BEDEL FINANCIAL CONSULTING, INC.

Financial Planning and Investment Management

THE FINANCIAL ASPECTS OF DIVORCE

WHAT YOU NEED TO KNOW BEFORE THE NEGOTIATIONS BEGIN

By Elaine E. Bedel, CFP®
President, Bedel Financial Consulting, Inc.

INTRODUCTION

Whether you should stay the course or get a divorce is never an easy decision. Divorce is a traumatic experience even if you are the initiating spouse.

There are many factors to weigh and consider before opting to dissolve your marriage. One of the most important factors is the financial aspects of a divorce. Financial issues can be the final straw for a shaky marriage and they can be one of the trickiest issues to navigate during divorce negotiations.

If divorce is the only solution, it is in your best interest to understand the family finances and your needs well before the negotiations begin. A divorce will have financial implications on everyone concerned long after the divorce has been finalized.

Here is a look at the things you'll need to do and the details you'll need to know to help you make informed decisions throughout the process.

FINDING AN ADVISOR

If you were negotiating the purchase of a company or contracting for services, you'd do your homework and ask for assistance if there were issues you didn't understand. That's a no-brainer.

Yet you may not devote the same attention to a divorce negotiation. Maybe you don't want to deal with it now, or you may feel it's worth it to give everything away to get out of a bad situation quickly.

But here's the truth: There's no place more important to be adequately armed with information than when it comes to a divorce negotiation.

A divorce is a life-changing event. Make a mistake during the negotiations, and you'll live with the consequences for years to come. Neglecting the financial aspects of a divorce will have a permanent impact on your well-being.

If the financial landscape of your marriage is a mystery to you, don't panic. Find a trusted advisor to guide you through the process. You don't have to navigate through the unfamiliar territory of finances alone.

A knowledgeable advisor doesn't need to be a paid professional, but he or she needs to be someone who can:

- explain the financial issues and help you understand them.
- assist with evaluating your current and future financial needs.
- outline your alternatives.
- give you all the facts you need to know to make a good decision.
- provide advice regarding which family assets should be retained.
- take away the emotion that can impact your decision-making.

Knowledge is the foundation for good decision-making. Any time you need to make a decision, especially one that involves finances, you must be confident that you have a true understanding of the situation.

If you find yourself entering agreements without fully understanding the financial ramifications, stop the process until you understand your options and the consequences of your decisions. Financial knowledge and understanding is absolutely critical when you are going through a divorce.

DON'T LET THIS HAPPEN TO YOU

Here is a true story about a recently divorced woman I met. We'll call "Sue." Her story illustrates what can happen if you don't have a realistic idea of your financial situation before the divorce settlement.

Sue's husband had taken care of all the family's finances during their marriage. She didn't have the latest information about what they owned and the value of their assets, and she didn't bother to find out. That was her first mistake.

Sue and her husband were having an “amicable divorce.” There were no bitter feelings on either side. Consequently, she was sure “Ed,” her divorcing spouse, would be fair during the negotiations. She trusted him to see that she received everything she was entitled to during the divorce settlement. That was her second mistake.

Sue gave Ed an open invitation to take advantage of her. Not surprisingly, he did. He convinced her that the divorce decree’s “right to discovery,” which requires each spouse to list all assets, was an expensive process that they didn’t need to go through. He assured her he’d listed all their assets and everything was in order and urged Sue to waive her right to discovery. She did.

After the divorce settlement, Sue had a rude awakening. She discovered their joint savings account had been depleted over the last few years of their marriage. She also became aware that an investment Ed, now her ex-husband, had made in a successful company while they were married had not been included as an asset. That lucrative asset should have been divided between them during the divorce settlement, but he got it all.

Ed had a definite advantage over Sue during the negotiations. He had the knowledge and used it to control the financial negotiations in his favor. Choosing to take a passive role and not asserting her rights during the negotiations had cost Sue dearly.

Sue’s story isn’t unusual. Having one spouse responsible for the family finances is typical for many families. In fact, the family unit can be more efficient when married couples divide their collective responsibilities. Who does what is often determined by who has the time or who has the knowledge and interest.

However, when it is necessary to terminate the marriage, it becomes paramount that the spouse who wasn’t involved with the finances, or even both spouses, have a trusted and knowledgeable financial advisor to assist with the process.

HANDLING THE FINANCIAL "FEAR FACTOR"

It isn't just the family assets that need to be addressed when you are headed toward a divorce. One of the most stressful issues you will have to deal with is how the divorce will impact your lifestyle. Having a clear understanding of your personal financial needs can help you put things in perspective and help relieve some of that stress of the unknown.

In fact, both spouses need to have a clear understanding of their financial positions and personal needs as they move through the pre-settlement negotiation stage.

The primary financial objective in a divorce settlement is to allow both spouses to be as economically secure as possible. If your family assets are limited and total security cannot be achieved, you must have a plan in place before the divorce is finalized. If you have confidence that your financial situation will be workable after the divorce is final, the impact of the "financial fear factor" will be minimized or eliminated.

PREPARING FOR NEGOTIATIONS

Preparation is key for keeping the divorce negotiations fair for both spouses. Before you reach that stage, you need to be sure you have completed these three steps:

Determine your living expenses. As you contemplate your future, reduce your thoughts to numbers. Calculate both an amount that will give you a "comfortable" lifestyle and the absolute minimum amount you need to meet your cost of living needs. Be sure to factor the impact inflation will have on your spending into the equation.

Examine your income sources. How do they stack up against your expenses? If you work, earned income will be a major source for meeting your living expenses. If you don't earn enough money to support most of your needs, you may need to consider finding another position or getting additional education. If you are working part-time, you may need to consider full-time employment. If you do not work, you may find yourself relying on investment assets to meet your living expenses.

Analyze family assets. It's not enough to list them. You need to determine the value and ownership title of all family assets. Be sure to include investment accounts, real estate, and employee benefit plans such as 401(k)s, stock options, and pension plans. You may need to have some assets appraised or professionally evaluated to determine a market value that both you and your divorcing spouse can accept.

It is also important to determine the cost basis of all assets. When assets are divided, you want to be sure that cost basis is divided appropriately so that one spouse doesn't incur an unequal portion of the capital gains tax liability. This is particularly important if a portfolio of stocks and bonds needs to be sold to meet the cash requirements of either spouse.

SURVIVING SETTLEMENT NEGOTIATIONS

If you've done all your homework, there shouldn't be any surprises. The negotiations should be fairly straightforward, assuming both you and your spouse play fair.

The settlement negotiations determine the asset division and the amount of supplemental payments. The appropriate assignment of assets can benefit both you and your spouse. The asset division may provide for a 50-50 split or may be weighted more heavily in favor of one spouse. One factor that may influence the percentage split is the unequal future income potential of one spouse over the other.

Agreeing on the settlement percentage is the first step. For the next step, it is important to understand the advantages of owning one asset over another. Selecting wisely can make a big difference.

Here are some guidelines for dividing assets:

- **When you need immediate liquidity.** Consider asking for the savings account and allocating the stock investments to your spouse.
- **When liquidity isn't an issue.** It is more advantageous to have a tax-deferred investment such as a 401(k) or IRA than a regular investment account where taxable dividends and interest are created each year. The tax deferral will allow the assets to increase in value more quickly. When liquidity isn't necessary, it's better to receive some portion of the retirement funds instead of other investment accounts.
- **When the family business is an asset to be divided.** It may be better for one spouse to accept a note from the other for his or her share instead of forcing the business to be sold. It may also be difficult to manage the business if both remain as shareholders.

FINALIZING THE DIVORCE AGREEMENT

To protect both parties, the divorce agreement needs to reflect settlement provisions as well as future financial responsibilities such as:

- **College costs for children.** Who will be responsible for specified college costs and for what percentage or dollar amount?
- **Medical costs for children.** Which spouse will carry the children on his or her health insurance plan?
- **Account or property transfers.** Which spouse is responsible for initiating account or property transfers?
- **Life insurance.** This should be considered a requirement on either or both spouses to assure financial responsibilities are met in the event of an untimely death. To determine the appropriate amount of life insurance needed, be sure to consider current and any future financial obligations, particularly with regards to any children.

WRAPPING UP LOOSE ENDS

Once the divorce is completed, review all aspects of your financial plan to make sure everything reflects your new situation. Here are some suggested items to include in your review:

- Review beneficiary designations on retirement accounts and life insurance.
- Review your estate plan and make appropriate changes.
- Establish credit in your name, if necessary.
- Develop relationships with new advisors and financial service providers, if necessary, so there is no conflict of interest.
- File a "qualified domestic relations order" (QDRO), with your former spouse's employer to protect your interest in qualified retirement plans. You may lose both pension benefits that commence some time in the future as well as the division of the current 401(k) plans if a QDRO is not properly filed.

IN SUMMARY

The financial aspect of a divorce settlement is key to the future security of both parties. The negotiation for a fair division of assets and supplemental income payments can be more easily attained if both spouses know their needs and the family assets, and have a good grasp on their future financial situations. Taking the time to understand and quantify the options will help you and your spouse through the process.

ABOUT BEDEL FINANCIAL CONSULTING, INC

Elaine E. Bedel, CFP®, is president of Indianapolis-based Bedel Financial Consulting, Inc., a wealth management firm. Bedel Financial Consulting provides fee-only financial planning and investment management services for individuals, consulting services for corporate retirement plans and investment advisory for institutions and endowments.

Bedel Financial Consulting works with clients to efficiently and effectively use their financial resources to accomplish their short-term and long-term goals. The firm provides guidance in the following areas:

- retirement planning
- investment strategies and management
- stock option analysis
- education funding
- income tax planning
- insurance needs analysis
- estate planning
- charitable planning
- divorce settlement issues
- family needs planning

For more information, visit **BedelFinancial.com** or email your comments to
Elaine E. Bedel at **ebedel@bedelfinancial.com**