Family Law Newsletter

Fall 2017: Will Your Client Outlive their Divorce Settlement? Using Financial Planning to Evaluate Settlement Proposals

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"Will I still be able to retire at 60?" "Can I afford to stay in my house?" "How much will I be able to leave to my children?" These are just some of the many financial planning questions that people ask their attorneys when they are going through a divorce. Divorce attorneys know that their clients face the largest financial transaction of their lives - one that will halve their marital net worth and force a major adjustment to their pre-divorce lifestyle.

In order to obtain a settlement that will be in their client's best interest, divorce attorneys need a full understanding of the finances at issue in each case so they can evaluate what mix of assets and income would be optimal for their client's long term fiscal health. A financial plan, prepared by a financial advisor, can help a divorce attorney evaluate the best settlement option for their client.

In our experience, individuals often meet with a financial advisor after their divorce is finalized. Usually at that point it's too late to renegotiate the terms of a settlement. If a client or their attorney can consult with a financial advisor before the divorce is finalized, the advisor has an opportunity to analyze different settlement options and find the one that would best serve their client's goals and objectives. The advisor could prepare a financial plan that would show the attorney and the client the expected results of different settle options. The visibility provided by this analysis has the potential to alleviate some of the uncertainty divorcing clients are feeling about their future financial circumstances and raise their confidence during settlement negotiations.

There are many situations when a financial plan could help a divorce attorney and their client understand the impact of the various settlement options they are considering. The following are two hypothetical examples.

Keeping or selling the marital home. Mary is divorcing Tom, her husband of 15 years. Mary will have primary custody of their three children ages 12, 10 and 7. Mary would like to keep the family's $2 million home in Wellesley (which has a $1m mortgage) but isn't sure she can afford to do so. Tom earns twice as much as Mary and is offering to pay her alimony and child support that would cover her expenses for the next 10 years. Mary is concerned that once the payments from Tom end she won't have enough income to continue to maintain the carrying costs for the Wellesley home.

Mary's attorney has reached out to a financial advisor to evaluate Mary's future financial circumstances. The FA runs three scenarios for Mary:

A - Keeping her $2M home (assumes Mary can refinance the mortgage in her name alone)

B - Selling her $2M home in ten years and buying a $1M home

C- Selling her $2M home shortly after the divorce and buying a $1M home

In addition to owning her home, Mary's other primary financial goals include retiring at 65, providing support to her aging parents, and leaving some assets to her children.

After receiving the relevant facts about Mary's finances from the attorney, the advisor begins building a plan to estimate the probability of Mary achieving all of her goals under each scenario. The advisor analyzes whether the net of Mary's future expected income from all sources including the ten years of support from Tom, minus her expenses, would be additions or subtractions to her net worth. Will she be able to add to her investment accounts each year or need to spend capital to pay her living expenses? The advisor analyzes all of the assets and liabilities Mary would have under each scenario and estimates how these assets will grow or shrink over time based on assumed rates of return for each asset class and the need to spend capital to pay expenses. The plan reveals that scenario C is her best option. By selling her home shortly after the divorce her annual expenses would be cut in half and Mary could use her excess cash flow in the years Tom is paying support to fund her investment accounts.

	Scenario A	Scenario B	Scenario C
$ left at end of plan (age 93)	$0	$200,000	$3,000,000
Annual additions to Mary's investment portfolio (first 10 yrs)	$0	$0	$90,000

Armed with this information, Mary and her attorney may decide that instead of negotiating for Mary to keep the Wellesley home, they take the position that the home be sold. Since the divorce proceedings are still on-going Mary has time to change her strategy and negotiate for a different, and perhaps better, settlement offer from Tom.

Dividing the family business. Bob is divorcing Carol his wife of 20 years. The couple has homes and investment accounts worth $12 million. Bob is also the 100% owner of a privately held medical supply company which has just been valued at $10 million by a court ordered neutral business appraiser. Bob wants to retain 100% of the company because he thinks he will be able to sell the company in a year or two for $20 million. Bob is willing to give Carol the vast majority of the other assets in order to keep 100% of the business. The divorce negotiations are going nowhere because Carol has heard Bob talk up his business for 20 years and she wants a third of any future sale.

Bob's attorney is concerned that his client is putting all of his eggs in one basket and has reached out to a financial advisor for help. He has asked the advisor to build a financial plan for Bob and analyze different settlement scenarios where Bob would keep more of the other assets and give Carol some percentage of the business. He's further asked the advisor to use a range of potential sale proceed amounts for the business so they can evaluate worst and best case scenarios.

With the financial plan and the results from the scenario analysis in front of them, Bob's attorney is able to get Bob to question his divorce strategy for the first time. Seeing how his goals for his retirement might be jeopardized should his business not sell for what he expects, Bob decides to offer Carol a significant percentage of the company for a greater portion of the other assets.

In addition, to educating attorneys and their clients on the financial implications of different settlement proposals, a financial plan could also be useful for attorneys when drafting divorce agreements such as a pre-nups, post-nups or settlement agreements. The attorney may be interested in an illustration of the long-term effects of the financial terms contained in the agreement. In the case of pre-nups and post-nups the attorney may have a client who would like to see what their financial circumstances would look like if marriage does not work out.

Will my assets support me through my retirement?

Ann is a college professor who gave up her career as an investment banker when she married Chris, a corporate attorney. The couple, in their early 50's, are having marital difficulties and are negotiating a post-nuptial agreement. Ann wants to make sure that the lump sum payment schedule Chris has agreed to in their post-nup would be sufficient to get her through her retirement. Her attorney has asked a financial advisor to build a financial plan for Ann. Ann would like to see how her assets hold up using an annual spend rate that is 85% of her current budget and using a lifespan of 100, an age she believes she is likely to live to. The plan allows the advisor to show Ann that the lump sum payments from Chris, when combined with the other assets she would retain, would be more than sufficient to get her to 100. Ann is reassured and tells her attorney she is ready to sign the agreement.

A financial advisor is in a unique position to be a resource to a divorce attorney and their clients. Using their financial planning abilities, advisors can help educate attorneys and their clients on the implications of the various settlement options they are considering. The earlier in the process the advisor is involved the more time the attorney and client have to evaluate their options and, if necessary, alter their negotiating strategy.

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CRC: 3837044 03/2026