Appendix 2

Illustrations of Allocation Methods

Note: This appendix is provided for informational purposes, but is not part of the standard of practice.

Basic Information

The plan provides a retirement plan benefit equal to 1% of the final year's compensation multiplied by years of service. Accrued benefits vest after 5 years of service, and participants are eligible to retire early at age 55 if they have completed 10 years of service. Normal retirement is at age 65. The covered party joined the plan at age 25, was married at age 29, and is age 40 at the allocation date. The covered party's historical service, compensation, accrued benefit, and vested accrued benefit are shown in the following table.

Age	Completed Years of Service	Prior Plan Year's Compensation	Accrued Benefit	Vested Accrued Benefit
26	1	$11,500	115	0
27	2	$12,500	250	0
28	3	$14,000	420	0
29	4	$14,500	580	0
30	5	$15,000	750	750
31	6	$15,500	930	930
32	7	$16,750	1,173	1,173
33	8	$18,000	1,440	1,440
34	9	$19,000	1,710	1,710
35	10	$20,000	2,000	2,000
36	11	$23,500	2,585	2,585
37	12	$25,000	3,000	3,000
38	13	$27,500	3,575	3,575
39	14	$29,000	4,060	4,060
40	15	$33,000	4,950	4,950

Direct Tracing Allocation Method

In the direct tracing method, the portion of the retirement plan benefit that is often considered to be marital property is equal to the actual benefit accrued during the allocation period (typically the period from the date of marriage to the allocation date). For example, in applying direct tracing to a defined benefit pension plan, the portion of the retirement plan benefit included in marital property would generally be the increase from the accrued benefit, if any, at the marriage date to the accrued benefit at the allocation date. If the direct tracing method were applied to the data given in the table above, subtracting the $580 accrued benefit at the date of marriage from the $4,950 accrued benefit at the allocation date would give the portion of the accrued benefit that is marital property: $4,370.

Alternatively, the direct tracing method could be applied to the covered party's vested accrued benefit. Under this approach, the entire $4,950 is marital property because the vested accrued benefit was $0 at the date of marriage.

<u>Fractional Rule Allocation Method</u>

The fractional rule method allocates the retirement plan benefit by multiplying the retirement plan benefit by a fraction. The fraction may be based on compensation, contributions, benefit accrual service, plan participation, employment, or other relevant historical data. The numerator is equal to the selected measure accrued during the allocation period (typically the period from the date of marriage to the allocation date). The denominator is equal to the selected measure accrued during the total period in which the retirement plan benefit is earned. When the selected measure is an elapsed time period, this method is commonly referred to as the *time rule*.

If the fractional rule method based on benefit accrual service were applied to the data in the table above, the $4,950 accrued benefit at the allocation date would be multiplied by the fraction (11 ÷ 15) because the covered party was married for 11 of the 15 years over which the benefit was accrued. The portion of the accrued benefit that is marital property is $3,630.

If the fractional rule method were based on compensation instead, the numerator of the fraction would be compensation earned from the date of marriage to the allocation date ($242,250), and the denominator would be the covered party's total compensation earned from employment date to the allocation date ($294,750).

When the $4,950 accrued benefit is multiplied by the fraction ($242,250 ÷ $294,750), the portion of the accrued benefit that is considered to be marital property is $4,068.

<u>Allocation Method for Age- or Service-Dependent Benefits</u>

Under both the direct tracing and fractional rule allocation methods, the allocation of age- or service-dependent benefits must be defined. Age- or service-dependent benefits are benefits for which the amount or timing of benefit payments depends on the covered party's age or length of service. Subsidized early retirement plan benefits are often age- or service-dependent. For example, a retirement plan might provide that the benefit payable upon early retirement at age 55 is 100% of the accrued benefit if the participant has completed at least 25 years of service, and 50% of the accrued benefit otherwise.

If the covered party has not satisfied the eligibility requirements at the allocation date but remains employed by the plan sponsor, alternative approaches are available. One approach would exclude from marital property any age- or service-dependent benefit that is available only if the covered party remains employed after the allocation date. A second approach would include such benefits in marital property under the assumption that the covered party will remain employed by the plan sponsor until eligibility conditions for the higher benefit level are satisfied. These two approaches may produce quite different results. Under the early retirement provision described above, including the value of the 25-years-of-service subsidy in marital property could double the value of the retirement plan benefit.

As these examples illustrate, retirement plan benefits included in marital property can vary substantially depending on the allocation method used. This highlights the importance of the point raised in the last paragraph of section 3.3.2. An actuary working in an adversarial situation where different approaches have been proposed or used should inform the actuary's client of the nature of those differences and the financial consequences of choosing one approach over another.