

## **Dividing Oregon PERS OPSRP and IAP Accounts**

### **Part 2 of a two part series on Oregon PERS retirement benefits**

*by Clark B. Williams<sup>1</sup>*

This is the second in a two-part series on dividing PERS benefits in a divorce. The first article, published in the April 2011 edition of this newsletter, examined the issues in dividing PERS Tier One and Tier Two benefits. This article will examine the issues in dividing the Individual Account Plan (IAP) and the new Oregon Public Service Retirement Plan (OPSRP).

Every PERS member has *two* benefits to divide, potentially, in a divorce. The first is the member's Tier One, Tier Two or OPSRP benefit, as the case may be.<sup>2</sup> The other benefit is the IAP account.

#### *Understanding the Individual Account Plan (IAP)*

Every active PERS member (except a member who terminated employment prior to 2004) now has an IAP account. The IAP account is derived from an "employee" contribution equal to 6% of the member's compensation each year, starting in 2004, plus earnings on those contributions each year. Approximately 70% of PERS members have their 6% employee contributions "picked up" by the governmental employer, so that it is actually paid by the employer and not the employee.<sup>3</sup> For the remaining members, the contribution is a mandatory after-tax deduction from their net paychecks. Many PERS members now have IAP balances exceeding \$30,000. The IAP is a different system from Tier One, Tier Two and OPSRP, and the division is handled separately.

The IAP accounts are like 401(k) accounts and other defined contribution plan accounts. They represent "cash in the bank," so to speak. The value of an IAP account is its balance at any time. This is unlike Tier One accounts and Tier Two accounts, which are worth much more (at least twice, and often even more) than the balance shown on the account statement. This distinction can be lost when looking at a member's "combined annual statement." The combined statement will

---

<sup>1</sup> Special "thanks" go to Paul Saucy, Esq. and to Peter Ungern, Manager of the PERS Specialty Services Section, for their contributions in the writing of this article.

<sup>2</sup> Tier One applies to members first employed in a PERS-covered position prior to 1996. Tier Two applies to members first employed between January 1, 1996 and August 28, 2003. OPSRP applies to members first employed on or after August 29, 2003.

<sup>3</sup> See "Oregon PERS at a glance - March 2011" at [http://www.oregon.gov/PERS/docs/pers\\_at\\_a\\_glance3\\_2011.pdf?ga=t](http://www.oregon.gov/PERS/docs/pers_at_a_glance3_2011.pdf?ga=t)

show both the Tier One or Tier Two balance and the IAP balance. The temptation is to add the two balances together to determine total value of the member's PERS benefits. But that would be mistake - - the two values shown on the combined statement are apples and oranges.<sup>4</sup>

The IAP is a giant pooled fund for all participants state wide, and the investments are managed by the Oregon Investment Council. The Council consists of a six-member board made up of four gubernatorial appointees, the State Treasurer and the PERS Executive Director. Because the IAP is managed as a giant single pooled fund, individual members of the IAP cannot self-direct their investments. Everyone in the IAP gets the same rate of return. In 2010, the IAP had a net investment return of 12.13%.

The IAP is valued as a whole, and individual account balances determined, just once per year as of each December 31. A member's account balance at each December 31 is the sum of the balance as of the prior December 31, plus the investment earnings (less losses) on that balance for the year, plus a new contribution equal to 6% of the member's compensation for that year. Because this balance is determined only once per year, it is impossible to precisely determine a member's balance as of any given date during the year. In other words, the IAP is not "daily valued" as are many 401(k) and other defined contribution plans.

IAP accounts are 100% vested at all times. They are fully portable. A member can apply to receive his or her IAP account generally within 90 days after termination of employment. Like any other distribution from a defined contribution plan, the distribution of a member's IAP account will be subject to income taxes and a potential 10% early distribution penalty for participants under age 59 ½, unless the distribution is rolled to an IRA account. At retirement, the member can elect a lump sum distribution or an IRA rollover, or installments over a 5, 10, 15 or 20 year period. The balance remaining at the member's death will pass to the member's designated beneficiary.

#### *Implications for Dividing IAP Accounts.*

IAP accounts are easily divided in a divorce.<sup>5</sup> However, the fact that IAP accounts are valued only as of December 31 each year means that IAP accounts can be divided only as of December 31 of any given year. Any order or judgment purporting to divide an IAP account as of a date other than December 31 (e.g., a judgment that purports to divide the account "as of the date of this judgment") will be ineffective and will be rejected by PERS (unless, in fact, the date of the judgment is December 31).

So, to effectively divide an IAP account as of any other date will require doing some math

---

<sup>4</sup> See the April 2011 Family Law Newsletter for an explanation of Tier One and Tier Two benefits, and in particular how the account balance is only a fraction of the total value.

<sup>5</sup> The applicable regulation for dividing IAP accounts is OAR 459-045-0014.

by hand. You will need to know the prior December 31 value, then add the current year's 6% contribution to the date of the division, then multiply the sum by the appropriate percentage (typically 50%) and award that amount as a dollar figure as of the prior December 31. So, for example, if a member's account is to be divided evenly as of June 1, 2011 and the member had an IAP account of \$25,000 as of December 31, 2010 and has a monthly salary of \$3,500 per month, then the appropriate award will be:  $[\$25,000 + (\$3,500/\text{month} \times 5 \text{ months} \times 6\%)] \times 50\% = \$ 13,025$ . The judgment or order would award that amount as of December 31, 2010.<sup>6</sup>

This method presents challenges early in each calendar year, before the annual account statements are available for the prior year (e.g., the 2010 combined statements came out the second week of May 2011). However, an estimated IAP earnings rate for each year is usually available on the PERS website<sup>7</sup> by the end of January, and is normally reliable to within a few hundredths of a percent. So, for example, an equal IAP division to be done as of a judgment dated March 1, 2012 will have to be manually calculated by starting with the December 31, 2010 IAP balance, adding the estimated earnings for 2011 based on estimated rate of return posted on the PERS website, adding the 6% contribution for all of 2011 and for January and February 2012, dividing by two and awarding that amount as a dollar sum as of December 31, 2011.

Once awarded, PERS will segregate the alternate payee's share into a new IAP account in the alternate payee's name as of the applicable December 31. The account will also be credited with its share of IAP earnings (less losses) thereafter. The alternate payee can immediately access the account, even though the member cannot if still employed. Any amounts taken directly are subject to tax withholding, as with any qualified plan. Also, the alternate payee's account can be rolled tax free into an IRA or other qualified plan. Or the alternate payee can leave the account in the IAP as long as he or she wishes.

### *Oregon Public Service Retirement Plan (OPSRP)*

OPSRP is a pure defined benefit plan, very similar to private sector defined benefit plans. There is no "account" and no "money match" formula. No lump sum payments are available. Rather, OPSRP provides retirement income for the life of the member and, potentially, for the life of a beneficiary (including a former spouse). Think of it like Social Security.

---

<sup>6</sup> In this example, one might think to be clever by drafting the judgment or order to award "50% of the member's account as of December 31, 2010 plus \$525," with the \$525 being half of the 6% contribution for the first five months of 2011. This would save having to actually know the December 31, 2010 balance and to do the math for a total gross dollar award. But PERS regulations provide that the IAP division must be expressed *either* a percentage *or* as a dollar amount, and cannot be a combination of both a percentage and a dollar amount.

<sup>7</sup> See [http://www.oregon.gov/PERS/section/financial\\_reports/financials.html](http://www.oregon.gov/PERS/section/financial_reports/financials.html)

The OPSRP formula is simple: 1.5%<sup>8</sup> times years of service times “final average salary.”<sup>9</sup> Normal retirement is age 65. A member can retire as early as 55 with an actuarially reduced benefit to reflect that is starting early and will be paid out for a longer time. The reduction in the monthly payment may be as much as 60% to start at age 55 instead of age 65.

At retirement, five payment options are available:

- the Single Life Option which pays for the life of the member only (like Option 1 under Tier One and Tier Two);
- a Full Survivorship Option which pays for the life of the member and then for the life of a designated beneficiary if the beneficiary survives the member (like Option 2);
- a Full-Survivorship Increase Option which pays for the lives of the member and a designated beneficiary but which increases to a Single Life Option if the beneficiary is the first to die (like the Option 2A “pop-up”);
- a Half Survivorship Option which pays for the life of the member and then 50% thereof for the life of a designated beneficiary if the beneficiary survives the member (like Option 3); and
- a Half Survivorship Increase Option which pays for the life of the member and then 50% for the life of a designated beneficiary if the beneficiary survives but which increases to a Single Life Option if the beneficiary is the first to die (like the Option 3A “pop up”).

The largest monthly amount is paid under the Single Life Option. The other payment options produce slightly smaller payments because they are paid over two lifetimes. A married member is required to elect the Half Survivorship Option unless the spouse of the member, at retirement, consents to an alternate form of payment. All benefits, once payable, will be subject to annual cost of living increases not to exceed 2% per year.

If a member dies before retirement, then only 50% of the accrued benefit is available to be provided to a surviving spouse, former spouse or other beneficiary. The other 50% reverts to the PERS system. This is important to recognize.

#### *Implications for Dividing OPSRP Benefits.*<sup>10</sup>

As stated earlier, OPSRP applies only to government employees first employed by a PERS

---

<sup>8</sup> (Age 60 for police and fire employees) This compares to age 60 for Tier Two and age 58 for Tier One (age 50 for police and fire employees).

<sup>9</sup> (1.8% for police and fire employees.) This compares to 1.67% for Tier One and Tier Two (2% for police and fire employees).

<sup>10</sup> The applicable regulation for dividing OPSRP benefits is OAR 459-045-0012.

covered employer on or after August 29, 2003. And it takes five years of service to vest in OPSRP at all. So only recently have OPSRP benefits become sufficiently valuable to merit being divided instead of being valued and offset in the overall divorce settlement.

OPSRP represents retirement income often decades away and is not immediately available in cash. And for this reason it is still preferable where possible to allow the member to keep the OPSRP benefit and to offset that value against other assets being awarded to the spouse. The OPSRP benefit should be valued actuarially to see if an offset is practicable.

In my experience, particularly for younger members, the value of the OPSRP may be less even than the value of the IAP. So in those cases, it is possible (and usually preferable) to evenly divide a member's combined PERS benefits by awarding all of the OPSRP to the member, then an equal value of the IAP to the spouse, and to split the balance of the IAP. This will require a valuation of the OPSRP. This allows the spouse to maximize current cash while preserving the long-term benefit for the member, and it serves to best disentangle the parties. I recommend this approach for younger couples.

For those close to retirement, particularly if the alternate payee can wait until the member's actual retirement to receive his or her share, then it may make better sense to divide the OPSRP at retirement. The alternate payee may prefer a retirement income instead of a cash settlement. And in that situation, the appropriate method to divide the OPSRP is the "time rule" as with any defined benefit plan.<sup>11</sup> Under ORS 238.465, the alternate payee can elect to commence receipt of his or her share of the benefits at any time after the member's earliest retirement date<sup>12</sup>, even if the member is still working beyond that date.

Under OPSRP, each party is allowed to elect their own benefits separately for their own lifetimes. This is the so-called "separate interest" approach to dividing the benefits. The judgment or order can provide that the alternate payee may elect to commence his or her share at any time on or after the member's earliest retirement date under OPSRP. The alternate payee must elect to receive benefits, however, no later than when the member does. In a separate interest division, the alternate payee's benefits will be paid to as a Single Life Option for the alternate payee's lifetime in an amount which is re-annuitized by PERS using an appropriate actuarial equivalency factor based

---

<sup>11</sup> The "time rule" is also referred to as the "coverture fraction." It is an arithmetic way of determining each spouse's interest in the plan benefit by separating out the premarital or postmarital portion of the benefit by multiplying the marital share (usually 50%) by a fraction. The numerator of the fraction is usually the number of years and months during the marriage that the employed spouse earned credit for service under the retirement plan. The denominator is usually the total years and months of service under the retirement plan to the point of retirement or termination of employment. *See Richardson*, 307 Or 370, 378-379, 769 P2d 179 (1989) This formula has the effect of treating each year of service during the member's career as having equal credit in determining the former spouse's share, even though the benefits may not have accrued uniformly during the employee's career. That is why the Court of Appeals in *Kiser*, 176 Or.App. 627 (2001) referred to the "time rule" as the "straight line method."

<sup>12</sup> Age 55 for general service workers, and age 53 for police and fire employees with 25 years of service.

on the alternate payee's life expectancy. So the alternate payee will receive life income independent of the member and regardless if whether the member survives thereafter. This means that, unlike Tier One and Tier Two, under OPSRP we don't need to worry about post-retirement survivor benefits to protect the income stream to the alternate payee if the member dies first. That helps in disentangling the parties (particularly if they are relatively young).

On the other hand, if the parties are close to retirement it might be appropriate to hold the benefits together, mandate a survivorship election (e.g., the Full Survivorship Option), and to split the payments for as long as both parties live until the first death, and with the survivor to receive both halves thereafter for the survivor's lifetime. This is the so-called "shared payment" approach to dividing benefits. This approach allows the alternate payee to capture the member's income stream, too, at the member's death if the alternate payee is the survivor. This approach most closely resembles how the benefits would be paid if the parties had *not* divorced, and the alternate payee may want to argue that he or she is entitled to preserve that expectation. And this approach may be particularly important to the alternate payee if it is likely that the alternate payee will survive the member for a number of years. For example, if the parties are close to retirement and the OPSRP benefit will be \$2,000 per month, then rather than a "separate interest" approach allowing each electing \$1,000 per month for as long as each lives, it might be better to mandate a Full Survivorship Option so that, perhaps, benefits are paid at \$1,800 per month for as long as *either* party lives. The payments would be split, \$900/month to each as long as both live. But then on the member's death, the alternate payee would continue to receive the full \$1,800/month as long as the alternate payee lives thereafter. Likewise, if the member is the survivor, the member will receive the \$1,800/month for as long as the member lives thereafter.

PERS allows only one survivor beneficiary at retirement. So if the member expects to remarry before retirement and wishes to name the new spouse to receive survivor benefits, then the member will likely object to the "shared payment" approach and insist on a "separate interest" approach so that the member can provide survivor benefits to the new beneficiary.

If the member is already retired at the time of divorce, then the retirement election "is in concrete" and the best that can be done is to split the payments as they come out. If the member retired with a Single Life Option, then there is no way to protect the alternate payee's income stream after the member dies. The parties can split the payments for as long as the member lives, but then benefits will stop to both parties when the member dies. If the member retired with a survivorship option, then the judgment or order should expressly preserve the survivorship benefits for the alternate payee. Otherwise, after the divorce the member would be allowed to designate a new beneficiary for the survivor benefits or, if an "increase option" was elected then to "pop up" to the Single Life Option, either of which would deprive the alternate payee of survivor benefits after the member's death. Also, in all circumstances, the judgment or order should address the possibility that the alternate payee will be the first to die, and what becomes of alternate payee's share thereafter for as long as the member then lives. The alternate payee can be allowed to designate a beneficiary, or the benefits can revert to the member, as the judgment or order provides.

Similar to private sector plans, the member has to survive until retirement for a full benefit to be payable. For an OPSRP member who dies prior to retirement, only 50% of the benefit is available to the member's beneficiary (including an alternate payee), and the other 50% is forfeited. So to protect the alternate payee's expectancy, it is appropriate for the judgment or order to provide that if member dies prior to retirement, the alternate payee be named as survivor beneficiary as to 100% of the marital portion (not just 50%) so that the alternate payee will get the equivalent of a 50% benefit if member had survived to retirement. For example, if an OPSRP member retires with income of \$1,600 per month having been previously divorced and if marital share by the time rule fraction is \$1,000, then the alternate payee would expect to receive 50% of that or \$500 per month. But if the member dies even one month before retirement (and if the alternate payee had not already commenced benefits separately), then only \$800 is payable and the other \$800/month is simply lost. So to protect the alternate payee, it is necessary to award the alternate payee pre-retirement survivor benefits equal to 100% of the marital portion, not just 50%, so that the alternate payee still to receive \$500/month of the \$800/month available. Otherwise, the alternate payee's share is reduced to \$250/month by virtue of the member's death after divorce and before retirement. Even if the alternate payee receives \$500/month, that still leaves the other \$300/month available for the member's new beneficiary, which represents the survivor benefits attributable to service after the divorce.

Reciprocally, under OPSRP, if the alternate payee dies before benefits commence to either party, then the alternate payee gets nothing and all benefits revert back to the member. The alternate payee has to survive at least to the member's earliest retirement age to receive any OPSRP benefits.

#### *New Template Forms to Attach in Every Instance*

Finally, as stated in the first article, and pursuant to new PERS regulations effective January 1, 2011, new template forms must now be attached to any divorce judgment or supplemental order dividing PERS benefits.<sup>13</sup> The template forms do not replace the need for a judgment or court order dividing benefits specifically in compliance with ORS 238.465. Rather, these template forms are *in addition* to the judgment or court order and must be completed and attached thereto as exhibits. Further, if only one of a member's two PERS benefits are being divided (e.g., a member's IAP account is being divided but the member is keeping the OPSRP benefit), the judgment or order must still incorporate a PERS template form specifying that the benefit being retained is "free and clear" of any claim by the former spouse. So in every case at least two of these forms must be attached to the judgement or court order, one for the IAP and one for the Tier One, Tier Two or OPSRP benefit, as the case may be. And further, if the member is under restrictions or mandates as to beneficiary designations, additional PERS forms are required to be attached to identify those restrictions or mandates. PERS will now reject any judgment or order that does not include these forms.

---

<sup>13</sup> The forms can be found at <http://www.oregon.gov/PERS/MEM/docs/forms/046fs.pdf?ga=t>