

Discussion of QDRO Treatment for Early Retirement Subsidy in ERISA Plans in Light of In re Marriage of Gillmore¹

The defined benefit QDRO or a supplemental order should protect an alternate payee's right to claim an early retirement subsidy under the plan, in light of the nonemployee spouse's right to obtain a full community share of private pension plans as conferred by *In re Marriage of Gillmore* (1981) 29 Cal.3d 418, 174 Cal.Rptr. 493, 629 P.2d 1 (hereinafter "*Gillmore*") and Family Code Section 2610.

Election by alternate payee to receive benefits at participant's earliest retirement age frequently produces the maximum actuarial present value for the Alternate Payee's community interest. This phenomenon is created by what is commonly referred to as a plan's *early retirement subsidy*, an integral feature of many retirement plans.

A plan's subsidy for early retirement benefits is offset by payroll savings for the employer when workers leave. Conversely, when workers stay on the payroll and give up the subsidy, such workers reap the benefits of the higher salaries paid at the end of the career.

Under the Retirement Equity Act of 1984 (REA), the total value of payments under a QDRO cannot exceed the actuarial value of the total accrued benefits payable at normal retirement age (typically age 65). [IRC §414(p)(4)(A)(ii); 29 USC §1056 [Act §206] (d)(3)(E)(i)(II)] An adjustment to that total available value can take place if the participant later retires with early retirement benefits but because of the way the feature works, the adjustment will decline to nothing at normal retirement age--typically age 65.

The *Gillmore* case holds that, if an employee ". . . does not wish to retire, [the employee] . . . must pay . . . [the non-employee spouse] an amount equivalent to the non-employee spouse's interest. *Id.* at page 427. In order to provide Alternate Payee with an interest from the plan equivalent to what Alternate Payee would have received had Participant retired (i.e., full-*Gillmore* share), the domestic relations order must state "the manner in which such amount or percentage is to be determined,"[IRC §414(p)(2)(B); 29 USC §1056 [Act §206] (d)(3)(C)(ii)] to reach the result which would occur if Participant actually retired.

Let's say the community has two accounts each with \$10,000 through P's credit union. Account A is unavailable for distribution and earning no interest and will continue to be unavailable and not to earn interest *until P terminates employment*; Account B is available for withdrawal and earning market interest. P argues that he should not be stuck with Account A, as its value is diminishing; thus he calls for equal division of both accounts. When viewed in terms of *Gillmore*, the solution is easy. P should get the frozen, interest-free Account A because its release is in his own hands. The loss of

¹ Note by Barbara A. DiFranza, Reno, Nevada. (775) 852-2414; fax (408) 904-5215. This distills a longer article written for the *Family Law News* by Donald W. Parkyn and Barbara A. DiFranza in 1992. Permission is given to reprint part or all of this article, provided that the author is given full credit for same.

interest can be looked at as P's payment to continue receiving compensation that will no longer be shared with the nonemployee spouse. P's spouse should get Account B since it provides the *Gillmore* interest.

Many plans refuse to make any concessions to the alternate payee's Gillmore rights based on the following:

When payments are made to an alternate payee before the Participant retires, the payments are computed by taking into account only benefits actually accrued and not taking into account any employer subsidy for early retirement. The amount to be paid the Alternate Payee is to be calculated by using the Participant's normal retirement benefit accrued as of the date payout begins and by actuarially reducing such benefit based on the interest rate specified in the plan or 5 percent, if the plan does not specify an interest rate. A plan providing only normal and subsidized early retirement benefits would not specify a rate for determining actuarially equivalent, unsubsidized benefits. [98th Congress Report, 2d Session, Senate 98-575 (Dole, Committee on Finance)].

If the above is read out of context, the Plan's reaction to a full-*Gillmore* clause is understandable. On the other hand, there is nothing in this clause which prevents a plan from being held to a QDRO which says "Pay X to Alternate Payee at Participant's age Y." And, when one looks at the evidence of a Congressional policy of non-interference in domestic courts' disposition of pensions, the paragraph will be properly understood: The Alternate Payee's share cannot exceed the total of the unsubsidized benefits.

ERISA and REA were not intended to control substantive aspects of community property law. State domestic relations laws are not to be preempted unless Congress has "positively required by direct enactment" that state law be preempted. *Hisquiero v. Hisquiero*, 439 U.S. 572, 581, 99 S.Ct. 802, 808, 59 L.Ed.2d 1 (1979). Under this standard the state law must not only conflict with the federal law, it must do "'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden. *Id.* The legislative history of the REA indicates, in general, that the bill creates an exception to 29 U.S.C. 1144(a), ERISA's preemption provision, with respect to certain domestic relations orders called Qualified Domestic Relations Orders. [Footnote Omitted] 1984 U.S. Code Cong. & Admin. News, 1426, 2565.

The liberality with which a state court may define an Alternate Payee's interest is to be regarded by Congress is indicated in REA's definition of the Alternate Payee:

. . . any spouse, former spouse, child or other dependent of a participant who is recognized by a domestic relations order as having a right to receive **all**, or a portion of, the benefits payable under a plan with respect to such participant. [IRC §414(p)(8).] [*Emphasis supplied.*]

The willingness of Congress to allow a state to provide an Alternate Payee with all of the benefits of the Participant should clarify Congress's intent to leave the pension of married persons undergoing divorce totally under the auspices of the state domestic relations court.

The following table illustrates the application of the Gillmore QDRO:

Why the Early Retirement Subsidy is Important

	Item	Correct Analysis	Wrong Analysis
[1]	Benefit at 65	\$2000	\$2000
[2.1]	Plan document shows this to be the early retirement factor age 65 down to 55 (Gillmore factor--same as if he retired)	.8	
[2.2]	Plan actuary says that this is the actuarial equiv. factor age 65 down to 55 (Max. Payment Factor: REA) "Accrued Benefit" is a term frequently used.		.4
[3.1]	Benefit at age 55 if P retired.	\$1600	
[3.2]	Actuarial equivalent from age 65 down to 55	n/a	\$800
[4]	Time rule factor - Half Service is Community	.5	.5
[5]	Community interest (Assume half by time rule)	\$800	\$400
[6]	Her share	\$400	\$200
[7]	Maximum now payable (same as 3.2)	\$800	\$800
[8]	Lessor of [6] or [7]	\$400	\$200
[9]	Conversion for payments over a younger life, for example x .9	\$360	\$180

When a demand is made under *Gillmore* the following steps are required to determine

the benefit payable to A/P:

1. It is necessary to determine the benefit that would be payable if the member were to retire on the *Gillmore* demand date. This determination is made in item [1], [2.1] and results in item [3.1].
2. The next step is to apportion this benefit between separate and community property interests. This is done using the "time rule" factor shown as item [4] with the results being shown as item [5].
3. The next step is to divide the community interest. The interest of A/P is shown as item [6].
4. However, under QDRO rules the plan cannot pay an alternate payee more than the actuarial equivalent of the total benefit payable at age 65. The actuarial equivalence factor in this case is 0.4 (item [2.2]). When the total age 65 benefit is multiplied by this factor the maximum amount payable by the plan to the alternate payee is determined. This maximum liability amount is shown as item [7]. Unfortunately, PG&E's calculation used the Actuarial Equivalence Factor [2.2] at the point in the calculation where it should have used the plan's more liberal Early Reduction Factor [2.1]. Using the wrong factor in this stage of the calculation resulted in an incorrect diminution of the entire benefit.
5. In this case the \$400 benefit which should have been paid to AP is less than the \$800 limit the plan would have been allowed to pay under a QDRO so the "Correct" calculated amount could have been paid by the plan in compliance with the Retirement Equity Act's plan liability limit.
6. Under a QDRO, A/P is entitled to receive her interest in any form that is available to P. Since a form of benefit payment with benefits payable over his lifetime is available to P as a benefit, a form of benefit payment with benefits payable over the lifetime of A/P must be available to A/P. A typical conversion factor which might be found in plan tables for a younger A/P is shown on line [7]. The results of the conversion is shown on line [8] -- \$360 per month under *Gillmore* or \$180 ignoring *Gillmore*.