



PENSION PLAN BASICS

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In matrimonial matters, a party's pension assets are often the second and in many cases the largest asset for equitable distribution. Yet, these assets are not frequently given much attention within the Marital Settlement Agreement (MSA). Proper care needs to be paid to your client's and/or their former spouse's pension benefits from the early stages of discovery and not at the time that a Property Settlement Agreement is being negotiated at the Courthouse.

A review of the following information may assist in avoiding common pitfalls related to the negotiation of a party's pension benefits and the preparation of the Property Settlement Agreement.

I. OBTAIN DOCUMENTS.

- A. Determine in the early stages of discovery if any pension benefits exist. If so, obtain:
 - 1. Statements from date of marriage, date of filing of Complaint and most recent statement.
 - 2. A copy of the Summary Plan Description (SPD).
 - 3. Available QDRO Guidelines.

These documents are critical to determine what benefits are available to your client through the Plan. For example, a Plan may not have survivorship benefits, or may only have limited survivorship benefits, in which case you may need to negotiate differently for your client. You do not want to find this out after the Property Settlement Agreement has been entered into and it is too late to negotiate. Further, securing QDRO Guidelines early in the process ensures prompt preparation later on, if a QDRO is necessary.

II. DETERMINE THE TYPE OF PLAN.

- A. Is the Plan a Defined Contribution Plan? Some examples of this type of plan are:
 - 1. 401(k), 457 or 403(b) Plans.
 - 2. Profit-Sharing Plan.
 - 3. Employee Savings Plan.
 - 4. Employee Stock Ownership Plan.

- B. Is the Plan a Defined Benefit Plan? Some examples of this type of Plan are:
 - 1. Traditional Pension Plan.
 - 2. Annuity Plan. (Note, Unions call their Savings Plan an "Annuity").
 - 3. Cash Balance Plan. (A Hybrid form).

III. DEFINED CONTRIBUTION PLANS.

Defined Contribution Plans are separate plan accounts into which the employer and/or the employee contribute a certain amount of money each year for the benefit of the employee. There is an identifiable amount of money within the account, the value of which can generally be determined as of a specific date. The amount of the benefit is subject to investment performance and thus there is no guarantee as to the final benefit amount. The Participant has restrictions as to when and how he or she can withdraw the funds. In the case of a divorce, the spouse or the Alternate Payee in the QDRO generally has immediate access to the funds without paying early withdrawal penalties, but will pay tax consequences.

A. **Division of Defined Contribution Plan**

1. Percentage. Distribution of these accounts by way of a percentage is the most common method. The would generally state "50% of the marital portion of the account balance as of the date of filing of Complaint, plus or minus earnings or losses through the date of distribution"

Advantages: Most equitable and accurate method of distribution as long as the entire account balance was acquired during the marriage. No calculations are necessary.

Disadvantages: The distribution amount is not specifically defined in the Order. Does not take into account pre-marital assets if the account had contributions prior to the marriage.

2. Straight dollar amount. A straight dollar amount is often utilized when the fund is being used to offset other assets or if pre-marital assets exist in the account. The should state the specific dollar amount to be distributed as of a date and should state whether or not earnings or losses should be assessed against that amount.

Advantages: Provides for an exact distribution amount to a party. Can take pre-marital contributions into consideration.

Disadvantages: Requires calculations to be performed. Can result in an unequal or unintended distribution if the is not written properly.

B. **The Pre-marital Problem**

Often Participant's have contributed toward their 401(k) or IRA prior to the marriage date. The pre-marital contributions as well as any earnings or losses on those contributions are separate property. The problem is separating those funds out of the marital funds.

Rarely will the Plan will provide a value of the pre-marital funds as well as gains or losses. Assuming not, there are two options:

1. Coverture fraction evaluation. Where an evaluation of the coverture fraction determines the marital portion. This will take into account earnings and losses over the entire period of the account. This method cannot be used for an IRA.
2. Value of account as of marriage date. The Participant will need to produce a statement as of the marriage date and the parties will need to agree upon a percentage (i.e. 5%) of growth on the pre-marital amount.

C. Other Provisions

1. Gains and losses. A provision allocating gains and losses to either a percentage or straight dollar amount distribution should be included in the if it is so intended by the parties. The should include language similar to “the Alternate Payee’s allocated amount shall be adjusted for earnings or losses, dividends and interest from date of Complaint (include date) through the date of distribution”.
2. Loan Balances. If there is a loan against the account, or even if you are not sure whether or not there is a loan, the should address whether or not the loan will be a marital expense or born by the Participant only.

D. Pitfalls to Avoid - Case Studies

Although these plans do not often present with difficulties, there are some re-occurring problems which can be avoided. The most common problem is the pre-marital contribution as discussed above. Plans involving stock ownership can cause difficulty due to fluctuating market values. You cannot rely upon the value of these funds to offset other assets. Also, do not let your client try to predict market values by eliminating gains and losses.

Case: stated that Wife was to receive Husband’s entire 401(k) valued at the time of the marriage at \$250,000 plus an additional \$178,000 from the Husband’s Savings and Stock Investment Plan (SSIP) as a buy out from the marital home.

By the time the QDRO was prepared, the company stock had taken a precipitous drop. Unbeknownst to the attorneys, the Husband’s 401(k) was 60% funded with company stock and the SSIP Plan was funded with 100% stock. The Wife’s distribution turned out to be nearly one half ($\frac{1}{2}$) of what she should have received.

Case: Husbands 403(b) Plan had four years of record gains immediately prior to filing of Complaint. At the time of filing of the Complaint, the fund was valued at \$120,000. Property Settlement Agreement was drafted to exclude gains and losses from Wife's 50% portion of the distribution. When the QDRO was drafted two years later, the fund had experienced a decrease to \$90,000. Wife received 50% of value of fund at the time of filing of the Complaint with no adjustment for gains or losses equaling \$60,000. Husband was left with \$30,000.

Case: Participant was no longer employed with the Plan Sponsor (this is known as a separated employee) and thus, was capable of withdrawing funds. Participant withdraws all funds prior to the QDRO being put in place. Be cautious when dealing with the separated employee situation. You may want to include language in the for curative action including attorney fees should the Participant wrongfully withdraw funds prior to the QDRO distribution.

IV. DEFINED BENEFIT PLANS.

Defined Benefit Plan are employer sponsored pension that provide a benefit to an employee based upon years of service and salary history. The amount of the benefit is guaranteed by the employer, regardless of the performance of the underlying investment pool. The Plan funds are (usually) held jointly for all Participants and there is no actual account set up for a Participant until retirement.

A. Form of Plan.

It is crucial to investigate the form of the plan held by the Plan Participant in order to properly divide the asset.

1. Traditional Qualified Pension Plan. These Plans are "qualified" under ERISA (Employee Retirement Income Security Act) and the Tax Code and thus subject to federal regulation. These plan generally pays a monthly annuity starting at the Participant's retirement age. When dividing this pension, be sure to advise your client that he or she is not eligible to commencement this benefit until the Participant's earliest retirement age. Also be aware that the earlier the commencement benefit, the lower the monthly benefit (similar to social security). These pensions are not portable. These Plan require a QDRO (Qualified Domestic Relations Order) for division.
2. Qualified Cash Balance Plan. Also a "qualified" plan under ERISA. This Plan is a hybrid between a traditional pension plan and a defined contribution plan. The Participant (or former spouse) is not eligible to commence this benefit until retirement age; however, there is a specific cash value to the Participant's account. At the time of retirement, the Participant can choose to take the money in the form of a monthly annuity or in a lump sum distribution.

3. Non-Qualified Plan. Many executives have supplemental retirement programs which are non-qualified Plans. These Plans can be either a traditional form of pension or a cash balance form. These plans are often not subject to division by way of a QDRO and thus are very difficult to divide for a former spouse. Be sure to determine the value of this Plan so that you can secure an offset for the value from some other revenue source.

B. Is the Participant retired?

The answer to this question will dictate how the pension can be divided.

1. Shared Interest QDRO. This form of QDRO must be utilized if the Participant is already in pay status (retired) prior to a QDRO being put in place. A shared interest QDRO is basically a division of the Participant's annuity payment in a specified amount or percentage between the Participant and the Alternate Payee. Payments begin when the Participant retires, in the form chosen by the Participant, and end at the Participant's death. The state and local government Plans (i.e., PERS, TPAF, PFRS) are all shared interest DROs. This form of QDRO favors the Participant. For private plans it should be considered if the Alternate Payee is in poor health or significantly older than the Participant and thus, less likely to live long into retirement. If you intend to use a shared interest QDRO you must use very specific language in the such as "parties agree to a Shared Interest QDRO, based upon the lifetime of the Participant, with a reversionary interest to the Participant".
2. Separate Interest QDRO. A separate interest QDRO creates two distinct separate accounts for the Participant and the Alternate Payee. Each account is actuarially adjusted for the lifetime of each party. The Alternate Payee may select a commencement date to receive benefits different from the Participant and may chose the form of payment. Once benefit payments begin, they will continue for the lifetime of the Alternate Payee, but will not revert to the Participant upon the death of the Alternate Payee. Cost of living and other increases will not automatically be applied to the Alternate Payee's share, but must be specifically stated in the QDRO. Also, a QPSA needs to be in place to secure this benefit even with a separate interest QDRO in case of the pre-retirement death of the Participant. This is the form that will be prepared if nothing is otherwise specified in the .

C. Division of Defined Benefit Plan.

1. Coverture Approach - Marx Formula.

This is the standard formula set forth in New Jersey case law to divide marital assets in a pension. The Alternate Payee is entitled to 50% (or whatever fractional share agreed upon) of the Marital Portion. The Marital Portion is determined by the Plan multiplying the Participant's final pension benefit by a fraction: the numerator, which is the period of the parties' marriage during plan participation in months and the denominator, which is the Participant's total plan participation in months as of the commencement date.

2. Immediate Offset Approach.

This formula is still in use by some Plans and most often with a Cash Balance Plan. The Alternate Payee is entitled to a fractional share of the Marital Portion. To determine the Marital Portion, the Plan multiplies the Participant's pension benefit as of the marriage termination date by a fraction: the numerator which is the period of the parties' marriage during plan participation in months and the denominator which is the Participant's period of employment and plan participation in months as of the marriage termination date.

D. Survivorship Provisions.

1. Qualified Pre-retirement Survivorship Annuity (QPSA). In a Defined Benefit Plan, the funds are held jointly in a collective account for all the Participants. A Participant's individual account is not created until he or she retires. Thus, if the Participant does not survive to retirement, an account is not created and the funds remain in the collective account. Basically, the retirement benefit disappears. A QPSA provides that should the Participant die prior to reaching retirement, the named survivor will still receive their share of the pension benefit. A should state that "the Alternate Payee shall be treated as the Participant's surviving spouse for purposes of receiving a monthly Qualified Pre-Retirement Survivorship Annuity (QPSA) attributable to the Marital Portion of the Participant's accrued benefit under the Plan"

2. Qualified Joint and Survivorship Annuity (QJSA). This provision allows the retired Participant to name a survivor to whom a benefit will continue to be paid after the death of the Participant. A pension benefit of a married Participant automatically has a 50% QJSA provision unless waived in writing by the spouse. Shared interest QDROs should require this benefit choice by the Participant. The

should state that “at the time of retirement, the Participant shall elect the Alternate Payee as the Participant’s surviving spouse for purposes of a Qualified Joint and Survivorship Annuity (QPSA) attributable to the Marital Portion of the Participant’s accrued benefit under the Plan.” In a separate interest QDRO, this provision is not critical to the continuance of the Alternate Payee’s benefit.

E. Other Provisions.

1. Early Retirement Benefits. These benefits are sometimes provided by a company as an early retirement incentive to older, long time employees. New Jersey case law has held that these incentives are marital property. The should specifically state that “the Alternate Payee is entitled to his or her proportionate share of any employer-provided early retirement subsidy, supplement, incentive and/or cost of living adjustment.”
2. Cost of Living Adjustments. This benefit is not often found in private Plans; however, is frequently in government Plans to ensure that the Alternate Payee shares in this benefit, it needs to be stated directly in the QDRO. language provided above.

F. Pitfalls to Avoid - Case Studies. Defined Benefit Plans present with an array of options that can cause difficulty in the drafting of the and QDRO. The best defense for avoiding difficulties with these type of plans is to know the plan. Obtain plan documents before entering into a and be specific in your as to the provisions of the QDRO.

Case: Wife waived her interest in any early retirement subsidies available to Husband under his pension. At age 55 Husband had accrued a monthly pension benefit of \$1,200 per month. If he continued working to age 65 his benefit increased to \$3,600 per month. Husband’s employer offered an early retirement subsidy such that he could retire at age 55 with his age 65 benefit. Since Wife was not entitled to any share of the early retirement subsidy she receive \$600 per month (half of the accrued benefit without the early retirement subsidy) and Husband retained a \$3,000 monthly benefit.

Case: Wife had a significant pension, married to 20 year older Husband. In negotiating the , Husband was given 50% share of the pension with the understanding that Husband’s share would revert to her upon his death. Wife bargained away other assets to “retain” pension. Unfortunately the

was not written clearly enough to distinguish a Shared Interest QDRO which resulted in a separate interest QDRO being prepared and Husband receiving separate interest of pension. Wife lost the reversionary interest in 50% of her pension benefit.

Case: The death before QDRO cases. Three recent cases include Husband died in a car accident the weekend after the divorce. Husband died of a heart attack one month after divorce. Husband died of cancer three years after divorce but before a QDRO was prepared. In two of the three cases, Husband's death resulted in Wife losing pension benefit. In one case, the benefit was saved due to the adequate drafting of the . It is always a good idea to prepare the QDRO pre-judgment and file it at the same time as the Judgment of Divorce to ensure that the benefit does not get lost. If that is not possible, be sure to draft the specific enough that a judge could later rule it satisfied the Plan's requirements for a QDRO.

V. Solution and Suggestion:

One solution to some of the above case studies would have been a prompt and early preparation of the QDRO with filing of the QDRO at the time of the Divorce. Even if you are not sure if you will be dividing the pension assets, it is well worth the investment for your client to have the QDRO available at the time of the divorce to protect their interests.

If you cannot get the QDRO prepared and pre-approved early in the process is not necessary to obtain pre-approval by the Plan in order to file the QDRO. In fact, ERISA is written such that it anticipates that the originally filed QDRO may not be approved by the Plan and provides for an 18 month "hold" on the account to allow for revision and refiling of the QDRO. This "hold" on the account protects the former spouse from losing the pension post Divorce. The serving of a filed Order on the Plan is the only method which ensured that a "hold" is placed on the account. Without this hold, if the Participant should die subsequent to the divorce, the pension could be lost to the former spouse. Also, it prevents the Participant from withdrawing funds from the account.

In language in your MSA that indicates the intent of the parties, even if you are unsure of the actual or specific nomenclature of the Plan. For example, if you do not know the name of the specific survivor benefit for a State plan just include language that states: "It is the parties intention that the Wife continue to receive her awarded amount despite the death of Husband. Husband shall elect whatever survivor benefit is necessary to achieve that intention."

Include a catch all provision in your MSA that any retirement asset herein not discovered or disclosed at the time of the signing of the MSA will likewise be subject to equitable distribution.

QDRO CASES OF INTEREST:

Hayden v. Hayden, 284 N.J.Super. 418 (1995) set the date of marriage to the date of filing the Complaint as the marital portion of a pension.

Risoldi v. Risoldi, 320 N.J.Super 524(1999) following *Marx v. Marx*, 265 N.J.Super 418(1993) identifies the coverture fraction for the division of defined benefit pension plans.

White v. White, 284 N.J.Super.300 (1995) and *Panetta v. Panetta*, 370 N.J.Super 486 (2004) confirms the social security offset of the non-employee spouse of a CSRS pension recipient.

Reinbold v. Reinbold, 311 N.J.Super 460 (1998) held that the non-employee spouse is entitled to the coverture portion of any early retirement subsidies.

Sternesky v. Sternesky, 396 N.J. Super. 290 (App.Div. 2007), set forth the manner in which to determine the marital portion of a Participant's disability pension by (1) first, calculating fifty percent (50%) of the Participant's final average salary which is the benefit amount allowable to the Participant at the earliest ordinary retirement and then (2) second, determine the marital portion by multiplying the ordinary retirement allowance by a fraction "with a numerator equivalent to service during the marriage and a denominator equivalent to service required for an ordinary retirement allowance."

Painter v. Painter, 55 N.J. 196 (1974), defines marital portion as from date of marriage to date of Complaint.