



BENEFITS PERSPECTIVES

Current Issues in Employee Benefits

Are QDROs Driving You Quazy?

David Benbow, QPA, QKA

Divorcing couples are increasingly going after each other's pensions. Whether the intent is for the "alternate payee" (the ex-spouse of the defined benefit plan-covered worker) to obtain a fair share of the participant's assets or to exact revenge, the plan administrator is caught in the crossfire. Dealing with everything from the lengthy and highly technical legal process to having alternate payees who want to tell you all the gory details of their divorces, the plan administrator must often walk the line between pension analyst and psychoanalyst.

Domestic relations orders (DROs) are the court orders used to assign a portion of a plan participant's pension to a current or former spouse (or a child) as the alternate payee. Upon receiving a DRO, the plan administrator must "qualify" it by determining that it is consistent with both legal and plan rules, making it a "qualified domestic relations order" (QDRO).

This article provides an overview of the QDRO process for a defined benefit plan and discusses ways to simplify and facilitate administration and reduce the frustration for all parties involved.

There must be a better way

Have you ever:

- Received a DRO with language so vague that it couldn't be calculated?
- Dealt with attorneys who had little or no experience writing DROs?
- Seen a DRO that actually paid the alternate payee a shrinking share of the benefit?

- Read a DRO awarding the alternate payee more than 100% of the total benefit?

Many plan sponsors have reduced these headaches by creating model language, with their legal counsel, to help simplify the process for determining whether an order contains the appropriate information to render it a QDRO. While there is no requirement that QDROs adhere to the models, many attorneys will follow the language because doing so will make their jobs easier. Furthermore, using a model could lead to shorter periods for review and qualification by eliminating the need for multiple drafting of revisions.

What should the model look like?

Simply stated, the model should look like the kinds of DROs you have received and like best, taking into account specific plan design, rights, and payout options. As a starting point, the Department of Labor and the IRS have jointly released sample language for inclusion in a QDRO. All QDROs, for example, must include:

- The name and last known mailing address of the participant and each alternate payee
- The name of each plan to which the order applies
- The dollar amount or percentage (or the method of determining the amount or percentage) of the benefit to be paid to the alternate payee
- The number of payments or time period to which the order applies

Depending on the plan design and features, more specific considerations must be given to particular issues:

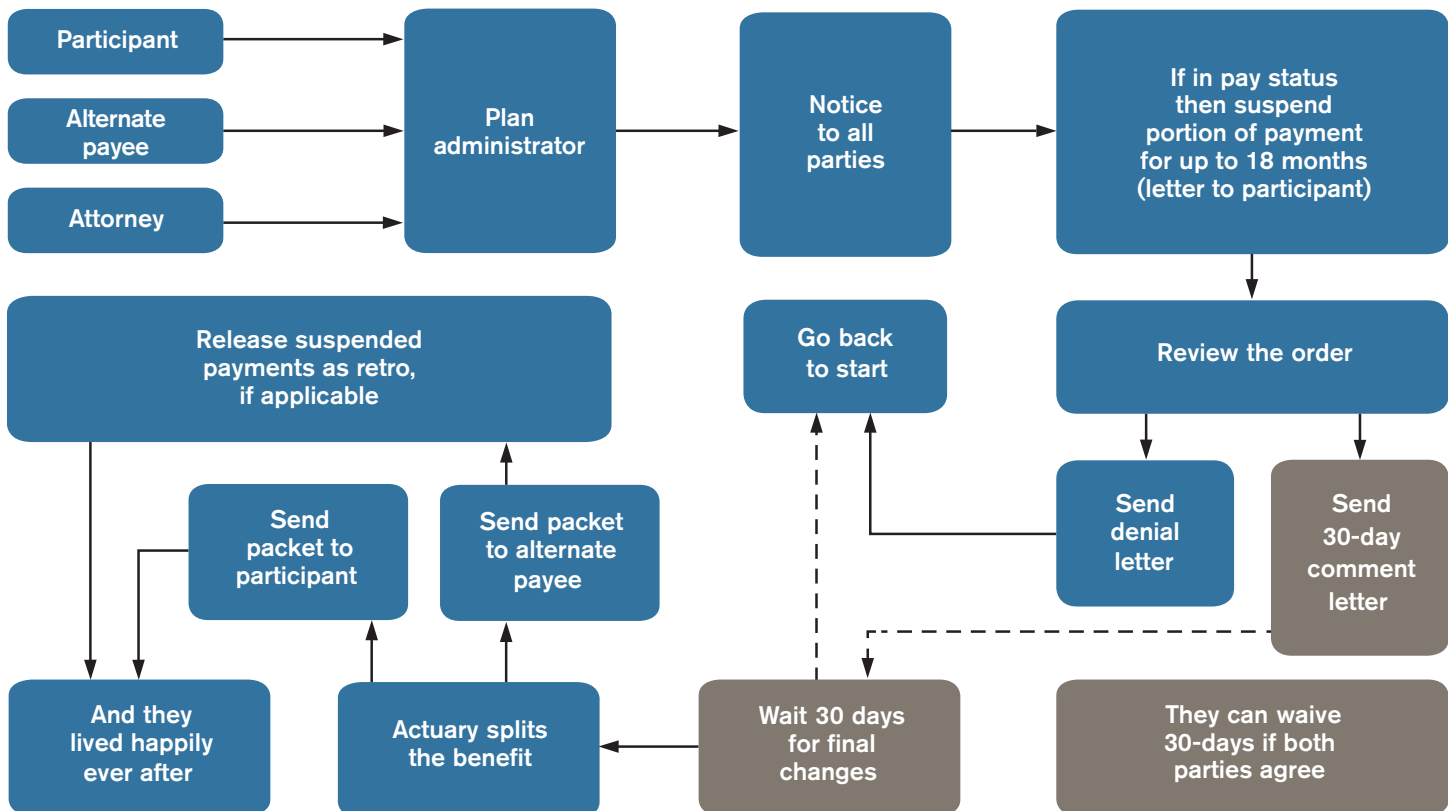
- Should the alternate payee share in the plan's early retirement supplements, subsidies, or cost-of-living adjustments (COLAs)?
- Should the alternate payee be entitled to survivor benefits if the participant dies first?
- Should the alternate payee's share be based on the participant's benefit at the date of divorce or on the participant's benefit at termination, prorated by a "marital fraction?"

The QDRO process

A DRO may originate from participants, alternate payees, or one of their attorneys. Upon receipt, the plan administrator (or third-party administrator) must notify all relevant parties that the DRO has been received, provide them an overview of the process, and let them know whom they can contact for more information.

Communication is a key part of the process. By its very nature, the QDRO process involves waiting periods, processing time, and research. This provides many opportunities for the affected individuals to become impatient and contact you for frequent updates. In addition to the written QDRO procedures that plan sponsors are required to provide, an overview of the entire process will help everyone be prepared for the long haul. The following chart illustrates the steps that may be involved in processing a typical QDRO.

FIGURE 1: THE QDRO PROCESS



Some plan sponsors omit the three steps noted in the gray boxes.

Many plan sponsors require that an order be reviewed by the plan's attorney as part of the process to qualify the DRO. As the plan administrator, you should work closely with the attorney to ensure that if the DRO is qualified, the benefit can be calculated and split according to its terms.

- If the order is denied—A denial letter must be sent to the order's originator indicating the problems found. The letter also should indicate possible ways of correcting them, as well as the plan's claims and appeals procedure. Because this will mean additional processing delays, copying other relevant parties on the denial letter will be a good way to keep everyone informed.
- If the order is qualified—Many plan sponsors apply a 30-day appeal period, during which any party can change his or her mind or suggest revisions. This rarely happens, so the participant and the alternate payee may agree to waive the 30-day period.

To streamline the process and to ensure that all the right steps are taken, plan administrators may want to create a QDRO checklist. This would include the criteria for qualifying the DRO, suspension of payments (if applicable), the various letters that are sent out and the dates they were mailed, transmission of documents to the actuary, and mailing of election forms to the various parties.

Special QDRO considerations

While creating a model QDRO, checklists, and appropriate processes will ease administration, special attention should be paid to less-thought-about issues that often come up. These include the division of a pension with early retirement subsidies, pensions already being paid to a participant, and pensions upon the death of a participant or an alternate payee.

Splitting the benefit

Typically, the plan's actuary splits the total benefit into the participant's and alternate payee's portions, because the calculation involves present values and age adjustments. Depending on the complexity of the calculations and availability of the actuary, this could be another delay in the overall process.

Many orders are vague or silent about early retirement supplements, subsidies, and COLAs. Technically, one may argue that if these are not mentioned in the DRO, they have not been awarded to the

alternate payee. However, many plan sponsors take the approach that a subsidy always is awarded with the alternate payee's share of the benefit, mainly because doing so simplifies the benefit calculation. Your model QDROs should be specific about how these components are treated.

Once the payment amount has been determined, you should send notices or election information and forms to the participant and the alternate payee. The election and payment process then should be much the same as for any participant.

Retired participants

You may want to have a separate model QDRO for participants who are already receiving pension payments. This type of QDRO is called a "shared payment QDRO" because the only way to divide retirement benefits that have already commenced is for the parties to share the payment the participant is receiving. For example, if the pension was being paid in the form of a life annuity, the alternate payee's benefit share should stop when the participant dies. If the alternate payee dies first, that share of the benefit would usually revert to the participant, unless the QDRO names a contingent alternate payee.

Depending on how the DRO is worded—particularly with regard to the timing of payouts, such as immediate or as of a determination date—all or a portion of the participant's payment may have to be put on hold (to a maximum of 18 months) and separately accounted for while the DRO is being qualified and appropriate payments are calculated. These held payments would then be paid retroactively to the alternate payee once the alternate payee's payments are started.

Till death do us part

Most QDROs describe what will happen to each portion of the benefit if either the participant or the alternate payee dies. This is another important feature to include in a model QDRO. Also, keep in mind that, upon the death of either party, you may have to adjust the benefit of the survivor (e.g., returning the alternate payee's share to the participant upon the alternate payee's death, or adjusting the alternate payee's payment for a joint-and-survivor annuity upon the participant's death). This can be difficult unless the participant and alternate payee are still linked somehow either in a system or with notes and documentation. If one of the parties dies, the plan administrator must have some way of knowing who the other party is and whether their benefit needs to be adjusted.

Post-death QDROs

Typically, once the participant dies, alternate payees no longer have an opportunity to pursue a QDRO. However, the Pension Protection Act allows the QDRO process to continue if it had already started prior to the participant's death. Some plan sponsors apply a liberal interpretation of this, allowing a DRO to be qualified if any documentation, such as a divorce decree specifying that a portion of the pension benefit was awarded to the former spouse, existed prior to the participant's death. Adopting this type of policy could leave the door open for many former spouses of participants to request benefits from the plan, so caution is advised.

No more quaziness

Let's face it. The QDRO process is likely to be unpleasant for everyone involved. The participant does not want to give up a share of the pension benefit. The alternate payee is upset about the delays in starting payments. The plan administrator is caught in the middle. To help ease the QDRO headaches:

- Have model QDRO language to make everyone's life easier—especially for you as the plan administrator. A model will allow QDROs to be processed more quickly and consistently.

- Be aware of required waiting periods and typical processing times, and keep all parties informed or they will contact you for frequent updates.
- Make sure the actuary also is aware of the deadlines so that workloads can be adjusted to ensure timely calculations.
- Consider using a checklist to ensure that necessary steps for processing a DRO are followed.



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