSA is not divisible. Rather, regulations provide that if the EPSA is payable at retirement, it will be disbursed to the parties proportionately to the division of the IAP. The specifics of how this will be done is unknown. Bottom line: You can ignore the EPSA in your divorce judgments - when the EPSA is payable and if at all (however doubtful), PERS will determine how the EPSA is apportioned between parties that had previously divorced.

- **Divorces Near Retirement.** Most PERS divisions before retirement will use the “separate interest” approach to fully disentangle the parties and to allow each party to decide when and how to take his or her share. However, in a long-term marriage where the divorce is close to retirement, the parties might prefer a “shared payment” division with a mandated joint-and-survivor benefit (Option 2), to provide a “double” survivor benefit to whichever party is the survivor, which will duplicate how the parties would elect the benefit had they remained married. This approach can be specified in the divorce judgment or supplemental judgment dividing the PERS benefit.

- **“Freezing” a Retirement Application.** If a member has applied to retire or might do so during the divorce process, consider obtaining a restraining order to “freeze” the application to preserve the status quo pending the divorce and to allow the former spouse the opportunity to have a “separate interest” division. See OAR 459-045-0020(2). The opportunity for a “separate interest” division is lost once the member retires and commences benefits.

- **Post-Retirement Divisions.** Dividing PERS benefits in pay status has its own special considerations. Generally, the benefit form is fixed and the best you can do is to divide the future payments while both parties are living and to specify where any remaining or survivor benefits go after the first death. However, if the member had elected a joint-and-survivor benefit with the spouse now being divorced, a court order can allow the member to change the survivor beneficiary to someone else and the monthly payment amount will be adjusted accordingly [see ORS 238.465(2)(d)]. Also, if the member elected Option 2A or 3A with the spouse now being divorced, the member may “pop up” under ORS 238.305(6) to a single life annuity (Option 1) on divorce and which will destroy the survivor benefit to the now former spouse, unless the court order restricts the member from doing so. These are complicated issues and you should engage a competent QDRO lawyer when considering these options.

- **If Both Parties in PERS, Consider Offsetting Benefits.** Where both parties are in PERS, consider offsetting the benefits rather than splitting both evenly. This may be a “win-win” for both parties because it allows each party to keep more (or all) of his or her own benefit so as to determine when and how to elect it. In PERS, the benefit elections available to an alternate payee are more limited and do not include a joint-and-survivor annuity option. Also, an alternate payee in
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PERS cannot commence before the member‘s earliest retirement age and must commence benefits when the member commences. So offsetting the pensions allows each party to control when and how to take a greater share of his or her pension. This approach requires that both PERS pensions be valued and then awarding a portion of more valuable pension to the party with the lesser pension equal to half the difference in their values.

- **Legal Separations.** All of the considerations above regarding PERS divisions on divorce above apply equally to legal separations, except for a “pop up” under ORS 238.305(6).

**IMPORTANT NOTICES**

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