



SOCIETY OF ACTUARIES

Article from:

Pension Section News

June 2001 – Issue No. 46

QDROs with Fewer Hassles

by Mitchell I. Serota

Although qualified domestic relations orders (QDROs) have existed since the passage of the Retirement Equity Act (REA) of 1984, their usage today still generates problems in execution. Lawyers are concerned with proper documentation, actuaries are encumbered by restraints on calculations, and human resource (HR) professionals have difficulty with administration. These problems are insignificant, by contrast, to the total lack of understanding of qualified plans on the part of the divorcing couple. Actuaries can play a crucial role in assisting the couple, the attorneys and human resource professionals in alleviating the headaches spawned by splitting benefits from qualified retirement plans. In particular, there are simple steps a plan sponsor's actuary can follow to minimize complexity, thereby saving legal and consulting fees for the divorcing couple and easing their stress.

Calculating Lump Sum Equivalents

Before a QDRO is issued, actuaries are routinely asked to calculate lump sum equivalents for marital settlements, even for benefits of plans that do not offer lump sums (exceeding \$5,000) as an optional form of benefit payment. The reasoning behind this request is that all property in a marital settlement must be valued. After that is done, the parties can begin the process of dividing the property. A fair market value must be assigned to the house, RV, boat, sound system, and retirement plan. In some cases, after determining a lump sum, a QDRO is not even

prepared. In these instances, the actuary makes a computation, the participant keeps his entire pension benefit, and the spouse receives compensation from other assets.

Often a divorce attorney will seek out an independent consultant for the computation. This, however, should be the second step in the process. The first step along the discovery process should be the request of the participant's human resource director for the benefit calculation, complete with any available options, especially lump sums. Each plan participant has a right, upon annual request, to a calculation of his or her accrued benefit. However, complying with the request to compute a lump sum equivalent, *even though it is not offered by the plan*, will save time and consulting fees for the divorcing couple. Telling the attorney that the plan will not pay out the alternate payee is helpful when the QDRO is being drafted, but the marital asset nevertheless must be valued. The plan's actuary can save many phone calls by kindly revealing the plan's assumptions for actuarial equivalence.

When performing the benefit calculation for the divorcing participant, the actuary must make certain that the lawyer, human resource director and actuary all agree on the assumptions involved: dates of birth of both spouses, dates of marriage and dissolution (or proposed dissolution), date of payout (if applicable). Explicit listing of relevant salary history will assist the independent actuary called upon to review the calculation. When the



defined-benefit plan does offer lump-sum payouts in excess of \$5,000, the review will be aided by disclosing not only the interest rate used, but also the mode of change (i.e., annual, quarterly, or monthly).

Human resource directors sometimes provide a recent benefit statement to respond to the attorney's request for information because distributing statements fulfills the requirement to disclose a participant's accrued benefit. Benefit statements, however, do not always provide adequate information for a QDRO. Whereas an accrued benefit may be displayed as of a certain date, there may be inherent or even intentional underestimation in the calculation. Using such a calculation would be unfair to the alternate payee unless there are caveats attached to the statement itself.

The general idea here is to assist the reviewers of the calculation rather than to erect walls of bureaucratic procedure. The information requested by the independent actuary via the divorce attorney will ultimately be obtained, but there is no professional reason for the plan's actuary not to disclose all assumptions and inputs used in making the determination of present value.

Drafting Clear Plan Documents and Administrative Procedures

Pension actuaries can further assist in the process by using their influence to keep the QDRO provisions in plan documents easy to administer. There are enough hoops to jump through in a divorce settlement without spending massive time and fees to figure out what a plan document provides and prohibits.

Regarding the timing of distributions, §414(p) of the Code allows a

50. This provision does not often make much sense, nor is it in the spirit of REA.

If a lump-sum benefit is payable as an optional form, pension actuaries can advise plan sponsors to allow the payment to the alternate payee to be made promptly, instead of waiting for the participant to turn 50-years old. The most common practical reason for promptly paying out in a lump sum is that the weaker partner in the broken up marriage, typically the female, needs the cash and needs it now. Retirement, or planning for years down the road, is not a consideration when she has mouths to feed and perhaps has to find employment for the first time in years. When possible, however, the actuary can offer a few minutes of time to explain the ramifications of taking a lump sum now rather than deferring receipt of an annuity in the future. The mindset of the alternate payee is almost

director would be a huge help. Similarly, when revising the Summary Plan Description, assist the communications consultant to include explicit instructions for the participant to follow in the event of divorce.

Finally, once a QDRO is accepted by the plan administrator, make certain that the HR director asks for a change in the beneficiary form. Language in the plan document may be added to specify that the acceptance of a QDRO automatically nullifies the beneficiary of record. It has happened that a participant forfeited a portion of his retirement plan in a QDRO, married another person, and upon death, left the new widow to find out that the first spouse was the beneficiary.

Pension actuaries are positioned to take on an important and effective role in the divorce arena. Since the process of divorce is complicated and unnerving, actuaries should be the professional of choice in assisting HR directors and attorneys, as well as the divorcing couple, in the matter of properly dividing qualified retirement benefits and advising between lump sums and annuities. The role of the pension actuary needs to become commonly accepted practice in the area of QDROs for all concerned parties, but it is our responsibility to educate our publics of what we can do.

“If a lump sum benefit is payable as an optional form, pension actuaries can advise plan sponsors to allow the payment to the alternate payee to be made promptly, instead of waiting for the participant to turn 50 years old.”

plan sponsor to postpone a distribution to the alternate payee until the participant turns 50. Volume submitter plans, written for ease of obtaining favorable letters of determination, often complicate administrative functions. For instance, many defined contribution plans obstruct the plan from paying a lump sum to a spouse out of the participant's account balance, simply because the participant has not yet reached age

always geared to taking the money now, whether or not it is prudent. Five minutes of volunteered time could at least alert the alternate payee to some options.

Pension actuaries can also help the plan administrator anticipate divorce problems by preparing a checklist for divorcing plan participants. Translating §414(p) and Notice 97-11 into simple administrative procedures for the HR

Mitchell I. Serota, FSA, MAAA, FCA, is president of Mitchell I Serota and Associates in Skokie, IL. He can be reached at actuary@miserota.com.