

# Navigating Retirement Plan Division in Divorce

A Comprehensive Guide for Financial Advisors

# Learning Objectives

- \* Identify all types of retirement plans
- \* Understand what benefit is being divided and how it is typically done in divorce
- \* Understand how the law affects what your clients can and cannot do
- \* Develop a strategy for supporting your client going through a divorce
- \* When your clients have clarity, it strengthens the trust they have in you!



# What this presentation is not....

It is not how to draft a QDRO.

A Certified QDRO Specialist™ is best suited to draft the legal documents necessary for dividing all types of retirement plans.

COMMONWEALTH OF MASSACHUSETTS

THE TRIAL COURT

PROBATE AND FAMILY COURT DEPARTMENT

MIDDLESEX DIVISION

DOCKET NO.

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Petitioner )  
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**QUALIFIED DOMESTIC RELATIONS ORDER**

WHEREAS, this Order creates and recognizes the existence of an Alternate Payee's right to receive a portion of the Participant's benefits payable under an employer-sponsored defined contribution plan which is qualified under Section 401 of the Internal Revenue Code of 1986 ("IRC") and Section 206(d)(3)(B) of the Employee Retirement Income Security Act of 1974 as amended (ERISA). It is intended to constitute a Qualified Domestic Relations Order ("QDRO") under Section 206(d)(3) of ERISA and Section 414(p) of the IRC.

# What is a QDRO?

- \* A “qualified domestic relations order” is a domestic relations order that creates or recognizes the existence of an “alternate payee’s” right to receive, or assigns to an alternate payee the right to receive, all or a portion of the benefits payable with respect to a participant under a retirement plan, and includes certain information and meets other certain requirements.

# Qualified Divorce Relations Order

- \* QDRO – Used for employer-sponsored (private sector) retirement plans, under ERISA – both 401(k)s and pensions;
- \* ERISA (1974) and Retirement Equity Act of 1984
- \* “Qualified” – means the QDRO conforms to IRC 26 U.S.C. §414(p)(2) and ERISA, 29 U.S.C. §1056(d)
- \* DRO - typically used for state, municipal pensions;
- \* Non-qualified orders
- \* COAP – Court Order Acceptable for Processing – FERS;
- \* Court Order Dividing Military Retired Pay

# Realty Check

- \* It is not up to the financial advisor how assets get divided – it's up to what the Plan will allow and state law
- \* Sometimes, how things get divided in divorce, you would never do for an “intact” couple
- \* You need to have an understanding as to how things are done in your state before making any recommendations or taking any actions
- \* Be mindful of your Code of Ethics
- \* Watch for Conflict of Interest and Biases
- \* Automatic Restraining Orders

# Identify the Plan



# Employer Sponsored Plans

## Defined Contribution

- ❖ 401(k), 403(b), Profit-sharing, ESOP, Teamster and Union Plans
- ❖ Stock bonus plans, Money Purchase Plans, Tax Sheltered Annuities (TSA)
- ❖ 457(b) Plans - gov. equiv. of 401(k)
- ❖ Thrift Savings Plan (TSP)
- ❖ "Non-qualified" – 409(a), 457(f) do not accept QDROs

## Defined Benefit

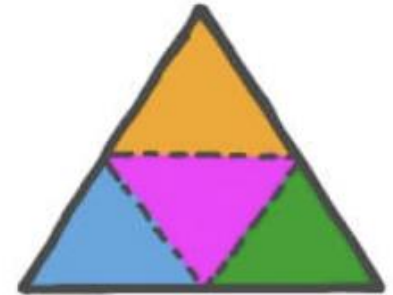
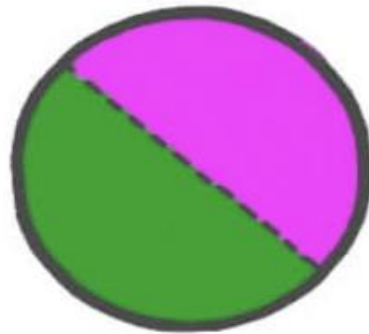
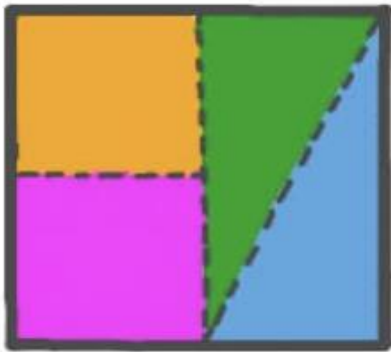
- ❖ Private sector pensions – IBM, Bose
- ❖ Cash Balance Plans – hybrid plan with features of both types
- ❖ Non-qualified defined benefit plans
- ❖ Supplemental pension plans
- ❖ FERS Pension, Military pension



# Obtain Plan Documents

- \* Summary Plan Description
- \* QDRO Procedures
- \* Union Plans follow ERISA, Member may also participate in the National pension fund
- \* Employees can participate in multiple retirement plans
- \* Frozen pensions may have been converted to a cash balance plan
- \* Non-qualified plans not required to have plan docs

# What is Being Divided? And How?



# It Depends...

- \* What gets divided depends on the laws, guidelines and case law in your particular state
- \* Earned during the marriage
- \* Equitable Distribution v. Community Property
  - \* Only 8 states are community property
- \* Equitable does not always mean “equal”
- \* Fair and Equitable – what is “fair”?
- \* Typical: 50/50 split for retirement assets

# Add it all up and divide by 2

## Defined Contribution/IRAs

- \* Divide each account 50/50
- \* Equalize multiple accounts
- \* Equalization payment
- \* Fixed dollar amount
- \* Gains and Losses
- \* Valuation date
- \* Pre-marital balances
- \* Pre-tax v. Post-tax (Roth)

## Non-Qualified Plans

- \* Plans not subject to the federal QDRO provisions
- \* May still be subject to other ERISA requirements
- \* Most plans permit benefit assignment under an approved DRO and will pay the Alternate Payee directly
- \* Some plans cannot be divided

# To Equalize or Not to



## Pros

- \* Reduces the cost
- \* If IRA is used for equalization payment, no QDRO needed
- \* If several smaller former 401(k)s consider consolidating into an IRA, can be done pretty quickly



## Cons

- \* What "as of" date to use
- \* Have to keep Roth IRAs separate
- \* Equalization payment may not be equal if gains/losses are also awarded on that account

# Defined Benefit Plans Private Employers

## What are we dividing

- \* Benefit earned during the marriage
- \* Brightline or Marital Coverture
- \* Freeze the benefit at date of divorce or use the benefit at retirement, allow growth, but only divide marital portion

## Other Considerations

- \* Separate Interest v. Shared
- \* Single Life or J&S
- \* Qualified Pre-Retirement Survivor Annuity – QPSA
- \* Early Retirement Subsidies
- \* COLA

# State Pensions

- \* All state employees- county, city, town, teachers, etc
- \* Governed by state laws – no plan documents
- \* In MA, they do not contribute to Social Security
- \* Mandatory contributions help fund the pension
- \* Shared Interest DROs – have to wait for Member to retire
- \* DRO can order a Member to elect Option C, can't change it
- \* If ex-spouse remarries prior to Member's retirement, she/he may lose survivor benefit
- \* All ancillary benefits must be addressed in the agreement and DRO

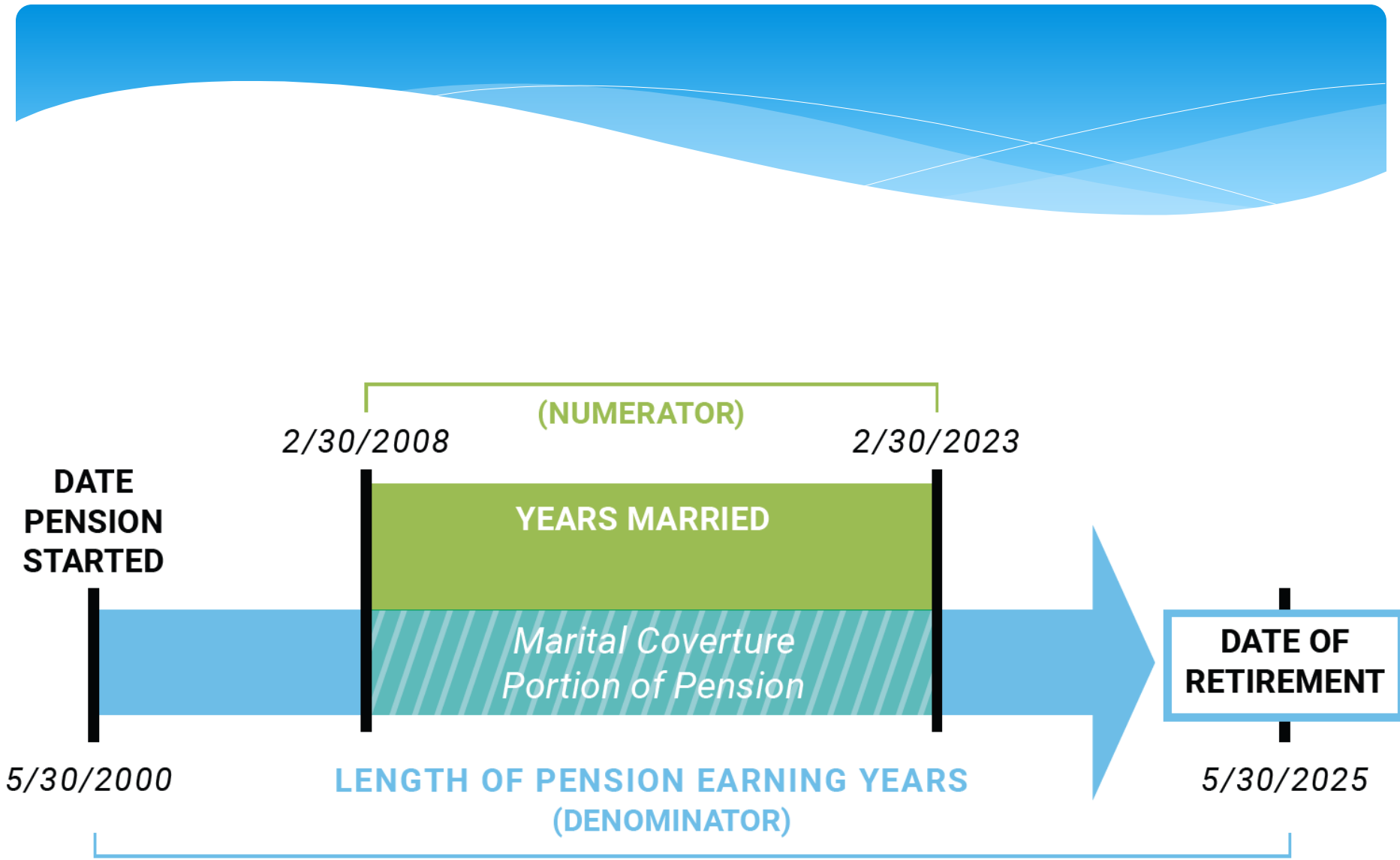
# Dividing Highly Emotional Assets

- \* Most states will divide a pension using the Marital Coverture fraction
- \* Some states, like Florida, only use Bright Line – freezing the benefit as of date of divorce
- \* Massachusetts is only state that allows both – creates misunderstanding and misinformation
- \* Other ways: percentage as of a particular date or a flat dollar amount
- \* Pensions in-pay status can be divided



# What is Marital Coverture?

- \* Most common way
- \* Also called 'Fractional' or 'Pro Rata'
- \* Used to exclude premarital years of service
- \* And/or to allow growth of the benefit if still working after the divorce
- \* Greatest growth occurs in last 10 years of pension
- \* **Numerator** is the number of years that marriage overlapped with pension
- \* **Denominator** is the total number of years at retirement
- \* Typical fraction is 20/30 or 67% of the benefit is marital



# Correct Use of Marital Coverture

NUMERATOR

15

YEARS MARRIED

*(Only years that overlap earning years in the pension plan)*

DIVIDED BY

25

DENOMINATOR

TOTAL YEARS OF CREDITABLE SERVICE

*(Years Participant earned from start of pension to retirement)*



$\$5000 \times 60\% = \$3000$

$\$3000 \times 50\% = \$1500$

# Pension Valuations

- \* The only time we do a pension valuation is when there is an asset of equal value on the 'other' side
- \* If eligible to retire, we use benefit as is they retired "today"
- \* If not, we use benefit as earliest retirement age without reduction in benefit
- \* There is no one value for a pension
- \* It depends on assumptions used:
  - \* Discount rate, mortality table, COLA, when can member retire
- \* Private sector pensions are much easier to value than state pensions
- \* Survivor benefits (Option C) have a value
- \* What role does Social Security plays in state pensions

# How You Can Help Your Clients

The slide features a solid blue background. At the bottom, there are several overlapping, wavy, light blue shapes that create a sense of movement and depth, resembling stylized waves or a modern graphic design element.

# Knowledge is Power

- \* If a client says they are heading to divorce, it may be best to refer them to a CDFA
- \* Help gather all the necessary account statements
- \* Educate yourself about all the plans your client has – old and new
- \* Expenses play key role in divorce
- \* The key to a settlement is are they going to be okay?
- \* Help them make smart financial decisions by keeping emotions out of it
- \* Run projections into the future based on the proposed division so they can see what retirement looks like

# Do's and Don'ts

- \* Do discuss their future needs and goals
- \* Do a distribution, if needed
- \* Do cooperate with all parties, even opposing counsel
- \* Don't rollover former 401(k)s during divorce
- \* Don't allow distributions from retirement accounts to pay for things
- \* Don't advise both clients, you may have to do a handoff



# Thank you!

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