401k Plans - Calculation of Pre-Marital Accumulations

Negotiating and Drafting Domestic Relations Orders

Counsel is urged to be alert to the potential for inadvertent insertion of flawed language into the allocation of benefits section of a Marital Settlement Agreement. Such potential is greater when the subject plan is a Defined Contribution Plan (e.g. 401k Plan, Savings Plan, Thrift Plan, Individual Retirement Account), and this Plan contains a Premarital Account Balance.

This article highlights the problems created by flawed division of benefits language and suggests alternative strategies intended to minimize the problems created by flawed language. This issue arises when an attorney fails to recognize the problems generated by the existence of a premarital account balance in a Defined Contribution Plan.

The genesis of this problem is a practitioner's insertion into the Marital Settlement Agreement of language akin to the following:

The parties shall equally share the marital portion of the ABC 401(k) Plan. Any premarital portion of the Plan shall be excluded and is the sole property of the Participant Spouse. From the date of this Agreement until distribution to the Alternate Payee, the Alternate Payee's share shall be adjusted for earnings (positive or negative).

CAUTION.

Did either attorney at the time of settlement, attempt to determine the existence of AND significance of a premarital account balance? If counsel did have this account balance data, was it then determined whether sufficient historical account balance statements from the date of marriage up to a near current date were available so that the following provision could be calculated?

Any premarital portion of the participant's account balance shall be excluded from this allocation to the Alternate Payee… [1]

Use of this or similar expressions are the basis for a plethora of challenges to counsel, unless:

Counsel has full knowledge of the value of the premarital balance as of the date of marriage, plus all subsequent account balance statements required to compute the growth on this premarital balance up to the Date Action for Divorce Filed (or to a near current date).

The origin of the problem.

The initial error is ill considered use of the term

“premarital component”.

The unanticipated result:

A settlement that can’t be implemented, because incautious counsel failed to ascertain prior to completion of the Property Settlement Agreement, the availability (existence) of account balance data regarding all premarital components of the 401k (from the date of marriage up to Date Action for Divorce Filed).

Specifically, counsel must confirm that the following data exists prior to preparing a Marital Settlement Agreement that acknowledges the existence of a “premarital account balance”:

The participant’s account balance as of or close to the date of marriage

Each consecutive account balance statement for this Plan from the Date of Marriage up Date Action for Divorce Filed

Data regarding any account transfers [2]

Amount of each transfer (if any transfers)

Computing worth of asset from the date of transfer to the Date Action for Divorce Filed (if any transfers)

Consider this provision:

The parties agree to equalize the marital portion of the Plan. Any premarital component shall remain the sole and separate property of the participant.

As a legal expression:

“equalize the marital portion of the plan”

or similar expression is meaningful. Unfortunately, this term is not easily translated into a “mathematical expression”, such that:

a pension analyst can calculate the current worth of any premarital Defined Contribution Plan Component. Absent the Participant’s full account balance history, “equalization” is not mathematically possible. In this circumstance, “equalization” though a legally valid expression is not convertible into a finite mathematical value.

Reason: Insufficient data exists to make the essential calculations. Neither the value of this asset as of or close to the date of marriage or the “earnings” on this sum are currently available.

Caution!

Be clear. All of the data must be available. If the date of marriage is years in the past, then the pension analyst must have each account balance statement from (of close to) the date of marriage, up to a near current data.

CALCULATION ALTERNATIVES

When counsel is confronted with this conundrum, three alternatives are available.

Caution.

… “alternatives” are available. Solutions are not. Thus, the attorney confronted with this circumstance opts for a “best effort” alternative in order to create a reasonable estimate of the current worth of the premarital component of the Plan. Further, note that the length of this article was initially thirty-pages. This was deemed too cumbersome (perhaps also boring). Additionally, this article’s complexity has been reduced by supplying the participant’s account balance as of the date of marriage. This was done for illustration purposes. In many cases this statistic will not be available!

In response to this issue, counsel is compelled to rely on calculation strategies that approximate but do not rise to the level of full mathematical validity. [3] In sum, the actual current worth of the pre-marital portion of the Plan is not ascertainable!

Alternative Calculation Strategies

Coverture Fraction (Time Rule)

Imputed Average Interest Adjustment (based on given average of the annual rate over the full measuring period)

Imputed Annual Interest Adjustment (actual annual rate method, using the “year by year” index for the full measuring period)[4]

Clarification.

Of the three above indicated methods, no single method is uniquely suited to producing a consistently accurate calculation. Based on the accrual period and the initial value (which it is emphasized is generally unknown) outcomes will vary. [5] However, the Imputed Annual calculation, is most likely to resemble actual economic conditions for the measuring period.

Further Clarification.

The difference between the two imputed interest methods can be substantial. The averaging method produces a positive linear slope, emphasizing the impact of compounding (there are no negative earning years). The actual annual performance method, includes possible negative earning years, producing a non-linear graph, reducing the impact of compounding and more closely reflecting actual market conditions for the measurement period.

METHODOLOGIES ILLUSTRATED

Coverture Fraction Method.

Calculation and Outcome.

Alert: For these calculations, there is no need to know the worth of the participant's account as or close to the date of marriage. [6] The balance as of the jurisdictions End of Marriage Date is necessary. Counsel, assuming more current data is available may then bring the calculated "End of Marriage Date" marital component up to a near current date.

Coverture Fraction Dates

12/31/2000 12/31/2019 (marital period) 19 Years

12/31/1992 12/31/2019 (total period) 27 Years

Resulting Coverture Fraction 70.37%

Actual Account Value on 12/31/2019 $841,712.45 [7]

Coverture Fraction Balance 12/31/2019 $592,316.17

($841,712.45 * 70.37%)

Half of Marital to Jane $296,158.08

Imputed Interest Averaging Method.

Calculation and Outcome.

Premarital Value on 12/31/2000 [8] $100,000.00 [9]

Index Used: Standard & Poor 500 Index

Growth Period from 12/31/2000 - 12/31/2019 [10]

Average rate of return for the S&P 500 6.43%

Value of Premarital account on 12/31/2019 $326,751.19

Actual Account Value on 12/31/2019 $841,712.45

Account Value on 12/31/2019 $841,712.45

Imputed Premarital Value on 12/31/2019 $326,751.19

Resulting Marital Balance 12/31/2019 $514,961.25

($841,712.45 - $326,751.19)

Half of Marital to Jane $257,480.63

Difference from Coverture Fraction: $38,677.46

Imputed Actual Interest Method.

Calculation and Outcome.

Premarital Value on 12/31/2000 $100,000.00

Index Used: Standard & Poor 500 Index

Growth Period from 12/31/2000 - 12/31/2019

Actual Annual Returns Calculated and Applied

Value of Premarital account on 12/31/2019 $300,117.45 [11]

Actual Account Value on 12/31/2019 $841,712.45

Resulting Marital Balance 12/31/2019 $541,595.00

($841,712.45 - $300,117.45)

Half of Marital to Jane $270,797.50

Calculation Method Difference

from Coverture Fraction $25,360.58

An Unhappy Spouse.

At this point the non-participant spouse, Jane Thomas, rejects the two outcomes. Jane then retains the naughty pension evaluator: Listajo Pacaro.

Listajo maintained that the best and most realistic Index to apply is the Consumer Price Index. Using this index, Listajo advised as follows:

Actual Account Value on 12/31/2019 $841,712.45

Premarital Value on 12/31/2000 $100,000.00

Premarital Value on 12/31/2019 $147,043.49 [12]

Marital Portion of Plan 12/31/2019 $694,668.49

Half of Marital to Jane $347,334.25

Summary: Calculation Methods: Jane's share:

Averaging Standard and Poor 500 Index $257,480.63

Actual Annual Standard and Poor 500 Index $270,797.50

Coverture Fraction $296,158.08

"IMPARTIAL EXPERT" LISTAJO PACARO

Consumer Price Index $347,334.25

Conclusion.

The intent of this article is to acquaint the family attorney with an issue that can have significant adverse impact on settlements of Defined Contribution Plans when a premarital component exists. The data acquisition problem and the conflicting views of "applicable interest assumptions" swiftly decay settlement efforts into a cesspool of bile, expense and recrimination.

For this article, several outcomes were calculated.

Was Listajo Pacaro correct or was he acting as an advocate (due to his "low" interest rate assumption)?

Before you determine the validity of Listajo's assumption consider the following chart of other average interest rates for the identical period. [13]

Source Average for period 2001-2019

Consumer Price Index 2.05%

10 Year Treasury Note	3.35%
30 Year Treasury Bond	3.70%
Prime Interest Rate	4.73%
AAA Corporate Bond	4.87%
S&P 500 Index	6.43%
Russell 2000 Index	8.36%
Average of all of Above	4.78%

Based on this chart, was Listajo an “expert” or an “advocate”?

Which rate do you believe most conducive to settlement?

[1] How can counsel exclude that which is either unknown or not ascertainable?

[2] Most likely a “Plan to Plan” transfer or a “rollover” into an IRA.

[3] The mathematics and charts used for this article were deemed beyond the scope of an introductory article. For those seeking elaboration and illustrations on the complexities of this issue contact Troyan directly.

[4] A substantially more comprehensive calculation.

[5] For a plan participant to retain account balance statements for more that a few years is unlikely. When the date of marriage was more than ten years ago, this probability of not having a premarital account balance is greatly enhanced.

[6] This statistic, though not expanded upon in this article, could be a critical consideration when the premarital balance is not ascertainable and the parties are truly hostile.

[7] Calculation not shown.

[8] Date of Marriage.

[9] Calculation not shown.

[10] Near current date.

[11] Calculation not shown.

[12] The CPI average for this calculation period was 2.05%.

[13] Greater commentary on interest rate calculations is beyond the scope of this article.

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