Articles

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Without exception, our clients want to move on with their lives as quickly as possible after they complete the financial negotiations of their divorce. Moving on includes taking control of their own finances. There is a long list of things to do in order to take control of post-divorce finances that are beyond the scope of this article; before the divorce is final, however, our best suggestion is to enlist the services of an experienced Certified Divorce Financial Analyst® (CDFA®) professional to ensure that the final agreement does not have negative long-term consequences for the client.

We regularly engage with clients to complete these items and there is one simple (to us) but infuriating (to clients) road-block that almost all face: changing or naming beneficiaries in the event of the client's death. The first steps should include opening new retirement accounts; in most cases, this will be an IRA. New account paperwork for an IRA contains a section for designation of beneficiary: the party who would inherit the account funds in the event of the account owner's death. While married, most people want their spouse to inherit the funds in their retirement accounts; after divorce, however, the last thing they want is for their former spouse to inherit the funds in their retirement accounts should they pass on. They will often want to name their children or siblings as beneficiaries.

Not so fast, though. If you live in a community property or marital property state, your client will need to obtain a signed consent from their current spouse to name someone else as beneficiary. In fact, most financial institutions require a spousal consent for a non-spouse beneficiary designation regardless of where the IRA owner resides. Experts believe this is simply a policy protection from beneficiary-related litigation for custodians.

Depending on a number of factors – including the divorce agreement – retirement savings accounts such as IRAs and 401Ks may require your client's former spouse to remain the beneficiary even after they have reached agreements around the division of assets.

Planning Consideration: Timing

Many people will negotiate the date on which they will take status as single individuals for tax or other purposes. Waiting until January 1st of the year following the separation may be mandated by state-instituted waiting periods, income tax planning, insurance eligibility, or any number of other practical financial considerations. This complication provides a perfect example of an unintended consequence of negotiations: if a specific status date is negotiated into an agreement, it may have unintended consequences on a client's financial future.

Here's an example. The final divorce agreement for our client, Jane Smith, was filed with the court on June 30, 2012. Part of her agreement with her ex-husband, John, says they will take status as single individuals on January 1, 2013. This was done because the couple's tax preparer advised them that they could save $2,000 in federal taxes by filing their tax return married jointly for the current year (2012).

From the federal government's perspective, the couple remains married for the whole year – even though they have completed their financial settlement.

The agreement awards 50% (~$600,000) of John's 401K account to Jane via a Qualified Domestic Relations Order (QDRO). In order to receive the funds, we are opening a Rollover IRA account in advance of the QDRO in Jane's name. This way, we can tell the 401K plan administrator exactly where the funds should go. Remember that state law, federal law, or custodian policy **requires an individual name their spouse as beneficiary of retirement funds, and our client is not yet officially divorced**. As CDFA professionals experienced in the intricacies of account transition, we will inform Jane that she has three options to remedy the situation and at least one to make it worse:

1. **Obtain the former spouse's signature on a Spousal Consent for the new account paperwork**. John must effectively agree to allow Jane to name her children as the beneficiary of the funds she was just awarded in the divorce.
    - Client Quote: "You mean I just spent 18 months and $50,000 fighting over this money and I still need his permission to do what I want with my money?!"
    - Practical Consideration: What if the relationship has deteriorated to the point where John refuses to agree to the change in beneficiary? It may cost thousands of dollars in attorney fees to force her to do so.
    - Practical Consideration: What if Jane doesn't want John to know who her financial advisor will be post-divorce?
2. **Name the former spouse as beneficiary temporarily**. In really bad circumstances, when a couple no longer communicates at all, it may be advisable to simply name the former spouse as beneficiary with the intent of modifying this as soon as the judgment is final.
    - Client Quote: "You mean we have come all this way and I have to keep him as my beneficiary and he will inherit my money if I die?!"
    - Practical Consideration: What if we decide to postpone but somehow forget to change the Beneficiary Designation once the judgment is final? Does the judgment awarding the 50% to Jane protect her?
    - Practical Consideration: What if something happens while the judgment is pending? Who inherits Jane's money?
3. **Delay the transfer of funds.** QDROs take time: the QDRO cannot be carried out until the final judgment is signed by a judge in most circumstances, and it is rare to see a QDRO completed in close proximity to a judgment of dissolution.
    - Client Quote: "But you said 'Taking Control Now' was the most important part of my financial transition after the divorce! Now you are telling me to wait?! Wait for what?!"
    - Practical Consideration: So what is the harm in waiting? Our major concern is the management of investments inside of the account. When transfers are delayed, the funds are often managed by the former spouse or by an investment advisor my client has explicitly chosen *not* to work with. I recently had a client tell me they would never invest in such a risky asset as the Facebook Initial Public Offering (IPO). Imagine her shock when I showed her the most recent account statement for her joint brokerage account and her

investment advisor had purchased 3,000 shares of Facebook in the IPO! The advisors used by a couple during marriage are rarely appropriate for both parties – particularly the woman – to work with after a divorce. Either they will be aligned with one party, unfamiliar with the specific needs of a newly-divorced woman, or unable to provide the necessary services. On top of that there is often a lack of trust. Without trust, an investment advisor has no business working with an individual.

- Practical Consideration: I have seen investment accounts lose half of their value during a dissolution proceeding. Guess who gets blamed for the losses? Usually the former spouse – which means the client may not trust anything they have to say and turn into thousands of dollars of additional unnecessary discovery efforts.
- Practical Consideration: We may want to obtain Authorization and Consent from the former spouse for our client to take over managing her portion of the funds.

4. **Ignore the problem.** We certainly would not recommend this option – and we would also be remiss if we failed to mention the ramifications of doing so.
    - Client Quote: "He has been jerking me around and lying to me for years. What is the worst that could happen?"
    - Practical Consideration: We actually don't know what the ramifications would be of disobeying from a legal perspective.
    - Practical Consideration: We *do* know if no spousal waiver has been obtained, the default plan beneficiary will be the participant's spouse, even if he is not the named beneficiary. US District Courts have affirmed this. In this particular case, John – not Jane's chosen beneficiaries: her children – would inherit the retirement funds if Jane should pass.
    - Practical Consideration: There is a bit of uncertainty and disagreement amongst experts whether these rules are equally as hard-and-fast with IRA accounts as they are with 401K accounts. The presence of uncertainty makes experienced financial advisors plan for the worst-case scenario, so ignoring the precedent is never presented as an option for our clients.

The financial transition following divorce offers the opportunity for clients to remake their financial lives in a way that supports their ongoing comfort, security, and dreams. Most importantly, it offers the opportunity to take control of their finances as a single individual and throw off the constraints of a power-struggle now terminated by a judgment of dissolution. The complications of such simple things as paperwork, as evidenced above, can have prolonged and lasting effects on your clients' lives when the power-struggle continues after the financial agreements are reached. Enlisting the services of an experienced CDFA professional during the process will help ensure your clients obtain the most financially advantageous settlement possible and support their financial independence far beyond divorce negotiations.

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