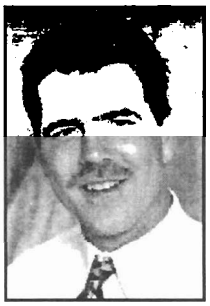

Federal Pensions in Divorce – Value for Offset or Divide?

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The family law attorney confronted with a federal pension within the context of divorce should pay careful attention to the difference, not only between the two primary federal pensions, but to the differences between the federal pensions and traditional "non-governmental" pension plans as well. The two plans discussed here are the Federal Employees Retirement System (FERS) and Civil Service Retirement System (CSRS). Emphasis is placed on the CSRS plan, since it is often the most misunderstood plan. It is also representative of many municipal plans, which provide retirement benefits for employees of local government institutions. The difference between FERS/CSRS and traditional non-governmental plans could mean tens of thousands of dollars, in terms of offsetting marital property values in divorce, or result in valuable benefits lost pursuant to a court-ordered division.

In many cases, we have seen settlements between divorcing parties mishandled because it was assumed that the employee contributions into these defined benefit plans represented the lump-sum present value, or that dividing these plans pursuant to a court order was similar to dividing them by way of a qualified domestic relations order (QDRO). Worse yet, we have seen cases where the parties, or their attorneys, assumed that certain municipal retirement plans, those not covered under the Florida Retirement System, could be divided by a QDRO when, in fact, some of these municipal plans cannot be divided by any type of court order for purposes of property division. Needless to say, these cases had to be reopened or the settlement agreements amended. Unfortunately, this is not as rare as one would hope.

Although this article emphasizes issues relating to the valuing and dividing of federal pension plans, it is worth suggesting that should a party to a divorce be a participant in a municipal plan, the attorney should then contact the plan to find out more about distribution options, especially with regard to treatment of a non-participant spouse, long before the divorce is granted. Discovery, analysis, and evaluation of benefit options should thoroughly be completed before the negotiation and/or drafting of the court order commences.

Because discovery into the value of plan benefits or the determination of an accrued monthly benefit is often difficult, we have provided some suggestions as to where to start obtaining information on a participant spouse with regard to FERS, CSRS, and the Thrift Savings Plan. First, if the participant spouse is not yet retired, the Office of Personnel Management will not yet have the participant's information. Therefore, one should consult the personnel department of the employing agency or agency's retirement counselor for retirement information. If the participant spouse is retired, the general telephone number for inquiries is toll-free 1-888-267-6738.

Following are brief discussions on the differences in FERS and CSRS; the approaches to valuing the FERS & CSRS plans - relative to traditional non-governmental pensions; court ordered divisions; as well as other benefit considerations, or rights, that a non-participant "alternate payee" spouse may have. Because of the many issues involved, and the vast differences between Federal pensions and traditional private plans, this article has been divided into two parts to aid attorneys in both the valuation issues and dividing pension benefits pursuant to a court order.

For starters, both the FERS and CSRS plans are administered by the same plan administrator in Washington, D.C., the Office of Personnel Management (OPM). When attempting discovery of information relating to the pension benefits of the plan participant spouse, a distinction is drawn between whether or not the party is retired. If the party is not yet retired, information regarding the participant's pension benefit, or income figures used in computing the retirement benefit, can be obtained through the participant's employer or employing entity. After retirement, the information can be obtained from the Office of Personnel Management in Washington, D.C. With regard to actual CSRS or FERS court ordered divisions, they are forwarded to the Court Order Division of the OPM, regardless of whether or not the plan benefits are in pay status.

First and foremost, however, the unsuspecting attorney representing the non-participant spouse is all too often willing to accept the employee account balance, i.e. employee contributions, as the lump-sum value of the plan when, in actuality, the employee contributions are unrelated to the monthly benefit the participant will receive at retirement. Therefore, the employee contributions are not indicative of the present value. These plans, FERS and CSRS, are not 401(k) savings plans. As an illustration of this point, we observed a case where an employee account balance, or contributions, totaled approximately $50,000, yet their accrued monthly benefit, accrued as of the date of separation, was roughly $2,500 per month at retirement. It doesn't take an investment analyst to see that a rather large and consistent rate of return would be required for the contributions of $50,000 to fund $2,500 per month, $30,000 per year, for the life expectancy of an individual, e.g. 20 years, not-to-mention with annual increases.

In yet another example, a FERS participant claimed that their $2,400 employee contributions was the

present value of their plan. Keeping in mind that the contributions for FERS participants are a great deal less than for CSRS participants, the fact was that the participant had accrued a monthly benefit of approximately $433, or $5,200 annually, resulting in a lump-sum present value nearly six times the value of the employee account balance, or approximately $15,000 in present value terms.

In reality, the government's portion of the contributions, including funding the annual cost-of-living adjustment (COLA), constitutes over two-thirds of the overall value of the monthly benefit. This means that the employee contributions alone fall way short of the actual value, yet sometimes the employee account balance is the only information provided to the attorney. Therefore, it is incumbent upon the attorney, especially with municipal plans not affiliated with the Florida Retirement System, which does provide a monthly benefit, to ask of the plan "what is the participant's *accrued* monthly retirement benefit as of a certain date" and when or at what age can they commence benefits. We emphasize accrued as opposed to projected benefits, which are primarily intended for retirement planning purposes.

In light of this, an award to the non-participant spouse of half of the employee contributions accrued during the marriage is not an equitable division of the benefit, especially when a refund of contributions is rare and considered a severe penalty. This, since the only way for the participant to receive their contributions is to request them *in lieu* of receiving a monthly benefit at retirement payable for their lifetime. Therefore, the participant would more than likely elect the monthly benefit instead of a refund of contributions. If the non-participant spouse is awarded "one-half of the employee contributions" and the participant elects to receive a monthly benefit instead of a refund of contributions, the non-participant spouse would receive nothing upon the participant's retirement, no benefit at all. However, please keep in mind that the account balances associated with the FERS and CSRS plans should not be confused with the account balance acquired under the Thrift Savings Plan, yet another Federal Plan, but one that is very similar to a 401(k) plan.

The primary difference between the FERS plan and the CSRS plan is that participants in the FERS plan also contribute to Social Security, while participants in the CSRS do not. This leads to the question of whether or not both plans should be valued in their entirety for purposes of property offset, since the Social Security benefits of the FERS participant, or other private plan participants for that matter, are not a divisible asset.

The Social Security factor will be briefly discussed a little later in this article and is an issue that was addressed in some depth in the Family Law *Commentator* back November 1997, Vol. XXIII, No. 1.

With regard to both federal plans, it is often unclear as to the exact plan in which the federally employed spouse is a participant, since the participant spouse may simply state that he or she is employed with the postal service or some other agency of the U.S. Government. Therefore, it is worth repeating that there are primarily two federal "pension" plans in which a U.S. Government employee can participate. In addition, the other most common plan, the Thrift Savings Plan (TSP), is similar to a savings plan or 401(k). The CSRS and FERS plans are defined benefit plans, while the TSP is a defined contribution plan, where the TSP account balance at any given time is the present value. The TSP is not emphasized here, however, some important points will be mentioned in the court-ordered section, Part II of this article.

Another plan not emphasized, but which can be encountered from time to time, is the Foreign Service Pension System. This plan is administered, not by the OPM, but rather by the State Department (202) 727-5280. This particular plan is very similar in structure to the FERS plan. Other smaller federal plans exist, such as the Judicial Retirement System (JRS), which also closely resemble FERS.

As previously noted, it is often unclear as to the exact plan in which a spouse in a divorce may be a participant. For discovery purposes, keep in mind that the Federal Employees Retirement System was implemented in 1984 for those participants/employees commencing employment after December 31, 1983, while the then CSRS participants could elect to remain in their system or transfer into FERS at that time. There have also been certain windows of opportunity to transfer from CSRS to FERS subsequent to that time. Therefore, if the participant spouse began their federal employment after 1/1/84, they are undoubtedly in the FERS plan, with the possibility of also participating in the Thrift Savings Plan.

At the present time, FERS participants contribute 1.2% of their salary to the FERS plan (1.05% last year and 0.8% in previous years), regardless of what they might contribute to the Thrift Savings Plan. CSRS participants currently contribute 7.4% of their base salary to their plan (6.2% in past years) which, coincidentally, parallels the contributions made by individuals actively contributing to Social Security. The CSRS participants contribute more than FERS participants, since they will not receive Social Security benefits, and in return, will receive a larger than normal retirement benefit.

In the past, courts have recognized this Social Security dilemma. However, the problem, for the most part, has been with quantifying some type of discount or consideration for those participants who do not contribute to Social Security during their years of participation in the plan. This, while their pension benefits are enhanced for lack of Social Security. The effect of the Social Security element is also quite evident in the calculation of retirement benefits under FERS and CSRS. FERS participants, who contribute substantially less to their retirement plan, receive a retirement benefit equal to 1% of the average of their highest three years of earnings, multiplied by their years of service,

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while CSRS participants receive 1.5% to 2% of their average annual earnings multiplied by their years of service. Given the impact of the Social Security element in marital dissolution cases, we have developed some solutions over the years which have been employed successfully in Florida cases, as well as in other parts of the country.

One method of extracting out the enhanced portion of the CSRS benefits, otherwise referred to as the Social Security element, or benefits in lieu of Social Security, is to calculate what the Social Security benefit would have been had the participant contributed to Social Security during their years of participation in the CSRS plan. This entails compiling the participant's earnings history under the plan, information often available through the participant's employing entity, and then proceeding to enter this information into the Social Security ANY PIA program to determine a Social Security benefit. A present value is computed based on this benefit and subsequently deducted from the overall present value of the CSRS plan.

A second approach would be to assume that since the contributions made to the CSRS plan by the employee parallel what would have been contributed to Social Security on the employee's behalf, that the value of the account balance could, in effect, be deducted from the overall value of the plan to arrive at the present value of the plan less the Social Security element. This approach has been used when the necessary information is not readily available or in cases where the parties wanted to avoid additional costs. It has been our experience in many cases where we have performed such calculations using the first approach, that the lump-sum present value of the benefits in lieu of Social Security came very close to the value of the employee account balance, providing justification for deducting the employee account balance from the overall pension value. Again, the employee contributions, along with that portion funded by the government, are used to provide for an annuity that is enhanced for lack of Social Security, but again, the employee contributions alone are not directly related to the amount of the monthly benefit the participant will actually receive.

A third approach is to value the Social Security benefits of both parties, along with their respective pensions, and derive the net difference in the values, as suggested by one Judge in Charlotte County. This particular approach does deserve merit, however, it requires a thorough investigation into how the Social Security benefits of each party are affected by certain offsets. In this particular case, the participant spouse had accrued some Social Security benefits outside their participation in the CSRS plan, which were affected by an offset but which was not disclosed on the Social Security Administration's Statement of Benefits. The Social Security benefit given by the Social Security Administration for the participant spouse did not account for the Windfall Profit Elimination offset nor did it reflect the increase in Social Security benefits due to the application of prior military service. To complicate matters, the participant, in effect, used marital funds to purchase the equivalent military time to be applied to his CSRS benefit.

According to the Social Security Administration and the OPM, the years of military service not used for military retirement can be applied to increase either the CSRS benefit *or* Social Security benefits, but not both. Purchasing the additional time, or making a deposit with the OPM, means that the participant has opted to apply his/her military time to their Social Security benefits. This benefit increase is not evident on the information, or benefit calculations, provided by the Social Security Administration. If a CSRS/FERS participant has not accrued the total 20 years of military service required to receive military retirement benefits, the years of military service can be applied to the CSRS/FERS plan, year for year in computing the monthly benefit. The significance of applying military service time to a CSRS/FERS pension is that the deposit made to purchase additional time is used to: 1) *increase* CSRS/FERS benefits if benefits commenced before the participant's normal retirement, usually age 62, and 2) to prevent any reduction in the CSRS/FERS benefit once Social Security benefits commence, if Social Security benefits accrued outside any participation in the CSRS plan.

It should be apparent that the deduction of the Social Security element from within the CSRS pension benefit greatly depends on the circumstances of the case. Again, a classic example is when one spouse is in the CSRS plan and the other spouse is in the FERS plan, yet the Social Security benefits of the FERS spouse, or any spouse in the private sector, is not considered in the equitable division of marital assets, and rightfully so. However, nor should the entire value of the CSRS pension be considered because of this issue of the Social Security element, or enhancement. It should also be noted that another aspect of the plan federal employees may participate in, is the CSRS Offset. CSRS Offset participants do contribute to Social Security, much like FERS, however upon commencement of Social Security the CSRS benefit is reduced, or offset, by the amount of Social Security received, the opposite of what occurs when one is a full CSRS participant.

As with most pensions or retirement assets in divorce, they should first be valued to determine whether or not the participant can retain the entire pension on their side of the marital asset ledger without the need for drafting an order to divide the benefit, with the objective being to provide for an equitable distribution of all retirement benefits. Valuing the monthly benefit, for either FERS or CSRS, is performed much the same way as any traditional defined benefit pension, however, factoring in the annual cost-of-living adjustment should not be ignored. It should be noted that most, if not all, governmental plans do allow for annual increases in the retirement benefit, an

aspect not often found in private non-governmental plans. For instance, a 2 to 3 % COLA increase can increase the lump-sum present values upwards of approximately 40%, a valuable aspect of the plans sometimes overlooked by evaluators.

In conclusion, the primary differences are that FERS participants receive Social Security benefits while CSRS participants do not, along with the differences in the contribution rate, (1.2% for FERS as opposed to 7.4% for CSRS) and, lastly, that the employee contributions, or account balance, is not the present value of the plan benefits since it usually pales in comparison to the present value of the monthly benefit. Many municipal retirement systems will also have employee contributions or account balances. The plan administrators of these plans may initially provide account information while failing to provide an accrued monthly benefit based on the participant spouse terminating/retiring as of a specific date, i.e. the date of separation. All of these factors are a must in the discovery process and issues that should be pursued upon the onset of a divorce. More information on dividing retirement benefits under FERS, CSRS, and TSP will follow in Part II of this article, with information related to the appropriate agencies to contact.

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