

12 QDRO Mistakes *to* Avoid

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Mistake #1 – Misunderstanding the Type of Plan to Be Divided

This is probably one of the most common mistakes in settlement agreements and even final judgments, since often times attorneys prepare the final judgment which the judge simply signs. It often erroneously states “retirement plan” without ever defining the type of plan(s) to be divided.

Retirement plans can be defined contribution plans, defined benefit plans or some type of hybrid. These plans are vastly different and have different implications when trying to divide them. In defined contribution plans, an employee and/or employer make contributions into an account maintained in the employee’s name. These plans have a known account balance at any given time, since the underlying account is nearly always invested in publicly traded securities. In a defined benefit plan, the employee accumulates credits towards their retirement based upon years of service to an employer, and often based on compensation earned.

Typically, when a settlement agreement says the parties will “divide a retirement plan” it can be interpreted that the non-employee is going to receive a lump sum amount. However, if the plan is a defined benefit plan, they may not be receiving any money until the working party retires. Further, they may never receive a lump sum – but rather a monthly benefit payment.

Knowing the plan type and the benefit that can be divided (a lump sum now, a lump sum later or a stream of income) can substantially affect how you may choose to negotiate a resolution.

Practice Tips:

- ☑ **Include the plan type in your agreement if it is not part of the name of the plan.**
- ☑ **Describe in the agreement if the receiving party will get a lump sum now, a lump sum at a future date or payments over time and when those payments will begin and end.**

EXAMPLE: The husband participates in the “ABC Company Pension Plan” which has a cash balance plan with a defined benefit component. If the parties desire to divide the cash balance equally and the defined benefit component based on the marital coverture, the language must be specific. In this case “divide the retirement plan equally” would not be an acceptable reference for the plan administrator to implement a QDRO.

Mistake #2 – Not Using the Correct Name of the Plan

If you start with the premise that you know what type of plan your client and adversary have interests in, the next step is to know what they are named. Often there is reference to “the husband’s retirement plan and the wife’s retirement plans shall be divided equally.” Often parties have multiple plans because they have had multiple employers over the years and/or their employers have offered different types of retirement plans.

If you do not include the actual plan names then, ultimately, you may have situation where one party says their intent was only to divide their 401K retirement plan and not their pension. The other party says, “No, no, no. Retirement plan to me meant pension as well as the 401K.” Being specific about the plan type(s) eliminates confusion.

In addition, often the plan name inherently tells the type of plan it is. For instance, if you have “ABC Corporation 401K Plan” you know that it is a defined contribution plan because the name itself indicates it is a 401K plan. Similarly, if you have “ABC Corporation Qualified Pension Plan” you know it is a defined benefit plan.

The more specific you can be on the plan name, the less confusion can arise in the future. If you list the plan name(s) and upon receipt of a statement identify additional plans, it becomes clear that they were not previously listed and a division not previously negotiated.

The research to find out the exact plan name often includes receipt of a statement and/or a discussion with the plan administrator (often referred to as “TPAs” or third-party administrators), whose contact information can be obtained from human resources or the accounting department at the company. You may uncover there are other plans in place. Most often, the uncovered plans are defined benefit plans to which the employee may not have known they were vested. That is why it is important to check with former employers and be specific on the plan name.

It is important to note that sometimes even third party administrators do not handle QDROs directly, but rather outsource this function to another administrative organization. If you can find that information out ahead of time, it will make the QDRO process much more efficient.

Practice Tips:

- Get a statement and Summary Plan Description (“SPD”) for each plan**
- Contact former employers to uncover any plans not disclosed or known by the parties**
- Obtain contact information for the person that will implement the QDRO for the company, which may or may not be the plan administrator**

Mistake #3 - Trying to Divide Non-Divisible Plans

The “Qualified” in qualified domestic relations orders means that the plan is covered by the Employee Retirement Income Security Act of 1974 (ERISA), a federal law that sets minimum standards for pension plans in private industry. Not every type of retirement plan is governed by ERISA, and therefore those plans are not qualified. Most federal, state and local government pension plans

are not required to follow ERISA guidelines. These plans are often divisible by a domestic relations order or DRO, though.

However, there are many other types of non-ERISA plans that are non-divisible. They are usually for high level executives and may be a “golden handcuff” or “golden parachute” type of payment. They are designed to retain employees. These plans are often called “supplemental”, “non-qualified” or “excess benefit” plans. They may also go by other names. No matter what your agreement dictates, they are not going to be governed by ERISA and not subject to division by a qualified domestic relations order.

If attorneys or parties negotiate into settlement agreements without knowing a plan cannot be divided, litigation can ensue and there may be risk for a malpractice claim. In addition, many non-qualified plans do not offer survivor benefits. If a plan benefit will terminate upon the death of the employee, it is critical to identify that in the agreement and address it during negotiations. In this scenario, it may be appropriate to obtain permanent life insurance coverage to protect the recipient spouse.

Practice Tips:

- ✓ **Find out if your clients have any non-ERISA plans**
- ✓ **Determine the options for division, if any, provided by the non-ERISA plan**
- ✓ **Know if there is a survivor benefit option**
- ✓ **If division is not an option, attempt to negotiate a credit against other assets**
- ✓ **Consider using a trust or “alimony” as a means to equalize non-ERISA plan benefits**



Retain a joint QDRO expert to help craft a resolution that can be implemented

EXAMPLE: Husband participated in a non-qualified deferred compensation plan that will not cooperate with any type of division of benefits. The plan provide for the husband to receive payments for the next 10 years. The parties may agree that the pension benefits be paid to a trust and the trust pay income tax upon receipt of the income, with the remainder to be divided equally by the parties. In the alternate, the Husband may collect 100% of the proceeds and pay the wife 50% of the amount as alimony. In this scenario, you obviously want to consider the tax implications because they are not simple.

Mistake #4 – Not Setting a Clear Date of Division

When the agreement says, “the Husband will receive fifty percent (50%) of the Wife’s ABC Company 401k Plan” there is still a mistake. This can be a significant problem for many reasons because if you do not have a date of division then either side can argue on the date that was intended. One might advocate for the date of the filing for the divorce, the date the agreement was signed, the date of the final judgment, the date of retirement or any other arbitrary date.

By way of example, the value of a 401K plan upon filing for divorce was \$100,000 and by the date the agreement was signed the employee had contributed another \$6,000 and it was now worth \$106,000. To further complicate things, when the QDRO is drafted, the employee continued contributing and the balance is \$108,000. Each side is certainly going to have to argue whatever is going to benefit them the most financially. If you do not have a clear date for division, then you are leaving the door open for future conflict.

It is so easy to avoid all of this by adding another sentence in there that indicates the date. Ideally, you want to pick the first day or the last day of the month because it is generally a lot easier to get an account statement and account value on those dates. If you pick the date the complaint for divorce was filed, say

May 8th, a lot of times it is a little bit more challenging to get the actual value on that exact date. It may be in the interests of both parties to use May 1st or May 31st to avoid a delay in the preparation and implementation of the QDRO.

Practice Tips:

- ☑ **Agree upon a date to be used for the QDRO**
- ☑ **Utilize a date on the first or last day of the month to simplify the implementation of the QDRO**

Mistake #5 - Not Addressing Gains/Earnings and Losses in Defined Contribution Plans

Only defined contribution plans have market fluctuations that can affect the balance of the account. You always want to address within a settlement agreement whether earnings and losses affects the balance that will be divided. As an example, if it says “the husband shall receive \$25,000 via QDRO from the wife’s ABC Corporation 401K Plan as of April 1st” there is no clarity on what should happen to that amount during the pendency of the division.

There is typically a 60-90 day window before the terms in the signed settlement agreement are conveyed in a QDRO, approved by the plan administrator, signed by the judge, sent to the plan administrator and when the plan administrator disperses the funds.

During the date specified in the agreement and the time of a disbursement, you must indicate if the amount should remain stagnant or fluctuate. Because we know that the stock market fluctuates up and down, one side is going to be upset either way if gains and losses are not addressed.

It is also important to note a similar error. There are no earnings or losses in defined benefit plans, yet attorneys often list in their settlement agreements that

the pension award will be “adjusted for earnings and losses”. Since those plans are based on years of service, compensation and actuarial calculations, there is no adjustment required.

Practice Tips:

- ☑ **Do NOT include references for earnings or losses in defined benefit plans**
- ☑ **ALWAYS include a reference to either “a fixed sum of \$x” or “\$x plus or minus gain or losses”**

Mistake #6 – Failing to Address Surviving Spouse Issues

All defined benefit plans have rules and elections regarding how benefits will or will not get paid in the event the participant dies, referred to as survivor benefits. These rules and elections may be different during employment, at termination and/or upon the commencement of benefits. Neglecting how a survivor benefit election has been or will be made is a major area of malpractice claims as well as one of the most litigated areas in QDRO's. Every substantive point in a QDRO must be addressed in a summarized fashion in the settlement agreement. If not, you leave yourself exposed to all kinds of issues.

This mistake can be avoided if you “do your homework” and speak with the plan administrator to understand what options exist as it relates to a division of benefits.

The common options are:

- A benefit will only be paid to the participant if they are alive at the time they are eligible to collect benefits
- A reduced benefit will be paid to the participant if they are alive at the time they are eligible to collect benefits and if they are not alive, 100% of the benefits will be paid to a surviving spouse or ex-spouse.

- A reduced benefit will be paid to the participant if they are alive at the time they are eligible to collect benefits and if they are not alive, some portion of the benefits will be paid to a surviving spouse or ex-spouse.

If divorcing parties are not currently receiving the benefits, you want to consider requiring them to make some sort of election that allows the other spouse to continue to get benefits should the participant spouse die.

If an irrevocable election has already been made waiving spousal benefits, not even a Court order would change the election. In this scenario, you should consider obtaining a permanent life insurance benefit to protect your client's interest.

Let's assume the husband is getting a \$1,400 monthly pension benefit, and he irrevocably elected a single-life payment. Had he elected the joint payment option, he would have gotten \$900 a month. One option is to evaluate how much life insurance can be obtained with \$500 a month.

Another important item to address in your agreement is Qualified Pre-retirement Survivor Benefits, or QPSA. If a participant gets divorced after 10 years of service and cannot retire for another 12 years, there is no benefit actually due to the alternate payee until the participant retires. If they die prior to retirement, there may be QPSA benefits or the alternate payee may lose all the benefits they anticipated. You should note which scenario is possible in your agreement.

Sometimes there is a cost associated with QPSA benefits. The participant should determine if there is a cost, and if so, what it may be, prior to your agreement on how to handle QPSA benefits. Again, the failure to address QPSA or other surviving spouse elections in your agreement does not make these issues disappear.

Practice Tips:

- ✓ **Determine if the participant already made an election that's irrevocable. If they made the election for a survivor annuity, there is no issue.**
- ✓ **Find out if there is an option for a separate interest. A separate interest allows the alternate payee to have their own pension benefit completely dissociated with the participant. This is the best option since it completely divorces the parties from one another as it relates to the plan.**
- ✓ **If only a shared interest survivor annuity election is an option, elect that. Also determine if there are QPSA elections and agree upon how they will be handled.**

Mistake #7 - Incorrectly Handling the Equalization of Multiple Plans

A lot of people will have multiple IRA and 401k plans. In some instances, the settlement agreement dictates that each individual plan must be divided. This is often unnecessary, and many attorneys know that plan balances can be offset against one another. In an attempt to reduce the costs and complexity that would result from dividing each plan – a settlement agreement often has as an objective to equalize (evenly divide) all of their retirement accounts.

The most common problem relates to how these instructions are written. In order to equalize the plans, a date must be agreed upon when the calculation should take place. Thereafter, the earnings or losses must be addressed, from the date of the valuation forward.

For example, on May 1st the Husband has three plans: Plan A valued at \$20,000, Plan B, \$30,000 and Plan C \$100,000 and the Wife has two plans, Plan D valued at \$10,000 and Plan E, \$20,000. A best practice would be to equalize

the values at May 1st – i.e. the Wife should receive \$60,000 ($\$150,000$ for Husband less $\$30,000$ for Wife = $\$120,000$ divided by 2 = $\$60,000$ to Wife). The only plan from which the Wife could receive $\$60,000$ is the Husband's Plan C. Since we know the QDRO may take 60-90 days to implement, we must dictate how gains and losses will be handled. Remember, then, that the Wife will only participate in the gains and losses on Plan C. Therefore, if the Husband were to lose money in Plan A and Plan B, that would not impact the calculation of the amount the Wife is to receive.

The worst mistake is when the settlement agreement says that, “the Wife shall receive an equalization payment based on the value of each plan as of May 1st adjusted for earnings and losses.” It is impossible to accomplish this task, since the calculations cannot be done and implemented in a time period where there are no fluctuations in the balances of the accounts. So the only plan in this scenario that could be adjusted for any of the lawsuits would be the plan that subjects that's going to be divided to deal with the offset.

A note about Employee Stock Ownership Plans, or ESOPs, is warranted here. ESOPs are only valued annually. So, if you choose a date that is other than the valuation date of the ESOP, you will want to specify that the ESOP value will be based on the prior valuation.

Practice Tips:

- Do not attempt to equalize defined benefit plans and defined contributions plans**
- Do not equalize “Roth” accounts with non-Roth accounts**
- Identify which plan will be subject to the QDRO**
- State if the amount will be adjusted for gains or losses**

Mistake #8 – Ignoring Loan Balance

Loan balances are an often overlooked issue in every QDRO for a defined contribution plan. You need to make sure your settlement agreement addresses loan balances. Loan balances can affect the QDRO in a variety of ways. For instance, there is \$50,000 in a 401K and the settlement agreement states the alternate payee is entitled to 50% of the balance as of April 1st. If there is a loan balance of \$30,000, there are insufficient funds to pay the QDRO proceeds. Further, if the intent of the parties is to divide the value less the loan balance, then the agreement lacked the specificity required to properly draft the QDRO.

The larger the loan balance, the more room for error. Loans are complicated by the fact that most have a recurring repayment that will be made during the pendency of the divorce and subsequent period when the QDRO is intended to be implemented. Perhaps when there is a \$30,000 loan, the participant is repaying \$1,000 per month. Should the QDRO consider the loan balance at the date of division or the loan balance at a prior date?

You may also want to include language that protects your client from the diminution of value that would occur if additional loans were taken that you may be unaware of. Most of the time, plan administrators will freeze an account for 60 days or a period of time if they are provided notice of a pending divorce. It is certainly a good practice to notice the plan administrators in all cases, and especially those where the participants have existing loans.

Practice Tips:

- ☑ **Determine if the participant has any outstanding loans**
- ☑ **Notice the plan administrators of a pending divorce to prevent additional loans from being obtained**
- ☑ **Address how any loan repayments may impact the balance subject to the QDRO**

Mistake #9 – Not Stating Who Will Draft the QDRO

Unfortunately many agreements are silent on who will draft the QDRO. If the parties agree to use a joint QDRO expert, that expert should be selected and named in the agreement. Similarly, if one of the attorneys will be drafting the QDRO, it is important to indicate that as well. Further, you should agree on a timeframe for when the QDRO should be drafted and submitted for pre-approval to the plan administrator.

Many QDROs are never drafted because neither of the litigants or their attorneys have a responsibility to complete the process. This rarely happens in defined contribution plan divisions because the alternate payee is generally aware they are entitled to the QDRO proceeds. However, it is too common that in defined benefit plans, since the participant may not be retiring for years, and there is no lump sum payment expected in the near term, there is no sense of urgency to complete the QDRO.

Practice Tips:

- Agree on the party responsible for drafting the QDRO**
- State if the plan participant will be required to complete any forms, and if so, the number of days they have to complete and return those forms**
- Set a timeline for when the QDRO must be pre-approved by the plan administrator**
- State in your agreement which attorney will submit the QDRO for the judge's signature**

Mistake #10 – Failing to Address if the Plan Administrator Provided Forms Should be Utilized

Mistake #11 – Not Determining How Fees Will be Paid

These two mistakes go hand in hand because QDROs can be prepared with administrator-provided forms or customized forms. The form selection will be based upon the terms expressed in the settlement agreement. However, most plan administrators charge the participant a fee for handling a QDRO (in addition to the fees your clients may be charged by a QDRO expert for handling the QDRO). These fees vary by provider. Often, the use of administrator-provided forms is done at the lowest cost, whereas any other forms require additional fees be paid to the plan administrator.

Therefore, you first must determine if an expert-drafted QDRO will be utilized in lieu of a plan-provided QDRO form if that is what would be required to meet your needs. If the settlement agreement is silent, the plan-provided documents will be used as a matter of course so long as it can accomplish the objectives of the agreement.

Once common instance when plan-provided forms will not suffice is when the agreement refers to a marital coverture or exclusionary dates. If you are agreeing to use that type of calculation in your agreement, you also want to be sure you address that it may require a custom form.

Since the fees that the plan administrator will charge may vary if you use a form other than the plan-approved form, if you elect to have a custom form, it is even more critical to address how those fees should be paid. One of the largest plan administrators instituted a policy that if you use their online form for drafting, they charge a \$300 fee to the participant. They charge a \$1,300 fee if you use a customized QDRO - meaning you do not use their form. This is a significant difference, and even more so if it only impacts the participant.

Practice Tips:

- ☑ **Clearly state in the agreement if plan-provided forms should be used**
- ☑ **Agree on how the participant QDRO fee taken by the plan provider will impact distribution**

Mistake # 12 – Not Implementing the QDRO

Here's a harsh story. A poor woman in Virginia got divorced in 1997. At that time, her husband was working for a larger corporation and he was accruing retirement benefits. They had been married 10 years and the husband did not anticipate retiring until 2010. The agreement had the appropriate language to implement a QDRO, yet her attorney told her she did not have to do the QDRO now (in 1997) because the husband was not going to retire for years.

She actually said she was told this all along and it was confirmed when she would bring it up in conversation to other attorneys. Fast forward to 2010, she found out that her ex-husband had retired two years prior and was now dying from a terminal illness. Unfortunately, he had already made an irrevocable election of a single-life payment - not the survivor annuity. Even though her agreement did say that the husband was supposed to elect the survivor annuity, it was too late. The plan would not make any changes and the woman lost out on the survivor benefits.

The moral of the story is that even when there is a defined benefit plan, do the QDRO right away. The most important reason for that is because, obviously, you want to get money as soon as the participant starts retiring. And sometimes, they can retire 20 years, 22 years, 30 years; you don't know they could elect at any time or they can just save all and start getting benefits early. So, you want do the QDRO right away.

The biggest problem with waiting is the loss of the survivor benefits if the appropriate option is not elected.

Practice Tips:

- Have a process in place to follow up on all agreements where QDROs are required or hire a firm that provides you notice on every file so you are kept abreast of the status.**

QDRO Lingo

Many family lawyers get hesitant discussing QDROs because there are many acronyms related to the area. Below is a list that you should become familiar with.

“ERISA” - The “Employee Retirement Income Security Act of 1974.” Federal legislation enacted to secure individual retirement accounts.

“Non-ERISA” - Any plan that is not an ERISA qualified plan. These include federal and state plans.

“QDRO” - **Qualified Domestic Relations Order.** is a term of art used only in connection with ERISA qualified plans.

“DRO” - **Domestic Relations Order.** An as yet formally “qualified” QDRO, or any document used to assign an interest in a non-ERISA tax deferred savings account.

“QPSA” - **Qualified Pre-Retirement Survivor Annuity.** A company sponsored death benefit payable to the surviving spouse of an employee who dies prior to commencing receipt of retirement benefits.

“SPD” - **Summary Plan Description.** Provides the fundamental terms of the relevant plan.

“DCP” - **Defined Contribution Plan.** An individual tax-deferred savings plan where the present value is specified. Most common examples of a DCP are 401(k), IRA, and thrift plans.

“DBP” - **Defined Benefit Plan.** A tax-deferred savings plan where the present value is not specified, but is determined using a formula based on the employee’s earning history, tenure of service, and age. The most common example of a DBP is a pension.

“PA” - **Plan Administrator.** The individual responsible for managing the plan. Preapproves and ultimately approves acceptability of the QDRO.

“PP” - **Plan Participant.** The title owner spouse of the subject plan.

“AP” - **Alternate Payee.** The non-title owner spouse.

“PERS” - **Public Employee Retirement System.** Governs retirement plans for state teachers, firemen, policemen, judiciary, etc.

Noah B. Rosenfarb, CPA/ABV/PFS, CDFA

Mr. Rosenfarb has devoted his career to advising family lawyers and their clients on all things related to money and taxes. He is the Managing Director of Freedom Divorce Advisors, a uniquely specialized accounting and consulting firm dedicated to helping divorcing women take control of their lives and their financial futures.

Noah also offers expert pension evaluation and distribution solutions via Freedom QDRO Advisors; tax projections, planning and preparation via Freedom Tax Advisors, and short-term cash advances to litigants via Freedom Legal Finance.

At the conclusion of a divorce, Noah serves as a personal CFO and helps handle all clients' financial needs via his Registered Investment Advisory firm, Freedom Wealth Advisors, which was recognized by The CPA Wealth Provider for innovation in financial planning.

Prior to creating Freedom, Mr. Rosenfarb was Partner at a CPA firm. He developed a forensic accounting practice and helped over 700 families through the divorce process. His role involved dividing complex assets and creating win/win solutions in difficult situations.

Mr. Rosenfarb has testified in numerous courts as an expert witness and has lectured on technical topics such as business valuation, matrimonial accounting, tax and financial issues in divorce and lifestyle analysis. In addition he has authored numerous articles regarding financial and tax issues in divorce, is a frequent contributor to Divorce Magazine, WomansDivorce.com and Divorce360.com, and serves as a financial expert for Divorce Process and eHow.

In dedication to serving those less fortunate, Noah created The Divorce Education Center of NJ, the only NJ non-profit organization dedicated to educating divorcing women about money. Noah graduated from Rutgers College with a degree in Accounting and became a licensed CPA in 2000.

Dr. Robert G. Hetsler, Jr. CPA, CVA, MAFF, FCPA, CFF

Dr. Hetsler is the Managing Director of Freedom QDRO, a firm specializing in the division of retirement and pension accounts in divorce cases. Retirement benefits often comprise a significant portion of the marital assets, and dividing them between spouses is a common part of the divorce process. However, in order to divide them equitably, the value of the retirement benefits accumulated during the marriage must be accurately assessed.

Because of his unique set of financial skills, Dr. Hetsler is often called upon during divorce proceedings by attorneys and mediators nationwide to provide expert assistance in the division of retirement accounts. He has testified as an expert witness in divorce cases involving the valuing of retirement and pension accounts. He has also been retained to provide pension valuations and prepare qualified domestic relations orders (QDROs) for 401(k) accounts, military retirement divisions, pensions, 403(b) accounts, FERS, non-qualified plans and many other types of retirement accounts in thousands of divorce cases.

Dr. Hetsler has a doctorate degree in Jurisprudence (although he does not maintain an active law license), is a Licensed Virginia Certified Public Accountant (CPA) and a Nationally Certified Valuation Analyst (CVA), a Master Analyst In Financial Forensics (MAFF), a Forensic Certified Public Accountant (FCPA) certified by the Forensic CPA Society, and he is Certified in Financial Forensics (CFF) by the American Institute of Certified Public Accountants.

Dr. Hetsler is an active member of the American Institute of Certified Public Accountants, the National Association of Certified Valuation Analysts, the Florida Institute of Certified Public Accountants (Valuation & Litigation Section), the American College of Forensics International and the Association for Conflict Resolution.

Freedom QDRO Best Practice Checklist

Beginning of the case:

- Get the correct, full name of the plan
- Make sure you know what type of plan it is and whether or not it is going to be divisible either through a QDRO or DRO.
- If it's not divisible, understand what options you have.

During negotiations:

- Find out the current value at the date of filing and the current value and determine if changes result from contributions or loans or simply changes in market value.
- Find out if any loan balance existed at the date of filing or were taken during divorce
- Finding out spousal election rights and if any spousal elections have already been made.

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Call Dr. Robert Hetsler, CPA at (855) 540-0400 x400 to get your questions answered, or email QDRO@freedomadv.com. We look forward to serving you.

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When drafting an agreement:

- Use the correct, full name of the plan
- Describe the plan type – defined contribution, defined benefit or hybrid
- Indicate how benefits will be paid – lump sum now, lump sum later or monthly amount with the start and end dates
- Use a clear date for division, preferably the first or last day of the month
- Indicate how earnings and losses are going to impact the division for defined contribution plans
- Define which plan gets divided if you are offsetting plans.
- Agree on the attorney that will handle the drafting or jointly agree to use Freedom QDRO
- List a timeframe for when the QDRO shall be drafted and sent to the plan administrator
- Address who is going to pay the fees for the QDRO drafting firm and/or the plan administrator's charges
- Indicate if the QDRO drafting firm must use the plan provided form if the plan has one.
- Make sure the QDRO gets drafted, accepted, signed and implemented.



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