When Divorce and Retirement Collide

Jessie Foster, CFP®, CDFA

As advisors, we all know statistics related to the number of baby boomers who are retiring each year. We have worked hard to help get them to this place, gently nudging them to save more as well as to spend less. We’ve held their hands through the fear of market volatility and guided them to stay the course. Retirement for many can be a frightening time, one fraught with uncertainty, loss of identity, loss of social circles, and fear that they have not saved enough to last as long as they do. We have prepared them for this transition and are poised to use the many tools at our fingertips to help them move from a savings strategy to an income-distribution strategy and plan for this new stage of life.

All of this work can fall apart in dramatic fashion when our retiring clients inform us that they are getting divorced. According to a study by the National Center for Family and Marriage Research at Bowling Green State University in Ohio, the divorce rate for people over age 50 between 1990 and 2010 has doubled, leading to what is now known as the “gray divorce” (Brown and Lin 2013).

Divorce at any time can be financially devastating for a couple, but divorce at or during retirement adds another level of complexity and financial pitfall that can be catastrophic to the financial well-being of both parties in their later years.

Some mature couples may have accumulated large financial portfolios so the division of assets such as stocks, bonds, annuities, certificates of deposit, savings accounts, retirement plans, and pensions may be quite complex. They also may own multiple homes, vacation timeshares, or other real-estate investments. All of these types of assets need to be handled with great care and that care may need to be coordinated among a financial professional who is familiar with divorce laws of the respective state, an attorney who specializes in tax law or estate planning, and the family-law attorney to determine the correct value and strategy for an equitable division.

For couples who already were struggling to make retirement work before divorce due to smaller financial portfolios, outstanding debt, and limited income, dividing marital property may offer few options and may even force them back into the workplace—or, in some cases, into the workplace for the first time.

Child support likely is no longer an issue for most divorcing couples who are in their fifties and sixties, but income sources are extremely important. Every state treats alimony differently, so this may or may not be an option, even in a long-term marriage. Some states, such as New Jersey, will not automatically absolve spouses of responsibility for paying alimony just because they have retired and have less income. Age at retirement is often a pivotal factor, but a decision to retire early may be considered a voluntary event and attributed earnings ability to full retirement age could be factored in for support calculations. However, if spouses are age 65 or older, it’s reasonable to expect that they would retire and it is possible that alimony could be based on this lower income. More often, however, we see alimony ceasing all together at retirement age. Before you make any assumptions about income post-divorce, speak with a family-law attorney to understand the options available in your state. Because most retirees depend on retirement and savings accounts to produce income, property division becomes a crucial aspect in the gray divorce. Designing an income strategy for two households instead of one with retirement assets that have been divided during an older couple’s divorce is challenging and in some cases may not be enough.

Social Security benefits cannot be divided in divorce but may be taken into consideration when looking at income sources for alimony or property division. Spouses who have never worked will not qualify for their own Social Security benefits. However, if they have been married for more than 10 years and are older than age 62, they can collect Social Security spousal benefits on the former spouse without reducing the former spouse’s benefits.

A pension earned during marriage generally is considered to be a joint asset of both husband and wife, but it may be very difficult to determine the marital value. Working with a qualified pension-valuation expert is strongly recommended because the rules pertaining to the division of pensions are complicated and vary from state to state and retirement system to retirement system. If a pension is divided between divorcing spouses, it generally must be done at the time of divorce and done using a qualified domestic relations order (QDRO).

We now are seeing gray-divorce cases that involve two working spouses: one receiving Social Security benefits and one receiving a
Annuities come in many varieties and each periods and less-favorable benefit riders. Consequently, the parties may be forced of living benefits or added riders. Most contracts do not allow transfers or distribute the annuity in a lump QDRO and the annuity contract, the couple to protect any tax exemption. Based on the QDRO in order to divide the annuity and to divide the pension should be considered in the property division. Again, this adds a level of complexity because you must determine the pension option you are valuing (lump-sum value, single-life value, or joint-and-survivor value). Each will provide a different valuation and may favor one party over the other. Considering that Social Security benefits and pension payments are taxed differently, factoring in the after-tax value is important and often is overlooked in settlement agreements.

Many clients have purchased annuities with guaranteed income benefits that can provide an income stream in retirement. However, dividing an annuity in divorce can wipe out these benefits if handled improperly. Annuities held in qualified retirement plans (such as a 401(k) plan or individual retirement account) require a QDRO in order to divide the annuity and to protect any tax exemption. Based on the QDRO and the annuity contract, the couple may be able to divide future periodic payments or distribute the annuity in a lump sum. Most contracts do not allow transfers of living benefits or added riders. Consequently, the parties may be forced into new contracts with new surrender periods and less-favorable benefit riders. Annuities come in many varieties and each company has its own set of restrictions, so it is extremely important to understand the client's specific contract and the options available before dividing these contracts and to have the QDRO in place before the client's divorce is finalized to protect both parties. Too often we have seen a QDRO prepared after the divorce only to find that the annuity contract cannot be divided.

If a client's portfolio is large enough, couples may be better-served by offsetting the value of the annuity or pension with other assets rather than splitting these types of assets between the parties. Understanding the tax ramifications for each type of asset then becomes imperative so that you are truly comparing on an after-tax basis. Financially, older women may be at a significant disadvantage post-divorce. This is a generation of women who were traditionally homemakers and have no Social Security benefits or pensions of their own. Men, on the other hand, may balk at paying alimony after retirement, and many state laws support them in this position. The result is that divorced elderly women end up trying to exist on Social Security—or they face a job market for which they're woefully unprepared.

Other important components in a gray divorce include health and long-term-care insurance. Getting health insurance in your 60s can be particularly challenging when Medicare doesn't kick in until age 65. If the employee spouse is still working and the group health plan allows for former spouses to continue on the plan, this can be a good option. But when this isn't an option, clients need help comparing plans on the open market and finding one that fits their needs. The Affordable Care Act has provided some relief because insurers no longer can deny coverage or charge people more based on pre-existing conditions, but it has made it confusing for some to find the right plan.

Older couples also should pay special attention to long-term-care insurance policies. If they own a “shared care” rider that allows one spouse to tap into the other’s benefits, most insurance companies will allow the clients to remove this rider from the contract and reduce the premium. However, this loss of benefits can have real impact on a client’s later years, especially for women, because women typically live longer than men and are more likely to use these benefits. This loss of benefits should be considered when reviewing equitable property-division options. If clients don’t own long-term-care policies, you may want to recommend they apply for and purchase policies before the divorce is final to take advantage of any couples discounts that may be available. Once the policies have been issued, they will not lose the discount post-divorce and could save each party considerable money in the long term.

Generally we consider life insurance post-divorce to protect the stream of support payments over a period of time. If there is no support to be paid after retirement age, then why would life insurance be an issue? Many mature couples own life-insurance policies with considerable cash value that often pays dividends and accumulates tax-deferred. Many of these older policies’ dividend rates can exceed today’s low bond rates and offer an attractive alternative to a typical bond portfolio. Before liquidating a policy, consider the tax consequences, loss of dividend income, and the impact on the estate planning of each client post-divorce. A few options available may include the following:

- A 1035 exchange that allows the cash value of the insurance policy to be rolled into respective annuity contracts without any immediate tax consequence
- Keeping the policy intact and using other assets to offset cash value
- Using the policy for estate-planning purposes that will benefit the adult children and/or grandchildren of the divorcing couple. This can be accomplished through naming a trust as beneficiary or establishing an irrevocable life-insurance trust as owner of the policy.

With regard to estate planning, when a client informs you of a pending divorce, you want to review beneficiary designations on retirement accounts, bank accounts, life insurance, and annuities as well as powers of attorney for health care and finances. Depending on the state you live in and the divorce process your clients are going through, restraining orders may prevent you from making certain estate-planning changes until the divorce is final. If possible, you may want to encourage your clients to start updating their estate plans as soon as possible. Some state laws aim to protect people from accidentally leaving property to a former spouse, but those protections generally kick in only when the divorce is final. If a premature death should happen during the divorce process,

Continued on page 30
the beneficiary designations can supersede provisions in a pending divorce settlement.

Often when older couples divorce, they don’t want to waste their time going through lengthy court battles or spending hard-earned savings on expensive lawyers. Older couples may no longer want to be married, but they want to preserve family relationships with their children and grandchildren, and they want control over how they go through this process. Today, fortunately, we have many options in divorce processes other than litigation. Alternative dispute-resolution processes such as mediation, collaborative law, and arbitration all provide an opportunity for clients to control the costs of getting divorced, focus on their needs and goals, and maintain a positive family dynamic.

When retirement and divorce collide, clients need our skills. As trusted advisors we need to ensure they are well-informed of the numerous options available to them and guide them through these transitions. Jessica Foster, CFP®, CDFA, is an investment manager with Colman Knight Integral Wealth Advisory Services, where she works with women, business owners, and families to help them navigate life’s transitions. She earned an MBA from Simmons College School of Management. Contact her at jessie@colmanknight.com.

Reference