Defined Contribution Plans - Private and Public

SOURCES & AUTHORITIES

Joinder Pleadings: *Family Code §2060(b)* provides that "[a]n order or judgment in the proceeding is **not enforceable** against an employee benefit plan unless the plan has been joined as a party to the proceeding." [emphasis added]. Most plans, in response to being joined, place a hold or "freeze" on the retirement account for at least a short while to allow for entry of a QDRO, and that hold prevents withdrawals, loans, or other ATROs violations. In fact, some plans require joinder pleadings before they will enforce a QDRO. Review Form FL-318-INFO for information about which plans require joinder pleadings. However, even if the plan does not require joinder pleadings, in many cases it is still a good idea to order that the plans are joined to the dissolution case to ensure the plan is on notice of the pending family law case and try to keep all accounts maintained at status quo pending entry of Judgment or the QDRO. The only plans that will specifically refuse to be joined are Individual Retirement Accounts (IRAs), out-of-state government plans (e.g., Nevada Public Employees Retirement System), federal government pension plans (e.g., Federal Employees Retirement System), and the Armed Forces Retirement System (i.e., military pension), which will reject a joinder from a California court on sovereign immunity grounds.

Separate property: Any premarital contributions to a defined contribution plan, and any earnings or losses on those contributions during the marriage due to investment performance, are the Participant's separate property per *Family Code §770(a)*. Similarly, any rollovers made during the marriage from a separate property source, plus any earnings or losses on those rollovers, are the Participant's separate property. This means that at the date of separation, the Participant's account may be commingled, i.e., partially community property and partially separate property. Virtually no plans will calculate for the parties what portion of a defined contribution plan is community vs. separate; the parties must calculate it and award a specific amount or percentage to the Alternate Payee in the QDRO. Pursuant to *In re Marriage of Mix* (1975) 14 Cal.3d 605, 612, the spouse asserting an asset's separate character bears the burden of proof, so it is permissible to require the Participant to prove up their claim that the account is partially separate property, and if so, to what extent.

Account Transfers: Even if the account has no premarital contributions and no separate property rollovers during the marriage, sometimes separate property may still need to be calculated because of factors outside the Participant's control. For reasons often related to fees or other incentives, a plan may switch investment providers/recordkeepers at any time (e.g., moving a company's 401(k) plan from Principal to Empower). If this occurs after the parties' date of separation, it can cause issues. If the award includes earnings and losses that must be calculated from when the *prior* recordkeeper had the account, the new recordkeeper will reject the QDRO and say they cannot calculate it because they do not have the previous recordkeeper's documents. This may be surprising, but recordkeepers often will not accept responsibility for prior records.

For example, say Johnny and Frankie separate on 01/01/2020. Johnny has a 401(k) plan which is entirely community property as of the date of separation. On 06/30/2021, Johnny's 401(k) switches from Principal to Empower; 06/30/2021 is Empower's "earliest valuation date" for Johnny's 401(k). Their divorce Judgment and QDRO are entered concurrently (best practice) on 12/31/2022, and both documents provide that Frankie is to receive 50% of the 401(k) as of 01/01/2020, plus any earnings or losses earned on her share until the date funds are transferred to her. The QDRO is sent to Empower, who rejects it, saying they only have record of earnings and losses going back to 06/30/2021 so they cannot calculate the award to her. The parties must then have the earnings and losses calculated between the date of separation and the earliest valuation date to ensure Frankie receives her full community property share and Johnny's post-separation contributions are assigned to him as his separate property. For how that calculation may be done, see "Methods of calculating separate property," below.

Methods of calculating separate property: The most precise method of calculating separate property in a defined contribution plan is a tracing calculation. A tracing calculation tracks the performance of each investment in the account from the date of marriage or rollover. It requires most account statements from the date of marriage or rollover through at least the date of separation or division date, and it is more costly than other options. The need for account statements can present an issue in cases where, for example, the marriage was long-term and statements evidencing the premarital contributions or rollover are lost to time. However, it is by far the most precise calculation method.

The second method is called an estimated rate of return calculation. If there is evidence of - or the parties agree on - the account value as of the date of marriage or date of rollover, an expert or technology tool can estimate the earnings and losses using the relevant asset allocation in the portfolio and the general performance of broad-based stock and bond indices during the relevant period. Because it does not track the individual investments in the Participant's particular account, it is less precise than a tracing calculation.

Finally, pursuant to *In re Marriage of Brown* (1976) 15 Cal.3d 838, a time rule formula calculation is an acceptable method of calculating a separate property interest in a defined contribution plan. There are pros and cons to this method of division. It does not require plan statements or values, which can be helpful if the parties cannot obtain that information. However, it does not track investment performance and weights each year the same, when most people earn and contribute more in their later years. Nonetheless, it is specifically approved of for defined contribution plans in *IRMO Brown* and can be useful for adjudicating separate property claims when statements are hard to come by.

Earnings & losses: Money in a defined contribution plan is not just gathering dust. It is invested in the market, and the community property will experience earnings and losses based on how the underlying investments perform. Earnings and losses on the community investments are community property even if those earnings and losses occur post-separation. They are attributable to a community property source and retain their character as community property post-separation pursuant to *Family Code §760.*

Loans: Some defined contribution plans allow parties to take a loan against their account. If a loan was taken out during the community period, it is presumed to be a community property debt per *Family*

Code §910. Sometimes the court orders, or the parties agree, that the loan is the Participant's separate property obligation. Either way, the order should include a specific finding about how loans should be treated in the QDRO, either as community property, or the Participant's separate property.