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A CAUTIONARY TALE ON DIVIDING A PENSION

*By Steve Sebastian and David Kelley**

Note: This article is offered in the context of our CLE and writing experience which has found that one clear narrative about the pitfalls an attorney faces in a specific case is far more memorable than a dry recitation of general warnings. While the case is an actual one we have removed the names because this is less about criticizing or complimenting people than about offering practical advice to DR attorneys.

The Cincinnati attorney was worried. Despite having secured a *Hoyt*[1]-type coverture division of the Federal Reserve Pension of his client's husband, he was now being told that the Plan did not allow such an order. The person advising him to abandon the coverture order was an attorney he retained to draft the order and who had been recommended to him.

His expert—who we will call Preparer #1—told him that the best his client could expect was that she would receive "interest credits" on her separate account—and not a traditional coverture share of the benefit. He had come to this conclusion by reading the Guidebook, the QDRO Procedures and the Model order—which clearly stated that the benefit was to be frozen at the time of the divorce.

MISTAKE #1: BLINDLY USING THE PLAN'S MODEL QDRO

Preparer #1 decided to use one of the Plan's model QDROs, which contained the following benefit assignment language:

> The order assigns to the alternate payee an amount equal to (________% or $________) of the participant's vested accrued benefit under the Plan as of ________________________________
>
> (insert date).
>
> This amount shall be separately accounted for under the Plan for the exclusive benefit of the alternate payee. This portion of the vested accrued benefit shall be and is irrevocably assigned to the alternate payee.
>
> The *alternate payee shall have no rights to any increase in the participant's benefits under the Plan caused by service, earnings, separation programs, or Plan amendments occurring subsequent to the valuation date*, or to the portion of the participant's vested accrued benefit under the Plan not assigned in this order. (Emphasis added by authors.)

Preparer #1 made the following adjustments to the Plan's model QDRO:

- Entered 50% and the date of the divorce

*Steve Sebastian (ssebastian@qdrogroup.com) is general counsel for QDRO Group, LLC, and is licensed in Ohio and Kentucky. He is a Phi Delta Phi graduate of the U. of Michigan Law School and undergraduate from the U. of Kentucky where he was an honors accounting major. He has spent nearly 20 years in the employee benefits field including 15 years at regional and national law firms as an ERISA attorney where he advised companies regarding the design, legal compliance and administration of all types of retirement plans, including non-ERISA and/or non-qualified plans.

David Kelley (dikelley@qdrogroup.com), a principal at QDRO Group, LLC, is co-author of *Dividing Pensions in Divorce: Negotiating and Drafting Safe Settlements with QDROs and Present Values, Third Edition* (Wolters Kluwer Law & Business 2018) and numerous other articles and chapters of books on pensions and QDROs. He has testified over 1,500 times in court and taught over 100 CLE courses.

in the appropriate blanks, which effectively froze the benefit;

- Inserted, in the second sentence of the benefit assignment language, that the as- signed benefit would be "transferred to a separate account"; and
- Added a new section indicating that the assigned benefit would be insured by the Pension Benefit Guarantee Corporation ("PBGC").

MISTAKE #2: NOT UNDERSTANDING THE PLAN OR ERISA

Preparer #1 informed the Cincinnati attorney that an alternate payee in this Plan receives a share of the participant's lump sum account balance (similar to a 401(k) plan) that is increased by interest credits until distributed, which explains why the QDRO did not have a traditional coverture fraction, and why it did not address any early retirement subsidy/ supplement, COLA, or survivorship annuity.

Interestingly, the Cincinnati attorney shared the QDRO with the participant's attorney, who had an ERISA attorney in his firm ("Preparer #2") for review. Preparer #2 as an attorney trained in ERISA and employee benefits immediately corrected two clear errors and, in essence, restored the model order to its original form:

1) Because only ERISA plan benefits are insured by the PBGC and the Plan is a governmental plan that is not covered by ERISA as Preparer #1 thought.

2) More revealing was that Preparer #2 understood that, although the Plan offered an account balance benefit, it was still a defined benefit plan that separately accounts for the benefits of different participants/beneficiaries *but does not actually establish separate accounts for them.*

Thus, Preparer #2 deleted the direction for the Plan to transfer the assigned benefit to a separate account, as well as the provision regarding PBGC insurance. However, Preparer #2 did not revise any of the substantive benefit assignment language. Of course, Preparer #2 was advising the participant's attorney and the QDRO's assignment language of Preparer #1 benefited the participant.

STEP #1: STUDY PLAN DOCUMENTS

Rather than accept the advice of Preparer #1 and Preparer #2, the Cincinnati attorney sought a third opinion from the authors who we will call Preparer #3. Preparer #3 reviewed the Summary Plan Description (SPD) and detailed how the Federal Reserve Plan was a defined benefit that had a complicated "greater of" benefit formula. A participant's Plan benefit is the greater of (1) a traditional accrued benefit that is the product of a set percentage and the participant's years of service and final average salary, and that is expressed as a lifetime annuity amount, or (2) an account balance option (similar to a cash balance pension) that is the sum of annual salary credits and interest credits, and that is expressed as a lump sum dollar amount. To compare the two benefit amounts and determine which is greater, the Plan calculates the present lump sum dollar value of the traditional accrued benefit.

Because one of the authors is an ERISA attorney, Preparer #3 understood the Plan was a "governmental plan" because it was sponsored by the Federal Reserve Board, which is an "agency or instrumentality" of the U.S. federal government. As a result, the Plan is not an ERISA plan, and is not subject to the laws regarding QDRO's. However, a governmental plan may voluntarily comply with the QDRO laws/rules, which the Plan does.

Again, the participant and alternate payee had agreed to divide the marital portion of the Plan using a traditional coverture approach, which is consistent with Ohio law and the laws of the vast majority of states—especially with respect to the Plan's traditional accrued benefit. Although a traditional coverture approach may not be the most accurate way to value and divide a cash balance plan benefit, the Plan's account balance benefit feature is unique and is more compatible with a coverture fraction.

Because Preparer #1 clearly revealed he did not understand (1) how the Plan works, (2) what plans are insured by the PBGC, and (3) certain differences in defined benefit and defined contribution plan benefits the Cincinnati attorney had reason to continue his quest for a traditional coverture order.

But one oversight by Preparer #1 stands out. He did not even mention the "greater of" benefit structure and completely disregarded the possibility that the traditional accrued benefit in the Plan would be the greater benefit. Keep in mind that the first two oversights just highlight a lack of knowledge which the Plan would have corrected while the third has a direct adverse consequence to the alternate payee which the Plan would not correct. Preparer #1 assumed that an account balance benefit could not include any early retirement subsidy, COLA, or survivor annuity, and did not mention these in the QDRO. Even if the alternate payee received a portion of an account balance benefit, the Plan is a defined benefit plan that permits the alternate payee to convert that lump sum dollar amount into a lifetime annuity—which might include an early retirement subsidy, COLA, survivorship annuity, etc.

Besides including these items, Preparer #1 should have informed the alternate payee that she would not be eligible to receive a portion of the participant's early retirement subsidy or COLA, if any, if she began her benefit payments before the participant.

STEP #2: CRAFT A SOLUTION CONSISTENT WITH THE PARTIES' AGREEMENT

By using the Plan's model, virtually verbatim, Preparer #1 assigned to the alternate payee a frozen coverture amount that could be materially different than the amount to which the parties agreed. The Plan's QDRO Procedures did not require him to use the model and, in fact, clearly indicated that a preparer does not have to use the model. Plan administrators typically prepare model QDROs to include what is easiest to administer, but don't normally require the model to be used. Even if a plan administrator will not accept language that differs greatly from its model QDRO, a competent expert will propose a solution that accomplishes what the parties intended.

The Cincinnati attorney's question to Preparer #3 was clear: Why will the Plan not accept a traditional coverture approach?

Preparer #3 was able to explain to the Cincinnati Attorney exactly how the Plan's benefit structure works. He also explained that the Plan's model QDRO did not contemplate a traditional coverture approach and that the Plan might not accept a QDRO that contained such an approach, but that there were a number of ways to achieve the desired result.

The first is a good general suggestion for dealing with plans, especially union plans, whose models indicate that they do not like traditional coverture orders: Submit a traditional coverture QDRO, including a pro rata share of any early retirement subsidy and COLA, to the Plan for preapproval. If the Plan rejected the order Preparer #3 would explain to the Plan why it should accept it.

If the Plan refused to budge there is an alternative. Preparer #3 would enter a frozen coverture QDRO with the understanding that another QDRO would be prepared when the participant retired. This amended order would achieve the same result as a traditional coverture QDRO.

THE HAPPY ENDING

The Cincinnati attorney agreed with the advice from Preparer #3. Thus, a traditional coverture order was submitted to the Plan. The Plan then accepted the draft order and then the court-signed order. A traditional coverture order was accepted by the plan with no need to write long letters to them or to file an amended order in the future. And most important, the Alternate Payee will receive her full property interests in the pension rather than a frozen benefit.

PRACTICAL ADVICE:

And now to the practical applications of this case to your practice. The following are a few recommendations based on the facts of this and many other cases.

1) Do not rely on plan models that deny traditional coverture. You do not know the plan will reject them until you try. Even then you should not waive your client's rights without a fight in which you dispute the rejection. The authors are surprised at the number of times that a candid but respectful letter outlining Ohio and national law has been effective in moving what had previously been an obdurate plan administrator into the coverture camp.

2) Do not draft an order on a Plan that you do not understand. That means that you must read the SPD and understand it or hire a preparer who understands the plan and can explain it to you.

3) Do not think you have eliminated your liability by outsourcing your order. Recognize that when you hire a QDRO-preparer you are still responsible for the language and for your choice of preparers.

ENDNOTES:

[1]*Hoyt v. Hoyt*, 53 Ohio St. 3d 177, 559 N.E.2d 1292, 12 Employee Benefits Cas. (BNA) 2584 (1990), is the case where the Ohio Supreme Court adopted the "proportionate share" method, another way of describing a traditional coverture method, in which the credited service earned in the pension during the marriage is the numerator in a fraction where the denominator is the credited service *at the time of the participant's retirement* or the service at the time the non-participant begins to draw on the pension. *Frozen coverture*, of course, freezes the denominator at the time of the divorce thus not allowing the non-participant spouse to gain inherent growth on the portion assigned to them as the participant's salary increases over the years and recasts each year of marriage as more valuable