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, both the fees for the QDRO attorney and the fees charged by the plan itself.
  - 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 (DB) Plan. An employee accumulates credits towards their retirement based upon years of service with an employer, and often based on their earned compensation. Typically, the benefit is expressed as a monthly payment for the member's lifetime 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 the employee'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. A QDRO is not required, rather the terms of general judgment itself may be sufficient. See more below re: IRA divisions.

- **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/or with the plan administrator, 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. All private sector plans are required to publish QDRO procedures and make them available on request.

  - ■ 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-Qualified and Government Plans.** A “qualified domestic relations order” (QDRO) applies only to a “qualified” plan that is covered by the Employee Retirement Income Security Act of 1974 (ERISA). ERISA sets minimum standards for “qualified” pension plans (as defined by the tax code) sponsored by private sector employers. (Note that “QDRO” as defined by Internal Revenue Code § 414(p) has a more inclusive definition, and does include governmental plans).
  - o Not every type of private sector retirement plan is governed by ERISA. Some plans are not qualified. The types of non-ERISA plans in the private sector are often called supplemental, non-qualified, surplus or excess benefit plans, typically for high-level executives to provide extra benefits above the legal limits for “qualified” plans. Generally, these plans are not divisible on divorce and must stay with the employee. Also, stock options and restricted stock units (RSUs) are generally non-divisible. So a “constructive trust” arrangement may be necessary to effectively divide these benefits, whereby the employee is required to share the benefits or proceeds with the former spouse when and as received, perhaps years later, and after deducting for taxes paid by the employee on the former spouse’s share of those benefits. There are exceptions, and the IRS (Revenue Ruling 2002-22) allows an employer to apply QDRO-like rules to the division of these types of non-qualified benefits. So you should inquire in each case whether the employer will allow non-qualified benefits to be divided. Even when divisible by QDRO or its equivalent, the alternate payee’s portion may not qualify as an eligible rollover.
  - o Federal, state, and local government pension plans are not subject to ERISA. However, most of these plans have their own parallel federal or state law systems to divide benefits on divorce pursuant to a domestic relations order (DRO) (*e.g.*, for PERS see ORS 238.465; also see below for more on PERS).
  - o Many non-qualified plans do not offer survivor benefits, and are payable only for the life of the employee. 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 from losing benefits due to the employee’s death.
  - o FERS/CSRS and Military retirement plans provide for survivor benefits, but only if mandated by court order. So when dividing FERS/CSRS or Military benefits, consider whether also to mandate that the member elect survivor benefits for the former spouse at retirement. Or if the divorce is after retirement and survivor benefits have already been elected for the spouse, consider expressly mandating that the survivor benefit be retained. Otherwise, survivor benefits will be lost on divorce. Also, in both FERS/CSRS and Military, survivor benefits that are preserved for the spouse on divorce are lost anyway if the spouse remarries before age 55, in which case the spouse’s share of the monthly benefits will stop at the member’s death (provided, however, for the military only, that the spouse may again be eligible for military survivor benefits if they are no longer married at the death of the member). So where the parties are young and the spouse is likely to remarry before age 55, it might not be important to preserve survivor benefits for the spouse, or it may be better for the spouse to obtain replacement

life insurance on the member to replace the spouse's income stream at the member's death even if the spouse remarries. The Military survivor benefit is unitary and may only be awarded to one spouse, while under FERS/CSRS, the survivor benefit may be split between two or more former spouse(s) and/or a current 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 indefinite spousal support 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, or a date for which account statements are available (particularly if the plan is not daily-valued).

- **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 or general judgment whether the award is to be adjusted for gains and losses subsequent to the division date. It may take several months before the terms in the signed settlement agreement are conveyed in a QDRO, approved by the plan administrator, signed by the judge, sent to the plan administrator, and finally, before the plan administrator will dispense the funds. So be sure to indicate if the award is a fixed sum or if it will fluctuate with investment gains/losses; silence begs the question and does not answer it. Because the stock market is subject to great fluctuations, one party will be unhappy if gains and losses are not addressed (and no one has the crystal ball to know which party will be which).
  - ■ Never include any references for gains or losses in a DB plan QDRO, except that a QDRO for a cash balance pension plan should provide that the award will also include interest credits subsequent to the award date.
  - ■ 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, is to be included or excluded in determining the alternate payee's percentage share of the account.
  - ■ Consider notifying the plan administrator that a divorce is pending to prevent future withdraws or 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 may have to address what happens upon divorce. A QDRO may still be necessary to preserve a survivor benefit election for the now-divorced spouse, although some plans take the position that the survivor benefit is irrevocable, in which case a QDRO may not be required to preserve it. Further, in some plans a survivor benefit may be terminated upon certain contingencies (*e.g.*, death; less common, also divorce), in which case the member will "pop up" to a single life annuity, resulting in an increase in the monthly payment. In FERS/CSRS and Military divisions, a survivor benefit is automatically lost on divorce unless expressly retained. In CalPERS, a portion of the survivor benefit (the "survivor continuance") is lost on divorce and cannot be protected even if the parties want to. So every plan is different as to survivor benefits in post-retirement divorce. If the participant elected a single life annuity at retirement, then there is no survivor annuity and typically a survivor annuity cannot now be elected, even if both parties agree to it. (But in limited circumstances with Military benefits there can be a window to elect survivor benefits for the spouse post-retirement.)
- Pre-retirement. Is there an option for a separate interest QDRO? Most pension plans allow a "separate interest" division, which 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. Notably, however, FERS/CSRS, Railroad and Military retirement divisions do not allow a "separate interest" division but rather only a "shared payment" division (even pre-retirement).
    - Still, consider using a "shared payment" approach mandating a survivor annuity election, rather than a "separate interest" approach, if one party has a shortened life expectancy so that half of the benefit is not lost on an early death.
    - Provide that the former spouse will receive the pre-retirement survivor annuity (QPSA) if the member dies before benefits commence, and to the extent required or allowed by the plan.
    - 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 gains 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.
    - 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). Note,

however, caution regarding DC plans with a mix of Roth and pre-tax sources, as explained below.

- Use caution when equalizing DB plans. Consider: (a) having a present value calculation prepared for the DB pension to offset against other DB or DC values (note that this may disadvantage the alternate payee from benefitting proportionally in the DB plan 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); (c) in post-retirement cases, consider whether it is more appropriate to equalize income rather than values, and with or without taking Social Security into account.
- 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 agreed tax rate; rather, the Roth account balance must be divided by one less the agreed tax rate, *i.e.*, $x ÷ (1-y), where x = Roth account balance and y = the agreed tax rate). Approaches may vary on the tax rate to be used; and further, may be avoided by dividing the Roth and pre-tax dollars separately, on a like-kind basis.
- Increasingly DC plans include both Roth and pre-tax contribution sources; and moreover, many DC plans will not allow a division of only one or the other. That is, many DC plans require the DC plan to be divided in the same proportion, Roth and pre-tax, without differentiation. Consequently, a DC plan with a mix of Roth and pre-tax contribution sources is not a good vehicle to use as an equalizing source, and often, unless entirely offset, should be divided separately and independently from any other accounts that may be equalized.

- **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 under IRC § 414(p), but rather are done by a transfer pursuant to IRC § 408(d)(6) 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 specify a fixed dollar or a percentage award. Contact the IRA custodian to inquire what forms will be necessary and complete them with the parties. Do not refer to a QDRO or specify that an additional order will be entered (or the IRA custodian may require one even when not otherwise required).
  - The recipient spouse typically will need to open an IRA with the same custodian that holds the IRA to be divided, to receive the transfer.
  - Most IRA custodians will not adjust for gains and losses or use a prior date, so the language will be different from what is commonly used for a DC plan. Typically the IRA custodian will divide the IRA based on the asset values as of the date they actually divide the account. If the intent is for the award to share in interim gains/losses, then use a percentage rather than a dollar award so that the award will automatically adjust for gains/losses to the division date; and notably, the IRA owner should not make any contributions or withdrawals in the interim until the transfer is completed. (If either occurs, additional calculations between

the parties would be necessary, and possibly also an additional order(s), to implement the award.)

- 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***. This is a hybrid defined benefit plan. 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 does not reflect the actual value of the benefit. Dividing the account when the full formula applies will short-change the former spouse. However, a handful of Tier One members 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. Even still for members who are expected to retire under the "money match," the Tier account balance is not the actual value of the benefit, so never rely on the Tier One or Two account balance as its value. In all cases a valuation is needed to know the value of the Tier One/Two benefit. Avoid the term "account" and instead describe PERS as a "benefit."
  - ***OPSRP*** (for members first employed after August 28, 2003). This is a pure defined benefit plan. There is no "account" as such. OPSRP should always be divided based on the "time rule." A valuation is needed to know its value.
  - ***IAP***. This is an extra defined contribution plan account funded by employer contributions equal to 5.25% of the member's salary for OPSRP members and 3.5% for Tier One/Two members. This percentage was 6% prior to July 1, 2020 (see EPSA below). The IAP account is liquid 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, those contributions 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. PERS will never administer a fixed sum award from the IAP; rather, PERS will always adjust the award for gains/losses after the applicable December 31 year end. (Known gains/losses to date may be front-loaded in calculating the award, but prospective gains/losses remain unchangeable.)
  - ***EPSA***. This is a newer account effective July 1, 2020 that was created to help fund a member's pension benefit under Tier One/Two or OPSRP. For Tier One/Two members, 2.5% of the original 6% IAP contribution is diverted to the EPSA account, leaving 3.5% to go into the IAP account since July 1, 2020. For OPSRP members, .75% of the original 6% IAP contribution is diverted to the EPSA account, leaving 5.25% to go into the IAP account since July 1, 2020. 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 is not projected to reach 90% until the mid-2030s). Otherwise, PERS will retain the EPSA and use it to offset the cost of the member's Tier One/Two or

OPSRP pension. PERS regulations provide that the EPSA is not divisible. Rather, regulations provide that if any "excess EPSA" does become payable at retirement, it will be disbursed to the parties in proportion to the division of the IAP. 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 pre-retirement PERS divisions will use the "separate interest" approach to fully disentangle the parties and to allow each party to decide when and how to take their share. However, in a long-term marriage in which the divorce is close to retirement, the parties might prefer a "shared payment" division with a mandated joint-and-survivor benefit (*i.e.*, Option 2), to provide a "double" survivor benefit to whichever party is the survivor. This most closely matches how the parties would likely 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 benefit from 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, and moreover, the benefits then may be locked into the form of benefit elected upon retirement, which could be limited thereby to only the member's lifetime.
- ***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 to whom any remaining or survivor benefits are paid after the first death. PERS does allow each party to name a beneficiary ("secondary beneficiary") to whom their share may be paid if they were to die first. However, if the member had elected a joint-and-survivor (*i.e.*, Option 2 or 3) 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; certain provisions must be included, including a minimal award ($1) to the former spouse to "unlock" the statutory right to change the beneficiary [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. This will increase the member's monthly benefit by as much as 15%, but it will destroy the survivor benefit to the now former spouse. The right to "pop up" from Option 2A or 3A to Option 1 is statutory unless the court order restricts the member from doing so. So if the intent is to retain the Option 2A OR 3A survivor benefit so that the spouse retains the survivor benefit, the court order should explicitly restrict the pop-up. 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 their own benefit so as to determine when and how to elect it. In PERS, the benefit elections available to an alternate payee may be more limited and also, an alternate payee in 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 the party with the lesser pension is awarded a portion of the more valuable 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).
- ***PERS Subpoena***. Consider a PERS subpoena even in conciliatory cases. A PERS member's file may be subpoenaed for a very modest fee (historically just $30). Email to inquire: Public.Record.Requests@pers.oregon.gov.
- ***PERS Forms***. PERS requires all applicable PERS divorce forms be attached to a court order addressing a member's benefits, even when the member retains their benefit free and clear. The forms range in complexity and should be completed with careful consideration.