DOMESTIC RELATIONS ORDERS -- DEFINED CONTRIBUTION PLANS MEASUREMENT AND "EQUALIZATION" OF ASSETS

For Defined Contribution Plans when the settlement mode requires a Domestic Relations Order a frequent pre-drafting task is to find the pre-marital component of Plan benefits. This type of calculation, factoring out from the Plan's current worth asset(s) the accumulated values of any premarital components is an essential preliminary to insertion of dollar values into the Marital Settlement Agreement. This task has a veneer of simplicity. If fact it is often cause for unanticipated cost, complexity, delay and client dismay or worse.

Nevertheless, this type of exercise is required when attorneys agree to divide Defined Contribution Plans containing pre-marital components. Too often the magnitude and complexity of these tasks are unrecognized at the time of settlement causing the language relating to this type of settlement to be less than sufficient for this task. The unanticipated results range from minor error to a malpractice action. What is not understood or fully appreciated at the time of "settlement" is the difficulty of computing a mathematically valid algorithm to achieve attorney objectives. Moreover, cost and time constraints are factors militating against mathematically valid results. This article seeks to establish that there are many procedures that may be employed to in these efforts. Unfortunately, all but one method does not produce a mathematically valid result. In this article four Illustrations are provided to demonstrate the wide deviations in computed values that may be anticipated when mathematically flawed methods are employed.

Caution.
This article takes a strong position against any procedure that is not mathematically valid for the reasons developed in this article. However, the practitioner is alerted to the fact that mathematical validity may require more data than is obtainable by the most dedicated practitioner or litigants. This difficulty in obtaining essential data must be grasped by the practitioner and litigants early in the settlement process. When the pre-marital accumulations occurred many years in the past it must be understood that the possibility of obtaining the required statistical data may range from minimal to non-existent. Hence, those seeking quarterly earnings statement for a period going back more than four years are alerted to the likelihood that the data is either not available or no longer

exists.

Caution.

Consider a matter in which the earnings data go back many, many years. For example a spouse accumulated pre-marital 401(k) benefits prior to 1990. Even when available consider the costs of a quarterly earnings analysis. The costs range from $25.00 per quarter to beyond $50.00 per quarter (depending on the complexity of the data and the clarity of the statements made available). Thus, an earning analysis beginning with accumulations from March 30, 1990 and brought current to December 31, 2012 would be 91 quarters of calculations. The minimum fee for this calculation is likely to be:

$25.00 multiplied by 91 = $2,275.00

Clients may find such fees difficult to accept.

More Confusion.

Many cases will not be a routine linear analysis over a stated period of time. In many cases the initial amount that was pre-marital was distributed to the spouse or directly rolled over into an Individual Retirement Account. Further complicating matters is the probability that the spouse made additional contributions to her or his Individual Retirement Account. The pre-marital amounts then become blended with marital contributions further complicating the analysis.

A Further Complication.

Frequently, more than one Plan is involved. Occasionally, both spouses will have plans containing pre-marital accumulations. The levels of complexity resulting from this mix is difficult to anticipate. Attorneys are urged to recognize this potential. When it exists, make every effort to find an accommodation that does not require detailed calculations. When calculations are required, be sure to first consult with your expert in order to make clear to the client the fees involved and data required.

Still More Complications.

Even when the task is successful, experienced practitioners recognize that a value agreed to some months ago may not be distributed until a Domestic Relations Order is prepared, pre-approved, executed by the court and then submitted to the Plan for Qualification. This process takes time. Over this period the worth of the interest of an Alternate Payee may have

decayed significantly. This decay may provoke a less than rational reaction. The injured Alternate Payee will want the amount prior to the decay distributed, however, the Plan will distribute the decayed amount. Absent a well-crafted alert to this possibility an attorney representing the alternate payee may find herself or himself in a situation of discomfort.

Alternative Solutions.
This article discusses three "alternatives" to a mathematically valid "earnings analysis". As you will observe from the illustrations below there is no consistency in these alternate outcomes. A given method may prove acceptable in one scenario and outrageous in another scenario. Not one of the "alternatives" yields a mathematically valid result.

To provide the Family Lawyer with an appreciation of the variations in "earnings" analysis as it relates to the determination of the current worth of pre-marital assets the following Illustrated discussion is offered.

The general fact pattern for our discussion is as follows for the employee:[1]

Fact Pattern #1

Barron Thomas	
Date of Birth	January 1, 1964
Date of Hire	January 1, 1987
Date of Marriage	January 1, 1996
Date Action Commenced	January 1, 2012
Valuation Date	January 1, 2012

Barron has been a participant in a 401(k) [Defined Contribution Plan] since January of 1987. Upon divorce the parties agreed that each is entitled to half of the martial part of this Plan. All parties are seeking quick resolution at the least cost. Three quick solutions are shown (not offered) and one that is more complex with greater data requirements.

Each of these three "quick solutions" is available for a fee of less than $125.00.

[1] Data has been set in this format to avoid fractions and for ease of following all illustrations.

Proposed Alternate # 1.

- Difference in Value Between Date of Marriage and End of Marriage Date.

Beginning of Marriage Date Value:	$67,670.46
End of Marriage Date Value:	$226,658.94
Difference:	$158,988.48
Marital:	$158,988.48
Half to Wife:	**$79,494.24**

Proposed Alternate # 2.

- Coverture Fraction Method:

Coverture Fraction:	64%
Numerator:	16 Years
Denominator:	25 Years
End of Marriage Date Value:	$226,658.94
Marital:	$145,061.72
Half to Wife:	**$72,530.86**

Proposed Alternate # 3.

- Imputed Earnings over the Marriage.

Two Earnings Assumptions are Made	
Average of 30 Year T Bond over the Marriage:	4.41%
Current 30 Year T Bond Rate (June 2012)	2.7%
Pre-Marital @ 4.41%	$134,981.00
(factor for gain over 16 years)	1.9947
1.9947 X $67,670.46 = $134,981.00)	
Half to Wife:	**$67,490.50**
Pre-Marital % 2.7%	$103,639.71
(factor for gain over 16 years)	1.5315
1.5315 X $67,670.46 = $103,639.71)	
Half to Wife:	**$51,819.86**

A forth option is available. This option requires more data to provide a mathematically valid result.

THIS ALTERNATIVE PROVIDES A MATHEMATICALLY VALID RESULT.

Proposed Alternative # 4.

- Earnings Analysis Based on Actual Plan Earnings Statements.

Total Worth @ End of Marriage:	$226,658.94
Pre-Marital @ End of Marriage:	$131,192.73
($67,670.46 adjusted for earnings as shown below)	
Half to Wife:	**$65,596.37**

The following annual earnings were used for this illustration.

Year	Earnings
2000	7.00%
2001	7.5%
2002	6%
2003	4%
2004	6.5%
2005	8%
2006	5%
2007	6%
2008	-12%
2009	-14%
2010	4%
2011	3.5%

Percentage of Deviation from Only Accurate Method (#4)

Method #1	21.1870%
Method # 2	10.5715%
Method # 3	
@ 4.41%	-14.3536%
@ 2.7%	-29.4614%

Fact Pattern # 2

Martha Cronthal

Date of Birth	January 1, 1976
Date of Hire	January 1, 1999
Date of Marriage	January 1, 2004
Date Action Commenced	January 1, 2012
Valuation Date	January 1, 2012

Proposed Alternate # 1.

- Difference in Value Between Date of Marriage and End of Marriage Date.

Beginning of Marriage Date Value:	$83,162.31
End of Marriage Date Value:	$170,486.33
Difference:	$87,324.02
Marital:	$87,324.02
Half to Wife:	**$43,661.01**

Proposed Alternate # 2.

- Coverture Fraction Method

Coverture Fraction:	61.54%
Numerator:	8 Years
Denominator:	13 Years
End of Marriage Date Value:	$170,486.33
Marital:	$104,914.66
Half to Wife:	**$52,457.33**

Proposed Alternate # 3.

- Imputed Earnings over the Marriage.

Two Earnings Assumptions are Made

Average of 30 Year T Bond over the Marriage:	4.41%
Current 30 Year T Bond Rate (June 2012)	2.7%

Pre-Marital @ 4.41%	$117,452.78
(factor for gain over 8 years)	1.4123

1.4123 X $83,162.31 = $ 117,425.78)

Half to Wife:	**$58,726.39**
Pre-Marital % 2.7%	$113,731.10
(factor for gain over 8 years)	1.4123
1.2376 X $83,162.31 = $102,917.70)	

Half to Wife:	**$51,458.85**

A forth solution is available. These calculations require more data to provide a mathematically valid result.

<u>THIS ALTERNATIVE PROVIDES A MATHEMATICALLY VALID RESULT.
Proposed Alternative # 4.</u>

- Earnings Analysis Based on Actual Plan Earnings Statements.

Total Worth @ End of Marriage:	$170,486.33
Marital @ End of Marriage:	$90,511.52
Half to Wife:	**$45,255.76**
($83,162.31 as adjusted for the earnings shown below)	

The following annual earnings were used for this illustration.

Year	Earnings
1999	%
2000	8%
2001	11%
2002	12.5%
2003	13%
2004	22%
2005	11%
2006	9.85%
2007	13%
2008	-33%
2009	-26%

2010	6%
2011	4.5%

Percentage of Deviation from Most Accurate Method (#4)

Method #1	-3.5216%
Method # 2	15.9131%
Method # 3	
@ 4.41%	52.5606%
@ 2.7%	25.6537%

Comparison of Outcomes for Both Sets of Illustrations Against Mathematically Valid Quarterly Earnings Analysis

Alert: Note the Swings in Values!

	Fact Pattern # 1	Fact Pattern # 2
Method # 1	21.1870%	-3.5216%
Method # 2	10.5715%	15.9131%
Method # 3		
@ 4.41%	-14.3536%	52.5606%
@ 2.7%	-29.4614%	25.6537%

Conclusion.

What is clear is the fact that only a mathematically valid earnings analysis based on the earnings statements provided by the Plan can generate accurate results. Nevertheless, attorneys will often be challenged by situations in which the required data is not available or the costs are not acceptable to the parties. In such cases it must be understood that there is no certainty that any agreed allocation format other than the “earnings analysis” illustrated above will produce a mathematically valid result.