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Proskauer Benefits Brief: QDROs in 10 Easy Steps

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In this episode of the Proskauer Benefits Brief, Paul Hamburger, co-chair of Proskauer's Employee Benefits & Executive Compensation Group, and partner Robert Projansky discuss ten basic steps for how to manage qualified domestic relations orders (QDROs). A QDRO is a judgment, decree or order for a retirement plan to pay child support, alimony or marital property rights to a spouse, former spouse, child or other dependent of a participant. Many of our clients and plan administrators spend a significant amount of time on QDROs. Tune in and listen to how we make it easier for them to handle QDRO issues and administration.

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Robert Projansky: Hello. Welcome to the Proskauer Benefits Brief, hot topics on employee benefits law. I'm Robert Projansky and on today's episode, I'm joined by Paul Hamburger. Today we are going to discuss QDROs in ten easy steps. Paul, thanks for joining us. Paul many of our clients and plan administrators spend a significant amount of time on QDROs. My understanding is that you are going to give us some steps to make it a little bit easier for them to handle those things.

Paul Hamburger: Right. I think plan administrators tend to find QDROs to be a lot more complicated than at the end of the day they really end up being. So, what we want to do is run through some of the ten basic steps for how to manage qualified domestic orders also known as QDROs. In the world of qualified domestic orders there are only two kinds: either qualified or not qualified.

Robert Projansky: Qualified and not qualified, can you walk us through where you're headed with that?

Paul Hamburger: Basically, what I've seen is that often plan administrators will say that a certain provision of the QDRO is okay, but this other provision is not okay. Basically, that's a bad approach because what ends up happening is, you end up with an approved order and a bad provision. The other aspect is that often divorce attorneys will submit an order with boiler point language. Simply because it has boiler point language which says it's qualified doesn't make it so.

Robert Projansky: So, does that mean we shouldn't tell people what's wrong with their QDROs when we respond back to them?

Paul Hamburger: We should absolutely tell them what's wrong. There is a school of thought that says we shouldn't try to prefer one party over the other, but that's different than actually telling people what is wrong with their orders and how to repair them.

Robert Projansky: So, you would typically say this is what's wrong and here is how you can fix it.

Paul Hamburger: Correct.

Robert Projansky: Okay, so there are two types of orders: stream of payment and separate interest. How do we understand the difference between the two?

Paul Hamburger: It's helpful as an analytical tool to understand that there are only two types of qualified orders. The reason is, if I know it's a stream of payments certain things flow from it or perhaps my facts are such that the only type of order that is permissible is a stream of payment. Separate interest is another type of order and that dictates a certain outcome. So, what's the difference? The separate interest order is an order that says what's yours is yours and mine is mine. I'm going to split up this benefit through some marital fraction or some other kind of percentage bases. A stream of payments orders the hallmark language is if as and when something is payable to the participant. Pay a portion of it to the alternate payee. A great analogy to think about is: a separate interest is like splitting up a six pack of beer, where you take three bottles and I take three bottles and yours are yours and mine is mine. Whereas a stream of payment is a keg where there is one spigot and were just going to add another spigot and when you drink, I get to drink, etc., etc. so it's just and analytical way of looking at these orders.

Robert Projansky: You took me back to college Paul. That's sort of the crux of it. Now let's go into the more practical, items three through ten really. Okay, what do I need to ask myself as an administrator? So, the first is, which plan must pay? Tell us what you mean by that.

Paul Hamburger: Often plan administrators assume that they know which plan is supposed to pay. So, if you are a plan administrator and there are multiple plans within a controlled group. There might be a retirement plan, a 401k plan, might be a couple of retirement plans and an order comes in and it says pay under the "Exco" retirement plan. "Exco" being the name of a company. The plan administrator will often just assume which plan that means and that's a big mistake because you don't want the wrong plan paid. You want to make sure that the order is directed to the proper plan.

Robert Projansky: What if they get one word in the name wrong? Does that mean we reject the QDRO? Do we accept it, how do we deal with that?

Paul Hamburger: Normally we can accept it if it's clear from the words in the order which plan we are talking about, so it's sort of a rule of reason.

Robert Projansky: So, to whom it must pay. What kind of complications do you get in that sort of analysis?

Paul Hamburger: The basic easy answer here is that if an order is paying a former spouse, it's easy, we know who to pay. It has to identify the name of the former spouse. Same thing with children. Sometimes an order will come in and it will want to pay child support for specific children. Where it is a little tricky is sometimes an order will want to pay a third party, child support services or some other entity on behalf of children or perhaps even former spouses. That's where it gets a little trickier and you've got to be careful to make sure that you know who those entities are and whether they really are acting for the interest of the designated individual.

Robert Projansky: Can you ever write a check to the child support agency, does it have to be, let's say I get this sometimes, to the lawyer? Can you write a check to them or does it have to be a check to the actual alternate payee?

Paul Hamburger: It really has to be paid to the alternate payee and it is not enough to just say to the lawyer as an example, here's a check make sure you give the alternate payee his or her share of that after you have taken your fee out of that check. Which is typically why it going that way. No, you don't want to do that.

Robert Projansky: Okay Paul so one of the areas I find most difficult when I'm looking at QDROs is the how much to pay. How can you make that step easy for us?

Paul Hamburger: Often some of the challenges in determining how much to pay arise in defined contribution plans and the reason is the parties will want to take an account balance as of several years ago and then bring it forward with the actual earnings and losses from the date, perhaps the date of divorce which may of occurred a few years early, forward to today when the order is being entered and it can get very complicated particularly when plans simply don't have the records to go back and recalculate how much was attributable to which party. The easier thing to do particularly in the defined contribution plan is simply say how much money do you want? What percentage of the current account balance do you want? And let the parties determine how much is an appropriate martial share, as they go ahead and divide up the parties' assets.

In a defined benefit plan the most complicated features of determining how much to pay involves the martial fraction and often what happens is your taking a percentage of a certain benefit. The benefit then being determined based on the period of the marriage as compared to the period of employment and that can be one that is a very tricky analysis to pay. Generally, plan administrators should push that back to the parties to make sure that it is clear and that the plan administrator will be able to determine how much to pay without any argument later on down the road.

Robert Projansky: So now we've got the amount. Let's talk about when payments start. Paul we always hear questions about can I pay before earliest retirement age in the plan. And then the question is, what is our earliest retirement pay? Then the question is, what is the earliest retirement age? And what can we pay before then and when? Can you walk us through how we deal with that?

Paul Hamburger: One of the more confusing definitional terms in the area of QDROs deals with earliest retirement age and the reason is it's the early of two dates one of which is the later of two other dates. So, it becomes very complicated to figure this out. What we like to do particularly in defined contribution plans and even in defined benefit plans is have the plan written in a way that says for alternate payees we will pay even before earliest retirement age. If the plan says it, you can do it. The advantage to that is, you can begin payments immediately. Ideally you could even pay lump sums even in defined benefit plans where the plan doesn't otherwise have a lump sum feature you could add one just for alternate payees in order to pay the benefit have it be paid under the order and then move on and not have that order hanging out there forever.

Robert Projansky: So, we've got three more steps: when payments stop, what happens when people die, the participant or the alternate payee. Often you see a lot of language in QDROs on these issues. I'm guessing you have a way to make that much simpler than it actually looks.

Paul Hamburger: Generally, it is a lot simpler than people make it out to be. Often it's overlooked particularly the question rises what happens when the alternate payee dies. Does the money go back to the participant or does the money go to a beneficiary of the alternate payee and that can be very confusing? What the one thing that probably ends up being the most confusing is that in a separate interest environment where I've said here how much goes to the participant, here how much goes to the alternate payee. They will then name the alternate payee as a surviving spouse. The reason they do that is that they are worried that the participant predeceases the alternate payee. That the alternate payee's interest will disappear, will go up in smoke. And all you really need to do is say that the alternate payee can continue to receive the alternate payees' interest even in the event of the death of the participant.

If you name the alternate payee as a surviving spouse that will have implications down the road if the participant wants to elect any form of benefit for the benefit of the participant and some other beneficiary such as a subsequent spouse. That can tend to be very problematic. It's much easier to simply ask the question. What will happen when the participant dies? What will happen when the alternate payee dies? And explain what it is that you would like to happen and then let the plan administrator tell you whether that situation is permissible or not under the terms of the plan.

Robert Projansky: Alright so let's talk a little bit about procedures. You mentioned that plans need to establish procedures. Can you tell us what you have in mind in that regard?

Paul Hamburger: Sure. I think the statute contemplates that there will be QDRO procedures that will be made to participants and beneficiaries and those QDRO procedures can become very, very important. What the processes are, what steps are going to be followed and what items need to be covered in the QDRO are things like hold periods so that if I receive a prospective order that has not been entered by a court or a receive a letter from the parties saying we are seeking an order. I want to have an established procedure in my plan that says we will hold the participants benefit for a certain period of time, typically I'll see anywhere from 60-90 days. During which I will not let the participant have access to the participants' funds so that I don't end up with an order ordering me to pay those funds to an alternate payee. This can tend to put a little bit more focus or pressure on the parties to resolve the issue and come up with the order.

Robert Projansky: Is there an advantage to doing that besides just the idea that we will put some pressure on the two parties. Is there an advantage to the plan administrator for having something like that?

Paul Hamburger: Yeah, the big advantage is to avoid double payment, because orders can actually come in retroactively to particular dates and there are circumstances where you could end up having an order that literally orders you to pay out money that you had let the participant have access to and once the parties have put on notice that can be a risky proposition. The last point on procedures are to deal with allocation of funds.

For example, plans might have after tax money and if you have an order that simply says divide the account. How are you supposed to divide up the share of after tax money? How are you supposed to liquidate investments or allocate investments when orders come in and they simply say split the account. If you have a procedure, then the parties can be on notice that unless that order says otherwise we are going to allocate the after-tax money on a prorated basis or we are going to liquidate the investments on a prorated basis. So, procedures can actually help you manage that process.

Robert Projansky: Well thank you Paul, for making a little bit of a difficult issue a little bit easier today. Thank you joining us on the Proskauer Benefits Brief today. Stay tuned for more insights to the latest hot topics in employee benefits law and be sure to follow us on our iTunes.

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