Discussion of Divorce and Retirement Benefits

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It is important for retirement plan administrators to understand how a change in marital status may affect a participant's retirement plan benefits. Beneficiary designation updates can change who will receive payment in the event of the participant's death, and domestic relations orders (DROs) can result in the assignment of all or a portion of a participant's accrued benefit to a former spouse or child. In the case of monthly pension benefit payments from a defined benefit (DB) plan, tax withholding and filing status changes can increase the amount of tax withheld from each monthly payment.

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AT A GLANCE

- Federal antiassignment rules under the Employee Retirement Income Security Act (ERISA) do not permit any portion of a participant's retirement plan benefits to be assigned to another person; however, an exception is made for benefits assigned under a qualified domestic relations order (QDRO).
- The retirement plan administrator is responsible for determining whether a DRO is qualified. An alternate payee in a QDRO cannot be anyone other than a spouse, former spouse, child or other dependent of the participant.
- Approaches for dividing benefits under a QDRO include the shared payment approach and the separate interest approach.

What Is a DRO?

Under ERISA, when a state authority (such as a court or state agency) or an Indian tribal government issues a judgment, decree or order under state or tribal domestic relations law that relates to marital property rights, alimony payments or child support, including retirement plan benefits, it is referred to as a *DRO*. A divorce decree or court-approved property settlement may also serve as a QDRO if it meets the content requirements to qualify. However, a mere agreement between both parties is not considered a DRO, and there is no requirement that both parties agree to or approve a DRO.

Because ERISA, as federal law, preempts state law, a retirement plan is not allowed or required to follow the terms of a DRO unless it is determined to be "qualified" by the plan. If the plan qualifies the DRO, it is then referred to as a *QDRO*.

A DRO issued after the death of a participant can still be a QDRO if it otherwise meets the requirements under ERISA. However, an order issued after the death of a participant with respect to retirement benefits and community property laws not related to the dissolution of a marriage or recognition of family support obligations cannot be considered a QDRO.[1]

In addition, careful review may be needed if there is a subsequent surviving spouse at the time of a participant's death who may be entitled to survivor benefits under the retirement plan.

Nine states follow community property laws: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. These laws generally state that most property acquired during a marriage is owned equally by both spouses. When one spouse dies, the community property is usually split equally between the surviving spouse and the deceased spouse's estate. However, according to Section 514(a) of ERISA, ERISA overrides any state laws related to ERISA-covered employee benefit plans. This means that state community property laws cannot automatically treat a retirement benefit earned by a married spouse as community property, since ERISA rules take precedence.

How Does a DRO Become Qualified?

A DRO can be a QDRO only if it acknowledges the right of an alternate payee to receive—or assigns the right to receive—all or a portion of the participant's retirement plan benefits. An alternate payee cannot be anyone other than a spouse, former spouse, child or other dependent of the participant. However, if the alternate payee is a minor or legally incompetent, an order can require payment to someone with legal responsibility for the alternate payee. It is important to submit a DRO to the plan administrator promptly to ensure the division of benefits is handled smoothly and is successful.

In order to be qualified, a DRO must contain the following information.

- Name and last known mailing address for both the participant and alternate payee
- Name of the plan(s) to which the order applies
- Amount or percentage of the benefit to be paid to the alternate payee or a method to determine the amount
- Time period or specified number of payments to which the order applies

In addition, the plan administrator may require further details depending on the type of retirement plan, the nature of the participant's retirement benefits, the purposes behind issuing the order and the intent of the order.

A DRO cannot require the plan to:

- Make payment in a form not provided under the plan (e.g., a DRO cannot mandate a lump-sum payment if the plan does not provide otherwise for that option)
- Provide actuarially increased benefits
- Pay benefits to an alternate payee that have already been assigned to another alternate payee under another earlier QDRO
- Pay benefits to an alternate payee in the form of a qualified joint and survivor annuity with their subsequent spouse as beneficiary. That is, the law ensures that the former spouse of the participant is protected, but it does not extend those same protections to any subsequent spouse of the participant's former spouse.

Administrator's Responsibilities

The retirement plan administrator is responsible for determining whether a DRO can be qualified as a QDRO. A state agency or court cannot challenge an administrator on whether a DRO is considered qualified; however, a federal court may do so.

An administrator is required to avoid unnecessary and excessive administrative burden and cost to the plan when qualifying a DRO. To facilitate this duty, an administrator must establish and follow clear and understandable procedures to determine the qualified status of DROs and ensure timely processing.

The procedures are required to be reasonable and in writing. They should provide that each person specified in a DRO as entitled to payment of benefits under the plan will be sent notice of the DRO's receipt and a copy of the plan's procedures and permit an alternate payee to designate a representative to receive copies of the same DRO-related items that are sent to the alternate payee. Furthermore, the procedures should explain the following.

- What other information is available to assist in preparing a DRO, such as plan documents, benefit statements, model QDROs and summary plan descriptions (SPDs)
- Any time limits set by the plan administrator for making QDRO determinations
- Steps the administrator will take to protect and preserve retirement plan assets or benefits upon receipt of

a DRO, such as when and why plan assets will be segregated or benefit payments will be delayed or suspended
- The process to request a review of the administrator's determination of whether an order is a QDRO

An administrator is required to segregate amounts as if a DRO is determined to be qualified if the plan receives an order that would require payment to an alternate payee. This requires only a separate accounting, not an actual physical separation of such amounts. The amounts must be preserved for up to an 18-month period, ensuring that they remain intact pending qualification. The 18-month period begins on the first date a payment would be required to be made under an order following its receipt by the plan. During this period, the administrator may not make any distribution of the funds that might become payable to the alternate payee if the order were to be qualified. Once a DRO is qualified, distributions may be made, if appropriate, before the full 18-month segregation period has elapsed. If the DRO is qualified before the time benefits are due to be paid to the alternate payee, the administrator must continue to protect the alternate payee's interest in their assigned benefits. If, after the 18-month segregation period has elapsed, a DRO is not qualified, the plan can pay benefits to those entitled as if there was no order. If an order is later determined to be qualified, the QDRO will only apply prospectively.

Once a DRO has been qualified (or fails to be qualified), both the participant and alternate payee should be notified promptly of the decision. The notice should be written in such a way to be understood by all parties. If the DRO failed to be qualified, the notice should list the reasons for failure with corroboration, any time limits that might apply, and the modifications needed for it to qualify and why they are needed.

In the case of a defined contribution (DC) plan (e.g., a 401(k) plan), reasonable fees in connection with a QDRO determination may be charged to the participant's and/or alternate payee's plan account.[2] However, a DB pension plan cannot charge a fee to a participant or alternate payee for the determination of a QDRO.

Separate Interest and Shared Interest QDROs

Federal law does not require any particular way to segregate benefits and leaves the decision up to the drafters of QDROs. However, it is important for the drafter to understand the type of plan and the terms of the plan to which the order will apply. Retirement plans typically fall into two categories: DC plans and DB plans. DC plans include individual accounts for each plan participant or beneficiary. In contrast, DB plans guarantee a specific formula-based benefit amount at retirement, which is often determined based on the employee's years of service and/or salary and may also include subsidies for early retirement or cost-of-living adjustments (COLAs) after retirement. DB plans are designed to provide monthly benefit payments; lump-sum payments may or may not be offered under a DB plan. Reading the SPD and other plan documents to get a basic understanding of the plan will assist in drafting an order that will not fail to be qualified.

One approach to dividing benefits in a plan is simply assigning the alternate payee a portion of each payment to which the participant is entitled. This is called the *shared payment* approach, sometimes referred to as a *stream of payment* approach. It is much more common for this approach to be used for DB plans than for DC plans. Under the shared payment approach, the alternate payee receives payment only when the participant receives a payment or is in pay status and the shared payment would end upon the participant's death or other identified event. The order must specify when the payment begins and ends. Note: The beginning date under a DRO cannot be earlier than the date the plan receives the order.

Alternatively, if a participant is not in pay status, plans can use a *separate interest* approach. This approach divides the participant's benefit into two distinct portions, giving the alternate payee a separate right to their assigned portion of the benefit as well as the timing and form of payment. The alternate payee cannot, however, receive payment earlier than the date on which the participant would reach their earliest retirement age, unless permitted under the terms of the plan. If the alternate payee commences payment of their assigned benefits prior to the participant, the alternate payee normally will not receive any portion of any early retirement subsidy prior to the date the participant actually retires. Depending on the QDRO, if the participant later retires with a subsidy, the alternate payee's benefit can be recalculated to share in the subsidy.

A separate interest DRO for a DC plan should also consider and address the treatment of any participant loans, whether the assigned amount will be adjusted for account earnings from the date of assignment to the date of payment, and how the underlying subaccounts and investments will be allocated among the participant and the alternate payee's assigned portion of the overall account. Note: The administrator may include default provisions for these items in the plan's QDRO procedures to establish a plan default for how such items will be addressed in the event the DRO is silent. When drafting a DRO for a DB plan, both approaches should also address whether the intent is for the alternate payee to share in any subsidies (e.g., early retirement), benefit increases (e.g., COLA) and survivorship benefits upon death.

For tax purposes, a spouse or former spouse receiving payment under a QDRO is treated in the same manner as if they were the participant in the plan. However, the payment paid to a child or other dependent is taxed to the participant. A spouse or former spouse can also defer tax on any distribution that is eligible for rollover (such as a lump-sum payment) by electing to roll over any such payment into an eligible retirement plan, such as an IRA or their own employer's retirement plan in which the alternate payee is a participant.

Additional Considerations When Qualifying a DRO

Below are some areas that an administrator should consider when qualifying a DRO.

Court Approval

Is the document a final executed order or simply a draft? To determine whether it is a final executed order, administrators should check for court entries, a filing stamp, official certification and approval. The DRO must be approved, issued and signed by a state authority or judge in a court of jurisdiction as part of a dissolution of marriage or recognition of support obligations. An order is not a DRO unless it is a final, executed court order, judgment or decree. And the nonparticipant party with respect to an order does not have the status of an alternate payee until the order is a DRO.

Note: A DRO is not required to be issued as a separate order. It may be part of a divorce decree or property settlement agreement that is entered into the court with a filing stamp and approval so long as the provisions in the document satisfy the QDRO requirements.

Preserving the Alternate Payee's Portion of Benefits

An administrator must act as if a DRO is qualified once it is received and must separately account for benefits that could be payable to an alternate payee. This means that if the participant is not in pay status, the administrator should freeze the participant's account and no distribution should be made until either the DRO is qualified or the 18-month segregation period has ended. If the participant is in pay status, the amount that would be attributed to the alternate payee if the DRO is qualified should be removed from the participant's stream of payments and set aside.

AUTHOR

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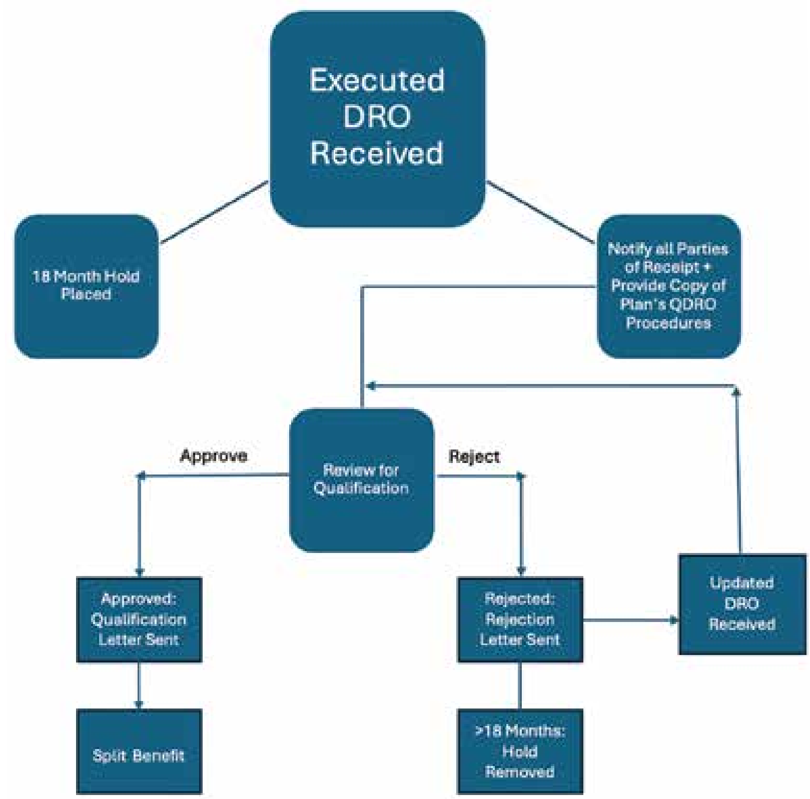
FIGURE

Domestic Relations Order (DRO) Qualification Process



Source: Created by author.

Provisions That Cannot Be Administered or Conflict With Plan Terms

The administrator should consider the benefit calculation and plan provisions when reviewing a DRO. The DRO may list a split method or a benefit to be assigned, but it may not be appropriate for the plan type or the calculation used, or it may relate to a period for which there is a lack of available records. An example of the former would be if a DB plan separate interest DRO lists a lump-sum dollar amount to be assigned to the alternate payee and the plan is a formulaic traditional DB plan with no lump-sum option. An example of the latter would be if a DC plan DRO references a date in the formula for the account split that is years in the past (such as the date of marriage) to exclude the premarital balance, but back statements are unavailable due to the plan undergoing various recordkeeper changes over the intervening years.

The administrator should follow the plan's written procedures when faced with such situations. They typically lead to the administrator rejecting the DRO and sending a letter to the parties explaining the reasons for rejection, what language would be acceptable, and the process and time frame for the parties to submit either (1) an amended DRO or (2) a clarifying letter agreed to and signed by both parties.

Communication With Alternate Payee

Once the DRO has been qualified, the alternate payee should be treated as a plan beneficiary, having the same rights under ERISA. Alternate payees should receive SPDs, annual funding notices, and all plan communications and notices—similar to any other plan participant or beneficiary. Addresses should be maintained and updated as needed.

Plan Participant's Status and History

An administrator should consider whether the DRO is reasonable given the participant's plan status and history. For example, administrators should consider whether the participant was a plan member for the time period covered by the split. Other questions include the following.

- Was the participant a member in the plan at that time?
- Was the participant earning service during the entire period?
- Was there a leave or a partial year of service that may skew the split one way or another?

For example, if a QDRO specifies that the split is based on a certain number of calendar months out of the participant's total service, the benefit split may not reflect the intended outcome if the participant was on leave or not a member of the plan during those months. A more accurate approach would be to base the split on the credited service earned during a specific time period relative to the total credited service. This method better captures the true intent behind the division of benefits.

Plan Termination and QDROs

QDROs need to be considered if the plan is terminated. The terms of the QDRO should be treated as if they were part of the plan, and the alternate payee, having the same rights as a beneficiary under ERISA, should receive all notices related to plan termination.

Plan administrators should provide all QDRO documents to the selected annuity provider with a record of current participant status and any provisions that need to be monitored. An example would be if an alternate payee under a separate interest QDRO went into pay status before the participant and did not receive an early retirement subsidy when their payments commenced. However, if the QDRO stipulates that if the participant later goes into pay status with a subsidy, the alternate payee's benefit should be recalculated to include the subsidy.

Conclusion

When a retirement plan participant goes through a change of marital status, such as a divorce, the plan administrator must proceed carefully if the plan receives a DRO. Handling and managing these legal orders can be complex and challenging to explain to all parties involved. It's important for administrators to thoroughly understand the process, have well-documented procedures and be clear about their responsibilities. BQ

Endnotes

1. Advisory Opinion 90-46A, U.S. Department of Labor (DOL).
2. Doyle, R. (May 19, 2003). Field Assistance Bulletin 2003-3. U.S. Department of Labor, Employee Benefits Security Administration. Retrieved February 17, 2025, from www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2003-03.

References

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