Federal Employees Retirement System Disability The Unforseen Issue Drafting Marital Settlement Agreements.

FEDERAL EMPLOYEES RETIREMENT SYSTEM
DISABILITY THE UNFORSEEN ISSUE
DRAFTING MARITAL SETTLEMENT AGREEMENTS

This article is limited to the significance of the post-divorce disablement of Federal Employees. Specifically those employees hired after December 31,1983. Such individuals will be participants in the Federal Employees Retirement System (FERS). For employees hired prior to January 1, 1984 there is a different federal retirement system. Employees hired prior to January 1, 1984 are members of Civil Service Retirement System (CSRS). This article does not discuss the disablement of a Civil Service Retirement System employee.

INTENT OF THIS ARTICLE:

Our intent is make clear to the family practitioner the size of the likely reductions to a FERS employee's pension benefits as a result of his or her post-divorce disablement. These reductions will be attributable to the failure of the attorney representing the FERS employee to anticipate this circumstance. In virtually all scenarios resulting from such disablement the Former Spouse will be the advantaged spouse. The magnitude of a Former Spouse's benefit increase as a result of the disability retirement of the FERS employee can approach 400%. This pension increase is attributable to the difference in calculating a disabled members pension as compared to a healthy retiree's pension. It is for this reason that the practitioner representing the FERS employee must be mindful at the time of negotiating his or her settlement of the need to consider the possibility of disablement of this FERS employee and to craft language into the Property Settlement Agreement that bars a Former Spouse from receiving an unanticipated and exorbitant benefits increase.

This article argues that attorney failure to give due recognition at the time of divorce to the probability of disablement, makes it difficult for respective counsel subsequent to the post-divorce disablement of the FERS employee to be able to deal with the unanticipated and substantial revisions to the respective spouses retirement benefits.

That the disablement will change the pension payments to the respective spouses is certain. What is not clear until the disablement occurs is the magnitude of the increases in the Former Spouse's pension benefits. Attorney failure to anticipate this circumstance will result in the employee becoming the economically damaged spouse. Because of this outcome, prudent counsel for the FERS employee will endeavor to insert into the Marital Settlement Agreement, language necessary to avoid the imposition upon the disabled employee of an unanticipated and substantial reduction to his or her benefit while affording the Former Spouse an economic bonanza.

Since, the Former Spouse is the economically advantaged spouse in virtually all scenarios it is the obligation of the attorney representing the FERS member to craft the necessary language to bar devastating loss to his or her client.

Now the Details.
Prior to development of this article it is necessary to understand that there are several distinct outcomes resulting from disability retirement. Age at the time of disablement and Social Security Disability eligibility determines the pension benefit formula applied by FERS.
Age at disablement:

Disablement prior to age 62
Disablement subsequent to age 62
POSSIBLE OUTCOMES RESULTING FROM AN EMPLOYEE'S DISABLEMENT.

Circumstance A: the employee is disabled prior to attaining age 62 and is not eligible for Social Security Disability Income (SSDI).

Circumstance B: the employee is disabled prior to attaining age 62 and is eligible for Social Security Disability Income (SSDI).

Circumstance C: either the employee has attained age 62 or the employee is disabled subsequent to attaining age 62.

Let us begin with the assumption that the pre-disablement division of the FERS retirement benefit was based on a Coverture Fraction (Time Line) formula. The language found in the COAP*, absent additional language in your Marital Settlement Agreement providing a foundation for the post-divorce modification of the initial COAP as a result of the employee's disablement, will become the basis for client dissatisfaction or worse.
*COAP: Court Order Acceptable for Processing. Essentially the Federal equivalent of a Qualified Domestic Relations Order.

Assume you have inserted the traditional allocation of pension benefits language as is found in a standard Coverture Fraction/Time Line formula. Be clear on the significance of using this traditional language, devoid of the caveats presented in this article. The practitioner will understand that when he or she uses standard Coverture Fraction/Time Line formula language, that this language will produce a wholly unanticipated pension benefit when the employee is disabled subsequent to divorce and retires under a FERS disability retirement formula.

Circumstance A: the employee is disabled prior to attaining age 62 and is not eligible
for Social Security Disability Income (SSDI).

RESULT
FORMER SPOUSE'S PENSION BENEFIT IS SIGNIFICANTLY GREATER

The post divorce retirement of an employee pursuant to the disability retirement formula causes the disadvantaged spouse to be the disabled retiree. The monthly benefit paid to the disabled retiree will be significantly less than anticipated. Alternatively, the Former Spouse will experience a significant and unexpected increase in retirement benefits. Based on the Statistical Data and Assumptions found at the end of this article, the first year increase in the monthly benefit paid to the Former Spouse is 350.79%. Thereafter, the percent of increase for the Former Spouse is 200.53%. This is computed as an increase from the employee's accrued benefit at disablement. This is an increase in monthly benefit from $302.50 to $1,363.64 in the first year and to $909.09 to age 62. These increases are based on the monthly benefit that would be paid to the Former Spouse if the employee retired on the date of disablement and began to collect immediately. See Appendix B, for a calculation of the Early Retirement Benefit Reduction. Be Clear! The source of the increased benefit paid to the Former Spouse is the benefit that would otherwise have been paid to the disabled retiree. At age 62, you will recall the disabled retiree's benefit is recalculated based on the non-disability formula. However, incorporated into this post age 62 calculation is service credit for all years during which the employee was collecting a disability pension. In addition to this service credit for all years of disablement the employee is credited with all statutory COLA pay increases he or she would have received had the employee not been disabled but had worked up to age 62. This formula produces a significant and unanticipated economic windfall for the Former Spouse.

COMMENTARY:
We have endeavored to keep the mathematics at a minimum. There are several variations on the payout calculations. Each of which advantages the Former Spouse. Under this scenario the loss of benefit to the employee and the increase in benefit to the Former Spouse is exceptional. Based on the magnitude of the unanticipated benefit increases to the Former Spouse I strongly urge the family practitioner to consider the reaction of the disabled employee to such unanticipated increases in the Former Spouses benefit. Especially, when such outcome could have been avoided by a person more familiar with FERS disability pensions.

Circumstance B: the employee is disabled prior to attaining age 62 and is eligible for
Social Security Disability Income (SSDI).

RESULT
THE FORMER SPOUSE WINS AGAIN! BUT NOT AS BIG AS FOR "A"!

The post divorce retirement of an employee pursuant to the disability retirement formula again results in the disabled spouse being the disadvantaged spouse. However, the magnitude of the increase to the Former Spouse's benefit, while substantial, is significantly less than under Circumstance A. The Former Spouse is advantaged in the first year of disablement by a benefit increase of 199.93%. For years two and up to the disabled spouses attaining his or her age 62 the percentage of benefit enhancement for the Former Spouse is 33.18%. This is computed as an increase from the employee's accrued benefit at disablement. This is an increase in monthly benefit from $302.50 to $907.28 in the first year and to $452.73 to age 62. Again, the source of the benefit enhancement to the Former Spouse will be a reduction in the benefit that would otherwise be payable to the disabled employee.

POST AGE 62 CONCERNS:

What retirement benefits may the parties anticipate when the disabled retiree attains his or her age 62? This is more complex question due to the increase in the number of variables incorporated into the calculations. Additionally, absent anticipatory language in the Marital Settlement Agreement a new issue will emerge: How to compute the Coverture Fraction benefit payable at age 62. Recall a new benefit is created at the retiree's age 62. Will the Former Spouse deem the initial Coverture Fraction relevant to this newly created retirement benefit? Based on the statistics found below, interpretations of the Coverture Fraction will result in different marital/community fractions of 90.91% or 57.14%. The magnitude of the difference is an open invitation to litigation and new expense to the parties. Our experience with the Office of Personnel Management (OPM) suggests that a Coverture Fraction favorable to the Former Spouse is likely, absent a clarifying successor COAP. If the Former Spouse prevails he or she, depending on the duration of post age 62 payments simply offsets losses incurred from the date of disablement up to age 62 or if payments are of longer duration such Former Spouse will have a very substantial increase in his or her overall benefit.

HOW IS AN ATTORNEY TO ANTICIPATE AND AVOID
THE ISSUES PRESENTED IN THIS ARTICLE?

Since each fact pattern is unique it is suggested that prior to settlement and drafting of the Marital Settlement Agreement you contact Troyan To discuss the specifics of your matter and receive language relevant to the fact pattern of your matter.

APPENDIXES
Appendix A: Basic Statistical Data for all calculations
Appendix B: Explanation of Early Retirement Benefit Formula
Appendix C: Explanation of benefit payable to not disabled employee retiring at age 49 with 22 years of service.
Appendix D: Explanation of benefit payable to an employee disabled at age 49, with 22 years of service and immediately receiving benefits. NO SSDI.
Appendix E: Explanation of benefit payable to an employee disabled at age 49, with 22 years of service and immediately receiving benefits. SSDI PENSION OFFSET.

APPENDIX A
BASIC STATISTICAL DATA

Employee Bobby Suggs
Date of Birth August 1, 1959
Date of Marriage August 1, 1985
Hire Date with FERS August 1, 1986
Date of Divorce August 1, 2006
Date of Disablement August 1, 2008
Age at Disablement 49
Total Credited Service at Divorce 20 years
Total Credited Service at Disablement 22 years
Time from Disablement to age 62 13 years
Final Avg. Pay at Disablement $60,000.00
Coverture Fraction 90.91%
Numerator 20 yrs
Denominator 22 yrs

APPENDIX B
Explanation of Early Retirement Benefit Reduction Calculation.

This reduction is 5% for each year prior to “normal retirement age”. An employee with 20 years of service may retire at age 60. Since Mr. Suggs is age 49 on August 1, 2008 he is retiring eleven years before his normal retirement age. Thus his early retirement reduction penalty is 5% X 11 years = 55%.

APPENDIX C
Explanation of benefit accrued at age 49 for not disabled employee with 22 years of service. Payable at age 60.

Employees monthly accrued benefit
at age 49 payable at age 60 $1,210.00
(.011 X 22 yrs X $60,000) ÷ 12 = $1,210.00
Marital Part $1,100.00
($1,210 X 90.91%) = $1,100.00
Monthly Benefit Husband $660.00
Monthly Benefit Former Spouse $550.00
Sum of Monthly Payments $1,210.00 (if payments begin @ 60)
Note the monthly benefit of $1,210.00 is an accrued benefit up to Mr. Suggs last day worked, i.e. age 49. If he stops work at his age 49, he may receive an unreduced accrued monthly benefit beginning at his normal retirement age (60). If the employee actually retired at 8/1/2008 and began to receive his benefit at his age 49, then the Early Retirement Reduction is: 55%. See Appendix B.

APPENDIX D
Explanation of benefit payable to an employee disabled at age 49,
with 22 years of service and immediately receiving benefits.
NO SSDI

Benefit Payable to an employee retiring after 22 years of service but before attaining age 60.*
*Normal Retirement Age:
Age 60 with 20 years of service
Age 62 with less than 20 years of service.
Total Monthly Benefit payable at age 49:
FERS disability benefit formula for employee's disabled prior to attaining age 62 and not eligible for Social Security Disability Income (SSDI).

Part One, Benefit Payable in first year of disablement.

60% of Employees Final Average Pay.
(60% X $60,000) ÷ 12 = $3,000.00

Part Two, Benefit Payable from the second year of disablement up to age 62.

40% of Employees Final Average Pay.
(40% X $60,000) ÷ 12 = $2,000.00

Coverture Fraction: 90.91%

Marital Part of Pension:
Year 1 $2,727.27
Years 2-62 $1,818.18

Allocation of the marital part Husband Wife
Year 1 $1,363.64 $1,363.64
Years 2-62 $909.09 $909.09

Allocation of total disability pension: Husband Wife
Year 1 $1,636.36 $1,363.64
Years 2-62 $1,090.91 $909.09

APPENDIX E
Explanation of benefit payable to an employee disabled at age 49, with 22 years of service and immediately receiving benefits. SSDI PENSION OFFSET.

Benefit Payable to an employee retiring after 22 years of service but before attaining age 60.*
*Normal Retirement Age:
Age 60 with 20 years of service
Age 62 with less than 20 years of service.
Total Monthly Benefit payable at age 49:
FERS disability benefit formula for employee's disabled prior to attaining age 62 and not eligible for Social Security Disability Income (SSDI).

Part One, Benefit Payable in first year of disablement.

60% of Employees Final Average Pay.
(60% X $60,000) ÷ 12 = $3,000.00

Part Two, Benefit Payable from the second year of disablement up to age 62.

40% of Employees Final Average Pay.
(40% X $60,000) ÷ 12 = $2,000.00

Coverture Fraction: 90.91%

Monthly SSDI Offset: $1,004.00
(average offset for 2008)

Benefit Payable After SSDI Offset:

Year 1 $1,996.00
Year 2 to age 62 $ 996.00

Marital Part of Monthly Offset:
Year 1 $1,814.56
Year 2 to age 62 $ 905.46

Monthly Allocation of Offset to Wife
Year 1 $907.28
Year 2 to age 62 $452.73