

FINANCIAL MISTAKES DIVORCEES MAKE

By Terry Donahe and Jim Corbeau

Going through a divorce is among life's most difficult experiences. There are emotional, social, psychological, economic and even physical consequences. In our decades of service to those going through or emerging from a divorce, we have identified several financial mistakes that divorcees too often make. Our hope is that you, as family lawyers, can help your clients avoid these pitfalls and, thereby, live more financially secure in the future.

Keeping the Family Home

The home provides comfort and security in addition to physical shelter. It is a very natural reaction to want to stay in our home when faced with loss, adversity, and disruption.

We often find that one spouse will want to remain in the home, and it is often the wife in a traditional (i.e. husband and wife) relationship. She usually has several reasons for this desire and one is keeping the children in their home in an effort to minimize the disorientation they experience.

Unfortunately, it is often not economically possible to remain in the family home. If the couple was able to afford the house before divorce, it is not a given that either spouse will be able to remain in the house after divorce.

We highly recommend that both spouses assess their post-divorce financial situation prior to reaching a settlement. Housing is usually the biggest expense incurred by them (together) before and after settlement (separately). Can one of them afford to live in the house they shared? It may be possible in the short-term, but what about long-term? Will remaining in the home prevent that divorcee from having a comfortable lifestyle, paying off accumulated debt, funding education for children or saving for retirement?

Tracking Investments

In the chaos of a divorce, it is often easy to lose track of the investments that the spouses have accumulated over their lives, before and during marriage. People change employers and they can forget to move their retirement accounts from prior employers to their current employer-sponsored retirement plan or into an Individual Retirement Account. If they have moved, they may no longer receive statements for these forgotten accounts.

The spouses may also have a Health Savings Account that was or is linked to a high deductible health insurance plan. If small, these are usually sitting in an interest-bearing account. Larger sums may be invested in stocks and bonds and other investments. An HSA is unique, because contributions are tax-deductible, growth of the account is not taxable and distributions for qualified medical expenses are tax-free.

If the spouses have children and opened a 529 College Savings Plan for the education of their children, it is important to determine how much is in the account(s) and who is titled as the owner. Such accounts should be referenced when determining who will pay for their children's education.

These accounts need to be identified and included in the settlement process.

Neglecting Tax Considerations

When spouses are negotiating their settlement, they must include taxes during the process. It is easy to forget that not all assets are alike once taxes are considered.

A 401(k) with \$800,000 is not equivalent to a home with a value of \$1 million and an outstanding mortgage of \$200,000. A brokerage account with \$250,000 and a basis of \$200,000 is not equivalent to a life insurance contract with \$250,000 in cash value. A pension that generates \$3,500 a month is not equivalent to rental property income of \$3,500.

A spouse earning \$250,000 a year is in a different tax environment than a spouse earning little or no income. Consequently, the way they should consider the assets that will comprise their settlement will differ.

Spouses should consult with a tax professional who can help them evaluate their assets on a tax-equivalent basis.

Financial Support to Adult Children

We have watched clients compromise their own long-term financial security by providing financial support to adult children. While it may be admirable to help children who are struggling economically, we believe divorcees should never do so if the support jeopardizes their own financial well-being.

It is one thing for an adult child to run into financial challenges during their working years when, presumably, they are able to right themselves (e.g. buy a home, pay off debt, find a new job). It is much more serious for retired divorcees to give away money that can never be replaced, because they are no longer working.

Advisors may need to intervene when they observe divorcee clients with limited resources giving money to children and grandchildren.

Not Returning to Work

If a spouse has been out of the workforce for some time during a marriage, a divorce may spur them to return to work. For example, women who have been home raising children during their married years often desire to work again, particularly after a divorce, so that they can generate additional income, make new social connections, and be engaged and stimulated.

Unfortunately, it is often very challenging for someone who has not been working for many years to re-enter the workforce. The skills and knowledge required to perform many jobs (even clerical and administrative positions) change over time. To secure a job, a person who has been unemployed may need to obtain new education and training. There is also, unfortunately, age discrimination in our economy, which can prevent older people from being hired for positions for which they may otherwise be qualified.

We have learned to advise clients to have conservative expectations about their ability to obtain a new job, and about the income that the job will pay. We have also observed clients who, while otherwise qualified to work, have chosen to not work even though they would be much more secure financially if they did work. So, the mistake here is planning on income that may never arrive.

Over-spending

People who have been married often become accustomed to a lifestyle that is only possible because they are married. Once the spouses divorce, the economics for both spouses can change dramatically. They are now splitting resources (income and assets) and duplicating things they once shared (housing, utilities, insurance, vacations, etc.). It's a double negative.

Divorcees are often reluctant to adjust their spending behavior, because incurring yet more change is undesirable and because they simply do not realize that a change may be necessary.

The harsh reality is that most divorcees must reduce their spending in order to avoid incurring debt, and to ensure that they will have enough saved to fund retirement. The sooner they realize this and make the necessary adjustments, the more likely that they will enjoy long-term financial security.

Personal Credit

People who go through a divorce should review their credit reports and make certain that there are no mistakes. Divorcees will often need to demonstrate good credit in order to rent an apartment, buy a house, secure a new credit card, buy or lease a car, etc.

We have seen situations in which poor financial decisions by a spouse during a marriage have left a newly divorced person with debts and other financial obligations that were unknown. It is important for the divorcee to act on such circumstances as soon as possible.

Given the Equifax security breach, we generally encourage our clients to "lock" their credit with all three agencies (Equifax, TransUnion and Experian). While there is a small cost to do this and it is inconvenient, preventing fraud and its consequences is well worth it. Credit can be temporarily "unlocked" when there is a need to release credit information to a legitimate third party.

Conservative Investments

Spouses who have investments will typically split them in their divorce settlement. Both spouses should then determine an appropriate investment approach for the future.

Usually one of the spouses has taken primary responsibility for the couple's investments. That spouse made (good or bad) investment decisions which affected both of them. The divorcee who was not as involved in making such decisions needs to quickly become aware of and involved with the investments.

Women tend to be more conservative investors than men. They will often adopt a very conservative asset allocation after divorce, because of their desire to preserve their nest egg. The problem is that such a focus on preservation of principal will result in very little growth of the portfolio. Most divorcees will need to grow their investments at some reasonable rate that is greater than the rate of inflation.

College over Retirement

Parents typically want to help their children obtain a college education. Couples who are married often agree to pay for some portion or all of the educational costs for their kids.

However, after a divorce it is often much more difficult for parents to support their own independent lives and pay for college for their children. Unfortunately, divorcees may commit dollars to paying for college that are then not available for their own long-term financial security.

Both spouses need to determine during the settlement process their ability to fund college for their children after their divorce. They should not obligate themselves to paying for college unless they can meet their own needs, current and future.

Social Security

Most people do not consider, much less understand, the benefits they will receive from Social Security until they reach an age at which they qualify for them. Social Security benefits are a very significant resource for most people and, consequently, they should be considered carefully in the context of a divorce.

We have seen numerous situations in which a divorced person did not understand the benefits that they will receive based on their own work history and, potentially, on the work history of a prior spouse.

We recommend that divorcees consult with an advisor well-versed in the nuances of Social Security. Unfortunately, one cannot assume that the information provided by the local Social Security Administration office will be accurate or complete. An independent expert can equip a divorcee with the information (and supporting documentation) necessary to apply for benefits.

Estate Planning

Many people fail to put in place a written estate plan. In Oregon, everyone (single, married, divorced) should have a will, a durable power of attorney for finances and an advanced health care directive. Those who have more complex circumstances should consider a trust.

Divorcees also need to change the beneficiary designations on their retirement accounts and life insurance contracts. If they have minor children, they need to determine custodian arrangements in the event of death.

Divorce is very emotionally draining. So, there is a natural tendency to avoid other emotionally taxing subject, such as estate planning. However, divorcees do so at their own peril.

Life Insurance

People need life insurance to provide resources to dependents (e.g. non-working spouses and children) in the event of death. However, just as people avoid estate planning, they also avoid life insurance. Both involve confronting mortality which is unpleasant.

The amounts of life insurance to be carried by both spouses post-divorce should be established in the settlement. The husband is often the primary income earner and the wife, if she works, has a lower paying job. Often, she has not worked and has remained at home to raise their children. After divorce, she receives alimony (and perhaps child support) from him.

These payments are dependent on the ex-husband remaining alive and working. So, the ex-wife needs to maintain adequate life insurance on him.

We have seen divorcees fail to address this issue in the settlement and we have seen them fail to acquire proper insurance after the divorced is finalized.

We recommend divorcees work with a qualified and experienced insurance agent to implement proper life insurance on their lives and, if appropriate, on their ex-spouse's lives.

There are many financial issues that surface in the midst of a divorce. Mistakes can be costly. You can help your clients by identifying these pitfalls and guiding them to resources that can help them.

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