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The goal of our monthly QDRO Newsletter is to keep you informed of Hot Topics regarding all aspects of QDROs. If you find our newsletter valuable, please forward it to a colleague. We hope you enjoy this month's topic.

NON-VESTED PENSIONS

Definition: A non-vested pension is one where the employee has not yet fully earned the right to receive the benefit. Typically, companies require a certain number of years of service before an employee becomes vested, and the employee becomes vested in increments. An employee is said to be vested when he or she completes the minimum terms of employment necessary to be entitled to receive retirement pay in the future.

General Discussion: Like their vested counterparts, non-vested pensions represent deferred compensation for service performed over a number of years, and their value cannot reasonably be viewed as accruing only at the particular point in time when vesting occurs. For example, an employee's benefit may vest after completion of 5 years of service; however, the employee could not achieve vested status without being employed for the prior 4 years and 364 days. Therefore, part of the value of the vested pension after 5 years must have been attributable to the first 4 years and 364 days of employment.

Including both vested and non-vested retirement benefits as marital property recognizes the legislative intent to treat them as the non-pensionholding spouse's contribution to the marriage.

Classification: Non-vested pension rights accruing during marriage constitute marital property. They may be divided through the present cash value method or the deferred distribution method.

State courts are all but unanimous in treating non-vested benefits as marital property subject to division.

The Oregon Court of Appeals held that even though a defined benefit plan has not vested by the time of the parties' separation, the interest in the pension acquired before the parties' separation must be considered marital property.

The Tennessee Supreme Court has also decided that non-vested pension rights accruing during marriage constitute marital property. The court pointed to the all-inclusive statutory language

defining the term *marital property* and to the failure to expressly exclude non-vested pensions from the statutory definition of marital property. The better-reasoned approach, the court said, recognizes that the concept of vesting is irrelevant to classification, and deals with contingencies when determining the method of distribution. The difficulty of valuing these benefits should likewise not affect their classification, the court declared.

New York's high court addressed the classification of non-vested pensions for the first time and held that such pensions are marital property despite their contingent nature. Having previously held that vested pensions acquired during marriage are marital property because these pensions represent the economic fruit of the marital partnership, the court applied the same reasoning to non-vested pensions and concluded that it would be consistent with both the purpose of equitable distribution and the broad legislative definition of "marital property" to classify non-vested pensions as marital.

However, a few courts have added qualifications. When additional employment is required before pension vests, a spouse's pension may not be treated as entirely marital, the Missouri Court of Appeals held in a case involving military non-disability retirement benefits and federal civil service retirement benefits. Although the non-vested status of a pension does not deprive it of its character as marital property, such a pension may not be classified as marital property in its entirety.

Not all courts are in agreement, however. An Indiana appeals court held that the unvested portion of a pension plan that is only partially vested is not divisible property. Under the state statute, the court said, the determinative factor in determining whether pension benefits constitute "property" subject to distribution is whether the employee spouse "possesses" the funds. To the extent a pension remains unvested at the time of equitable distribution, it will be "acquired," if at all, only after the dissolution and therefore should not be characterized as a divisible marital asset, the court added.

While the contingent nature of non-vested pensions may reduce their value, many states classify pensions as marital property regardless of whether they have vested. Two more states - Oregon and Ohio - take the view that vesting is not a prerequisite for classifying pensions as marital property. Confronting the issue of non-vested pensions for the first time in *Richardson and Richardson*, Oregon's high court held that an interest in a pension is a marital asset even if it has not vested by the time of separation (the state's cut-off date for acquiring marital property). The court reversed a trial court's decision awarding a husband's pension to him as his individual property because his rights in the plan vested after the parties had separated.

Oregon's equitable distribution statute, amended in 1983, provides that a pension or "an interest therein" is divisible property. Examining legislative history, the court found that the amendment was meant to overrule case law insulating unvested pensions from division and make it clear that both vested and unvested pensions are property subject to division. Consequently, it held, to the extent that an unvested pension is attributable to pre-separation employment during marriage, the present value of the pension is a jointly acquired marital asset. This is "the growing trend (and perhaps even the majority rule) among jurisdictions," the court added.

By statute in Ohio, divorce courts must consider "[t]he retirement benefits of the parties" when dividing property. According to Ohio's intermediate appellate court, this statutory mandate extends to unvested pensions. Addressing the issue for the first time, the court held that the language of the statute clearly requires consideration of unvested pensions as marital assets. The wording of the statute is quite broad; it makes no distinction between vested and unvested pension plans, the court observed. The trial court had excluded the husband's unvested pension from consideration as a marital asset on the ground that it had no present value. But the appellate

court disagreed. While an unvested plan might not have a present value, the court said, the pension does have some value for purposes of equitable distribution. Social Security benefits are unfunded and unvested but must be taken into account in divorce proceedings under Ohio case law, the court noted. The potential value of the pension was underscored by the husband's vigorous efforts to obtain it for himself alone, the court added.

Valuation: Determining the value of the marital portion of a non-vested pension can be difficult. To do so, courts consider 1) the time left before the benefits become vested; 2) the length of the parties marriage; and 3) the contributions of both parties (primarily and secondary) to the pension. Another approach is to defer distribution of the non-employee spouse's share until the time pension benefits begin.

One court set out a formula to delineate the marital portion of a non-vested pension: years of employee spouse's creditable service during the marriage divided by total years of employee's creditable service at the time of retirement times the monthly benefit. The court emphasized that this formula is not the exclusive method of determining the marital portion of a retirement plan that is non-vested and nonmatured at the time of dissolution. To determine the portion that is marital property, the "time rule" is used, the court instructed. That rule requires multiplying the present value of the pension by a fraction, the numerator of which is the years or months of service during which the spouses lived together as a marital unit, and the denominator of which is the total years of service required to receive the retirement benefit. Here, it was most equitable to compare the premarital period of employment with the 30 probable years of total service that would be required before the wife could retire.

Valuing an unvested pension as a marital asset is difficult, but trial courts must do the best they can, the court said. To accomplish this task, the court suggested, trial courts should consider "the time left before the pension becomes vested, the length of the marriage between the parties, and the contributions of the parties both primarily and secondarily to the pension plan."

The difficulty of determining the exact value of the plan can be avoided by deferring payment of the other spouse's share until the time pension benefits begin.

Distribution: Courts have taken different positions about the distribution of non-vested pensions.

The Alaska Supreme Court ruled that an employee spouse can insist on an immediate distribution of his pension even if it is not yet vested. In an earlier case, *Laing v. Laing*, 741 P.2d 649 (Alaska 1987), the court had held that a non-vested pension should not be divided as part of a property division; the trial court should retain jurisdiction until the pension vests and then equitably divide the marital portion. The court decided in *Wainwright*, however, that when the employee spouse willingly assumes the risk of nonvesting, the general rule that financial matters should be settled at the time of divorce should control. Since the husband here was willing to accept the risk of nonvesting, the trial court should not retain jurisdiction to divide it when it vested rather than valuing it and awarding compensatory property to the wife.

Deferred Distribution: A deferred distribution requiring the husband to pay the wife a percentage of his retirement payments was the most appropriate way to distribute his pension because uncertainties about vesting and maturity made it difficult to place a present value on the pension, the Iowa Court of Appeals held, reversing an award which allocated the husband's pension to him and offsetting property to the wife.

Deferred payment of present value share: Delaying distribution of pension benefits is not the same thing as delaying a decision about each spouse's share of a retirement plan. Some courts have condemned the notion of postponing a decision about pension distribution.

--Conclusion--

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Sincerely,

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