The four-letter word for divorce

By Kathryn Jankowski

Having a plan before a couple splits will make for an easier time of it in negotiations and acceptance

There is a four-letter word associated withdivorce: “plan.” While it’s strange planning atsuch an emotional time, it’s better to be preparedand proactive, than unprepared and reactive.

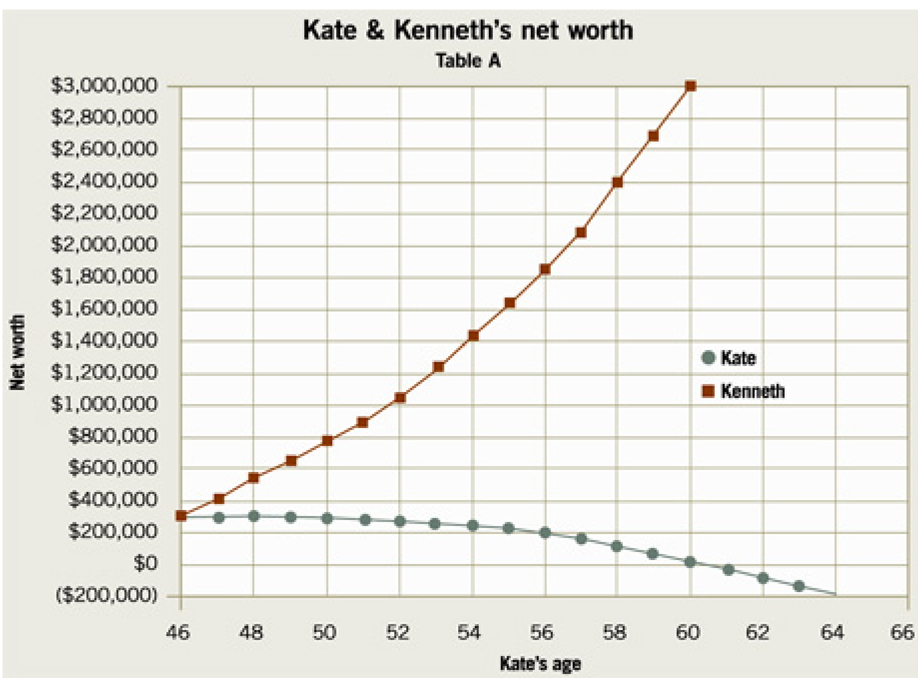
As professionals, we have divorcing clients who want help through this turbulent period of their lives. Lawyers typically quarterback the event, but the accountants, social workers, business valuators, pension actuaries and financial divorce specialists each play a role. Traditionally, lawyers offer legal advice on what is rightfully owed to the client, accountants help with the tax repercussions of the division of assets, social workers work with the emotional issues, and business valuators and pension actuaries ensure all items have proper valuation.

In this pool of professionals, however, there used to be a missing link. There was no single professional who could take all the assets, the income generation and the expenses of the divorcing individuals, and describe to each spouse the financial picture of going forward under a particular settlement arrangement. That is what gave rise to the financial divorce specialist, a recent specialization. The designating body overseeing the specialty, the Academy of Financial Divorce Specialists, was established in Canada in 2003. Essentially, the role of the FDS is to help clients avoid costly mistakes in the division of assets to ensure their future financial well-being. Keep in mind an FDS must be a financial planner, first and foremost and must possess a financial planning designation making the FDS designation, a specialty much in the same way a doctor would specialize in an area of medicine.

Some separation agreements look fair, but, as the old adage goes, 50/50 is not always equal. Let’s take a look at a common scenario — in this case involving divorcing spouses Kate and Kenneth.

Kate makes $21,600 a year and Kenneth’s income is $132,000. They have two daughters, aged 7 and 11. Kenneth has suggested Kate keep the equity in the house valued at $180,000, and he retain the business, also worth $180,000, and that they split their nonregistered mutual fund assets and their RRSPs on a 50/50 basis. Kenneth has also offered Kate $1,000 monthly in child support and $1,500 in spousal support for five years. As a professional, would you have any problems in telling your client this is a good offer?

While this might sound fair, in fact it is not. The financial projections show a path of financial hardship with Kate’s net worth declining over time (see Table A). She will be financially destitute just before reaching 65 years of age and ready to retire. The question becomes how much can Kenneth afford to give Kate without putting himself in a position of hardship? How much does Kate need in order to be able to rectify her situation?

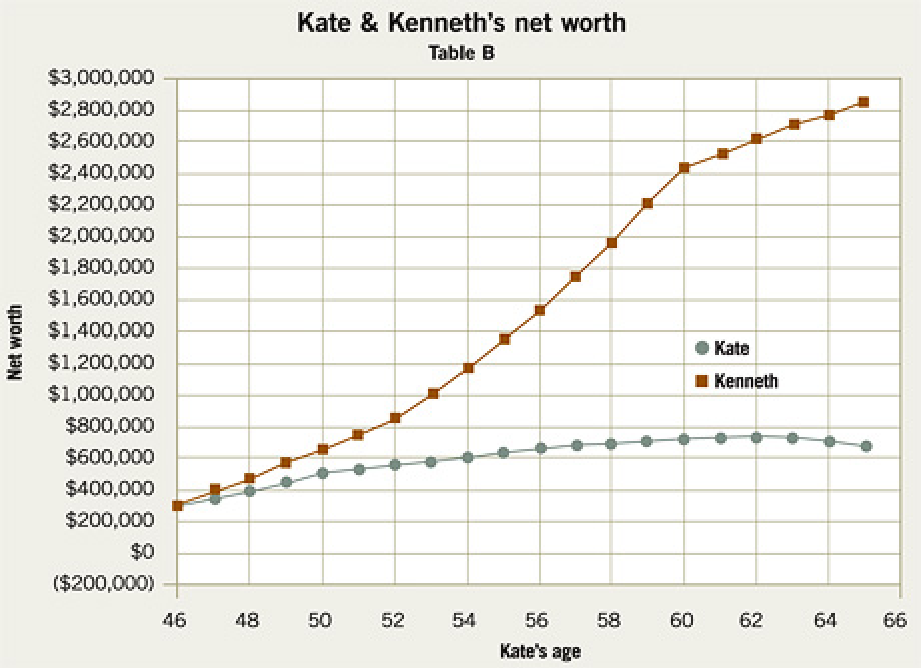


In order for your clients to avoid getting into Kate's situation, it is important for them to plan: prepare, list (or identify) their financial possessions, account for all their assets and liabilities, and then negotiate through to a logical settlement.

Preparation is important in every transition. Divorces are particularly taxing because of the physical, emotional and financial strains put on the spouses all at the same time. The role of various advisers is to be sensitive to these challenges and to do what they can to alleviate and not aggravate the situation.

Take the example of one client who, after ensuring confidentiality, asked if she could afford to divorce her husband. He did not know that she was thinking along those lines. However, she realistically prepared herself financially for her life going forward as a single woman. It is not really an outrageous idea. Most divorcing couples know, or at least have a feeling, that the marriage is not working well before the prospect of divorce is even raised.

It's important the client list his or her assets and income and expenses when getting ready to start divorce proceedings. For one thing, it gives the person and his or her advisers a starting point to develop the settlement agreement. In addition, many assets are not equal between the spouses, and that's not just the after-tax value of a cottage versus the family home.



In Kenneth and Kate's case, Kate kept the house and Kenneth kept the business. The house is an income depleter and the business is an income generator. The result for Kate, who has the lower income, is that she is left with a huge cash-flow problem. In order to sustain her income requirements, she has to supplement her income by way of her mutual fund portfolio and her RRSP. When those assets are depleted she will be forced to sell the house that she wanted to hold onto from the beginning.

An FDS can help with this process by showing couples that they are not realistic in their expectations and can help them make lifestyle decisions before they run into a desperate situation. For example, once the cash flow is calculated, an FDS may suggest such alternatives as downsizing the home or working full-time (instead of part-time) so that their client can generate more income to cover his or her expenses. Realistic lifestyle options are presented so that the client is not on a one-way track to financial destruction without even being cognizant of this direction.

Accounting for all assets and liabilities is the next step. This could require some forensic accounting, as some assets may have been owned before the marriage and, depending on the situation, may still be considered an individual's property. Of course, one must take into account the before- and after-tax issue and which assets are transferable without tax repercussions.

Keep in mind the family home (the primary residence) and the cottage (the secondary residence) do not have the same tax consequences. Would it be more beneficial to elect the cottage as the primary residence and if so, for how long? Are there any trusts involved such as a spousal trust? When is an insurance policy a joint asset?

Along with listing and accounting for all assets and liabilities, it is important to ensure your client is protected from any ill-will from the divorcing spouse.

Ensure clients change their bank accounts and personal identification numbers on their debit cards. They should also inform the bank of their separation status so that one spouse cannot wilfully run up joint credit cards where both are liable for payment. Change the beneficiaries of all registered assets, including pension plans. In addition, make sure that the client writes a new will and powers of attorney assigning benefits and authority to someone else. The last thing you want is for them to become incapacitated and have their ex-spouse calling the shots with the doctor.

Negotiation is the final stage. During this very emotional time in your clients' lives you must help them think things through logically, not emotionally. It is often a huge mistake that divorcing couples want to negate the day-to-day emotional issues by throwing in the towel just to have some resolve. It is paramount that divorce professionals direct clients to view their divorces as business decisions, rather than as emotional ones.

In Kate's example, with the proper advice she will be able to create the right arrangement to enter into a financially secure position over time. An FDS would advise her on various scenarios for allocating assets between her and her husband. For example, Kenneth can afford to provide her a larger sum of initial support without putting himself in a position of financial hardship, either in the short term while providing her funding or for the remainder of his life. In this situation, her financial net worth would increase at a healthy rate over the remaining years of her life (see Table B, which illustrates the projection).

Life does go on after divorce, but the giving away of assets and decisions on custody and access to children can be regretted when the emotional turmoil has diminished. Having a financial plan of their own helps individuals reinstate the confidence needed to address some of these other challenges. Choosing lifestyle changes that are conducive to a comfortable life on their own also helps clients visualize their new status, which helps them to reach the necessary and important stage of acceptance. Confidence in their direction, and an acceptance of their new status as divorced, will allow clients to negotiate their settlement in a realistic fashion.

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