

Market Volatility, Retirement Savings and Divorce: Avoiding the Pitfalls in Present and Post-COVID-19 Times

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Virtually every state in the union has, upon divorce, some form of retirement asset division based upon coverture.^[i] The traditional method divides the retirement asset at its value upon the date of the commencement of the divorce action.

Distribution of a portion of the asset to the non-employee spouse,^[ii] while maintaining the inherent tax benefits of the resource (i.e., such as a 401(k) Plan, defined contribution plans and profit-sharing plans)^[iii], requires the implementation of a Court Order known as a Qualified Domestic Relations Order or QDRO.^[1]

Drafting the QDRO to comport with the determined division to the non-employee spouse was rather uncomplicated when the financial markets were stable. But today is a new day, and one must ask what should be done in today's market to both protect the asset's value, while simultaneously not giving away too much?

Let's start with an example:

In November 2019 Spouse A agreed to give Spouse B \$500,000 when the profit-sharing plan in issue was valued at \$1 million. The QDRO is drafted just so.

By the time the QDRO is signed this month by the Court, there has been a downturn in the market and the value of the account has dropped to \$750,000.

Under the explicit terms of the QDRO Spouse A will still have to pay Spouse B \$500,000 even if the account is now worth only \$750,000.

Spouse B is now very happy. Spouse A is fit to be tied!

What to do? Avoid Flat Dollar Amounts; Specifically Address Earnings and Losses

Flat dollar amounts payable to non-employee spouses create agonizing results when account values shift into retrograde. This is because no provision has been made to adjust the spouse's amount to account for earnings or losses.

That is not to say that the employee owner should not always agree to a flat dollar amount. If he or she is a gambling type – then such audacity may be a successful strategy. If you negotiate a flat dollar amount, you need to understand this risk. The employee-spouse should only agree to this if he/she is willing to take the risk. And only then, if there are sufficient funds to handle an award even if the account value drops significantly.

The better way -- is to fix a percentage of the fund in issue to be distributed, and then add a provision along the lines of "including investment earnings and/or losses on that amount [the percentage amount] from [that date] until the date the funds are completely distributed to the [wife/husband]." Or, consider using the date of issuance of the judgment of divorce as the date to update all retirement account values attributable to post-commencement market forces. Even if the account is not actually divided for several years, each spouse will still get exactly what he or she would have received if the account had been divided on the agreed-upon date of division.

It is also good practice (though rarely undertaken), with any retirement account to insist that the employee spouse transfer the funds into a stable value fund (if such is available), while the divorce and QDRO are pending. If this option is available, this is the best way to preserve the amount of the account, at least until the QDRO has been executed.

Make Sure the QDRO is Prepared Promptly

Each financial company, bank, brokerage house, retirement plan etc., has its own particular QDRO, or at least language that must be present in a QDRO. There is no reason to delay in investigating the form needed or the language necessary to undertake the transfer once the case is settled. In short, the QDRO should be researched long before the settlement agreement is inked. There is nothing stopping the attorney from doing so. In fact, this writer makes it a necessary part of the work undertaken as the case is being prepared for trial or settlement.

Once the case resolves and the QDRO is prepared, it is then necessary to obtain the approval of the retirement plan's administrator, so as to ensure that they will accept the form of QDRO and act upon it once it becomes a Court order.

When the work is done in a timely manner, a QDRO can be filed at the same time as the settlement agreement. If that is not possible, it must be filed as soon as possible after the divorce is finalized because with further delay the non-employee spouse is putting themselves at risk to lose his/her benefits in a number of situations:

- The employee-spouse retires and starts drawing benefits without notifying their former spouse.
- The employee-spouse dies without a QDRO in place that locks in survivor benefits for the non-employee spouse.
- The employee-spouse takes a loan out that significantly reduces the account balance available for division pursuant to a QDRO.

Conclusion

Preparedness and diligent practice are the keys to success in ensuring a QDRO is properly written and ready to go. As we lived through a difficult time, and Courts were closed for all but emergency filings, it was more important than ever to get the QDRO process started for settled cases. Despite COVID-19, legal/QDRO teams for plan administrators moved quickly in their pre-approvals. Although we were not able to file the QDRO, best practices dictated having it ready for filing once the Courts opened, so that you did not end up at the bottom of the pile once normalcy returned.

[1] Division of an IRA or a Roth IRA upon divorce does not require the use of a QDRO.[ii] Historically defined as the condition or state of a married woman, considered to be under her husband's protection. Used in modern parlance to mean the marital portion of an asset.[iii] Referred to in the law as the "alternate payee."

[iii] Division of an IRA or a Roth IRA upon divorce does not require the use of a QDRO.