<u>SHARED PAYMENT QDRO vs. SEPARATE INTEREST QDRO</u>

Qualified Domestic Relations Orders (QDRO). Settlement Formats. Survivor Annuity Benefits.

Each of the following Settlement Formats represent a specific method of protecting the benefits assigned to an Alternate Payee in a Qualified Domestic Relations Order when the benefit is provided by a Qualified Defined Benefit Plan. [1] [2]

<u>Two Forms of Domestic Relations Order Awarding Retirement or Death Benefits to an Alternate Payee</u>.

• Shared Payment Domestic Relations Order

• Separate Interest Domestic Relations Order

Shared Payment Domestic Relations Order.

• Alternate Payee cannot commence benefit payments prior to retirement of the participant.

• Upon the death of the retiree all payments to the Alternate Payee terminate, however,

• For payments to continue to an Alternate Payee subsequent to the death of the retiree, there must be an award to the Alternate Payee of Survivor Benefits

When representing an Alternate Payee it is the attorneys duty to prepare a Marital Settlement Agreement, containing a clear and unambiguous award to the Former Spouse of Survivor Benefits.

Shared Payment QDRO's.

<u>Shared Payment Settlements and Domestic Relations Orders</u>.

For purposes of this discussion it is presumed that the participant is actively employed and not retired (this facilitates discussion of the QPSA and the Joint and 50% Survivor Annuity).

<u>Duration of benefit payments to an Alternate Payee</u>:

• Benefits Payable over the lifetime of the retiree

• Benefits Payable as a result of the Death of the Participant (preretirement)

• Benefits Payable as a result of the Death of the Retiree (postretirement)

Caveat (Mostly for the Attorney Representing the Alternate Payee).

The experienced practitioner understands that an award to an Alternate Payee of a survivor annuity benefit is separate and distinct from an award of benefits paid to an Alternate Payee over the lifetime of the participant/retiree. A comprehensive settlement will encompass both the living benefit paid to an Alternate Payee and the Survivor benefit paid to an Alternate Payee.

Failure of the attorney representing an Alternate Payee to bargain for and to insert clear and unambiguous language in a Marital Settlement Agreement that assigns to the Alternate Payee survivor annuity rights most likely results in loss of these rights to an Alternate Payee.

This is made clear in the Retirement Equity Act at Title 26 U.S.C. 414(p)(5)(A):

Treatment of former spouse as surviving spouse for purposes of determining survivor benefits.
To the extent provided in any qualified domestic relations order (emphasis mine)

(A) the former spouse of a participant shall be treated as a surviving spouse of such participant for purposes of sections 401(a)(11) and 417 (and any spouse of the participant shall not be treated as a spouse of the participant for such purposes),…

RE-EMPHASIS.

Again, it is emphasized that the survivor rights of an Alternate Payee are solely derived from the language of the Marital Settlement Agreement. Failure to insert an award to a Former Spouse of a Survivor Annuity in the Marital Settlement Agreement, is a bar to insertion of such award into the Domestic Relations Order.

A Domestic Relations Order is an instrument of communication, it is not an opportunity to renegotiate the settlement.

Costs of a Shared Payment QDRO. Survivor Annuity Benefits Have a Cost.

An issue that frequently arises in settlement negotiations is, who is to pay the cost of the Alternate Payee's survivor benefit. This issue will only arise when the form of settlement is Shared Payment.

Explanation: How is the cost of an award of a Survivor Benefit calculated?

The cost of a Survivor Annuity is not expressed as a "dollar amount". Rather it is expressed as a reduction to the annuity otherwise payable. The traditional form of payment of the retirement annuity is in a form termed "Single Life Annuity" (SLA). Any other form of retirement annuity is the "actuarial equivalent" of the SLA.

This means that all other forms of retirement annuity provide an annuity payout that is less than the SLA, because it provides for either a longer guarantee period or it applies to more than one life. The least costly benefit is termed the "Normal Form of the Benefit, i.e. Single Life Annuity". Other forms of Joint Life annuities are:

Joint Life Annuities
Period Certain Annuities

Joint Life Annuity:

This annuity normally takes the form of a "Joint and 50% Survivor Annuity".

Joint and 50% Survivor Annuity Defined:

An annuity payable for the lifetime of the retiree. Upon the retiree's death prior to the death of the second annuitant (usually the Alternate Payee), an annuity is paid that is equal to one half of the amount paid to the retiree on the date preceding her or his date of death.

Cost of the Joint and 50% Survivor Annuity.

This is a function of the life expectancy of the retiree at retirement and the life expectancy of the Alternate Payee. The younger the Alternate Payee the greater the reduction in the amount paid by the Joint and 50% Survivor Annuity. This reduction can be as slight as 1% or 2% to as great as 30% to 40% (for a "May and December" marriage).

Which Spouse Should Bear the Cost of a Former Spouse Survivor Annuity?

Statutes do not appear to address this issue. Exiguous case law is found on this issue. Since this is an "Inform and Educate" Article, no specific view is express as the author's position.

One View.

The cost (reduction in benefit) should be equally allocated between the spouses (BUT: Most Plans do not permit this option.

Second View.

The cost (reduction in benefit) should be proportionately allocated between the spouses.

Third View.

Based on Tax Theory, is that the "Burden Follows the Benefit"

(BUT: Most Plan Administrators do not allow this option).

Separate Interest Domestic Relations Order.

This form of Order is often termed "**Carve Out**".

• Alternate Payee may commence benefit payments whenever the participant has the right to retire (participant need not actually retire)*

• The death of the retiree does not impact on the retirement benefit being paid to an Alternate Payee [3]

*The experienced practitioner avoids advising the Alternate Payee to exercise this right. This avoidance is based on Title 26 U.S.C. 414(p)(3)(B) which provides:

…does not require the plan to provide increased benefits (determined on the basis of actuarial value),…

Discussion of this actuarial issue is beyond the scope of this article. But recognize that an Alternate Payee moving her or his benefit to pay status prior to the earlier of the participant's actual retirement or attaining Normal Retirement Age is likely to incur an unanticipated and huge reduction in benefit.

ALERT.

We repeat for emphasis: Once benefit payments to the Alternate Payee begin, the death of the participant does not impact on the retirement benefit being paid to an Alternate Payee. This is the central feature of the Separate Interest QDRO.

Caution.

Not all plans accept this "Carve Out" concept.

This "Carve Out" method, may not apply when the participant's date of death precedes an active participant's retirement.

Carve Out Limitations.

Many plans do not interpret a Separate Interest QDRO as becoming effective until the Alternate Payee has retired and commenced benefit payments. As a result of this Plan Administrator position, should the participant die while actively employed and the Alternate Payee has not commenced retirement benefit payments, many Plan Administrators consider this "death during the QPSA" period. Result, the "Shared Payment QDRO" is not yet in effect.[4] Because of this uncertainty, it is strongly suggested that when using the Shared Payment method the practitioner also award the Alternate Payee, a Qualified Preretirement Survivor Annuity (QPSA),if required to protect the Alternate Payee's benefits.

The Qualified Preretirement Survivor Annuity (QPSA).

The QPSA is an integral component of a Qualified Defined Benefit Plan. Title 29 U.S.C.A. 1055(a)(2), provides:

…in the case of a vested participant who dies before the annuity starting date and who has a surviving spouse, a preretirement survivor annuity shall be provided to the surviving spouse of such participant…

Caution.

The above ERISA guarantee of a QPSA, is limited to a "married" spouse. It does not automatically apply to a divorced spouse. When divorcing and in doubt as to the effective date of the "Carve Out" the attorney representing an Alternate Payee is well advised to confirm the Alternate Payee's necessity of a QPSA award. It is incautious to presume that once a "carve out" QDRO has been implemented rights of the Alternate Payee are fully insulated from loss. Confirm that the "Carve Out" effective date (at retirement of the participant or upon Qualification of the Order). Based on this information the need for a QPSA can be determined. Finally, note the there is virtually no cost to either spouse for the QPSA protection.

Footnotes:

[1] This article is limited to plans subject to Employee Retirement Income Security Act (ERISA).

[2] Alternate Payee is defined at Title 29 U.S.C. 1056(d)(3)(K):

The term "alternate payee" means any spouse, former spouse, child, or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant.

[3] It is for this reason that this form of settlement is often termed "Carve Out".

[4] The separate interest of the Alternate Payee is perfected at retirement, not before.