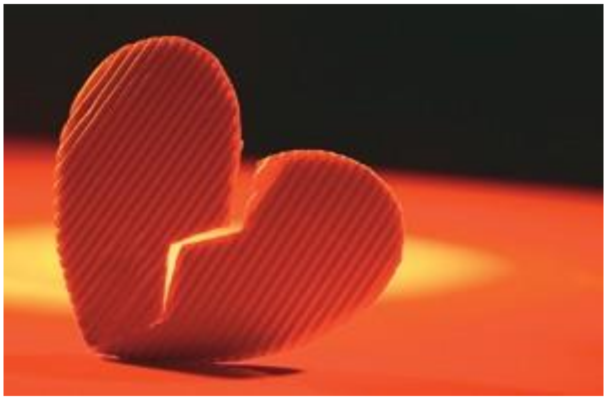
ADVISOR MAGAZINE
insurance investment income

February 28, 2019

Strategies For Protecting Threatened Wealth

How to advise older clients divorcing on the cusp of retirement



by Lili A. Vasileff, CFP, MAFF, CDFA

Ms. Vasileff is a fee only CFP, Master Analyst in Financial Forensics (MAFF™) specializing in Matrimonial Litigation, CDFA, and President of Wealth Protection Management in Greenwich, CT. Please visit wealthprotectionmanagement.com. She is author of three books: "Money & Divorce: The Essential Roadmap to Mastering Financial Decisions" published by the American Bar Association; and "The Ultimate Divorce Organizer, The Complete Interactive Guide to Achieving the Best Legal, Financial and Personal Divorce", and "The Divorce Planner Checklist". Her awards include the prestigious 2013 Pioneering Award for outstanding public advocacy and leadership in the field of divorce financial planning, the Women's Choice Award as a highly recommended Financial Advisor by Women for Women; CEO Today 2018 Business Woman of the Year Award; Five Star Wealth Manager Award for last 8 years, and Marquis Who's Who Albert Nelson Lifetime Achievement Award.

Grey Divorce

Every 10 seconds a Boomer turns 60 years old. Gray divorce is what many boomers face. Among U.S. adults over age 50, the divorce rate has doubled since 1994. Contrary to expectations, long term marriages are not immune to divorce and the largest increase (55%) is in first time marriages of over 20 years. With transition and the uncertainty of a divorce outcome, being able to meet one's needs and protect wealth are the two priorities expressed most often by older individuals who divorce.

Gray divorcees find themselves in the final financial phase of their lives: decumulation and final spend down. The knowledge they used to accumulate wealth and strategies utilized to grow wealth, may not be sufficient to carry them through a transition like divorce. Retirement planning is disrupted; divorce undermines existing, mature income plans. Picking up and starting over with limited time to rebuild wealth and a long horizon for preserving it can be emotionally and financially exhausting.

Threatened Wealth

The gray divorce phenomenon is much examined because of its impact on the economy. In general, the older you are, the more complicated divorce is financially. Couples who are age 50 plus face multiple competing demands on their time and wealth. There are surprisingly many nuances in the gray divorce statistics.

They may have to deal with:

- demanding jobs
- college tuition
- adult "boomerang" children living at home and/or spending down their assets
- adult children in conflict with each other/family in family owned business
- skyrocketing health insurance premiums and medical issues
- financial and care giving responsibility for ailing elder parents
- mismatched expectations heading into retirement
- significant age disparity (between spouses)
- blended families (if remarried)
- lack of knowledge about retirement savings

Divorce often lights a match to these stressors, exacerbating all financial issues by now dividing wealth into two households. In the present environment of great market volatility and low interest rates, there is an obvious call for knowledge of how to protect wealth and produce income.

Cash flow from earned income is finite based on years until full retirement age. When earnings cease, spousal support obligations generally end. One must replace this income stream well before compensation and/or spousal support ends. This goal requires renewed focus on how to divide mature retirement portfolios. Retirement assets are a significant part of marital property and are divided either equitably or equally, depending on the state where you live.

Not All Retirement Assets Are Alike

Not all retirement assets are alike in how you initiate drawing a benefit, make withdrawals, invest, or pay taxes. It is important to understand the nature of any asset you have to divide. There are employer sponsored retirement plans that are either qualified (such as a 401K, 403b, 457 plans and pensions) or nonqualified (such as supplemental savings, deferred compensation, and executive bonus). There are retirement accounts such as IRAs, SEP IRAs, Simple IRAs and ROTH IRAs.

By proportionately dividing all kinds of retirement assets in divorce, each spouse winds up with a comparable opportunity to employ the most tax efficient strategy for withdrawals. It has been shown that if one has taxable, tax-deferred and tax-exempt accounts, you can increase the longevity of a portfolio by withdrawing in the most efficient sequence to minimize the average of the marginal tax rates on these withdrawals. Most often, this means withdrawing first from the taxable account, then from the tax deferred account, and lastly from the tax-exempt account. Other tax advantages should be explored for minimizing taxes with strategies for potential conversion to ROTH IRAs and timing application for Social Security benefits.

Not all retirement assets are alike in how you initiate drawing a benefit, make withdrawals, invest, or pay taxes. It is important to understand the nature of any asset you have to divide...

Annuities play a key role in portfolio diversification and can anchor fixed income allocation for those nearing retirement. It would not be unusual if you or your spouse owned an annuity outright or owned an annuity as part of your retirement account. However, in divorce, annuities can also be the black sheep of the marital pie.

First let us define what is an annuity. Annuities are designed to be a reliable means of securing a steady cash flow for an individual during retirement years and to reduce fears of outliving one’s assets. An annuity is a legal contract that binds an insurance company to provide guaranteed periodic payments to the annuitant for a specific time period or for lifetime. In retirement, an annuity guarantees risk free retirement income.

Annuities come in all shapes and sizes. Each annuity contract varies among provider companies and each has its own set of rules. Each annuity contract specifies the structure (variable or fixed rate), any penalties for early withdrawal, surrender period, spousal provisions such as a survivor clause, death benefit, etc.

Some are in retirement plans and some are not; some have living and death benefits, others do not. Some are deferred or immediate; some are non-qualified or qualified. Some require a Qualified Domestic Relations Order (QDRO) to divide; some do not.

Annuities Not Easy To Divide

The complexity of the nature of annuities makes this asset very difficult to divide or value for purposes of equitable distribution. Unfortunately, annuities are not like other marital assets which can be divided readily between both spouses. Divorce attorneys may not understand the impact of dividing annuities.

There can be significant risks with changing an original annuity contract and there can be disastrous tax consequences if the annuity is not divided properly pursuant to divorce. You absolutely need to know all about the annuity, and along with the help of a financial expert, to determine if, and how, the annuity can be split. Otherwise, you could suffer lasting damage.

If you split an annuity, any share of the annuity you receive will not be taxable at time of transfer in the context of divorce. However, if divided, you can receive at most the benefits of the existing contract, nothing more. You need to read the annuity contract to know if you are able to receive via QDRO a lump sum, cash-out, or rollover to an IRA. If the answer is no, you may not want this annuity as part of your share of the marital assets.

There are four options for dividing an annuity. The first option is a withdrawal of all or part of the annuity with a direct distribution to you. The second choice is to transfer the amount awarded to you, whether a specific dollar amount or percentage of total contract value, via a direct transfer to your IRA. The third method, preferred by the vast majority of insurance companies, is to take a “withdrawal” from original contract and then issue two new contracts to you and your ex-spouse, that set forth pro rata benefits and new account values. Processing new contracts is much easier and less of an administrative burden for the insurance companies. The last choice, that does not split the annuity but may be necessary in some divorce agreements, is to transfer ownership of the contract in whole to you, in which case, a new contract goes into effect.

With any of these options, the annuitant must authorize the insurance company to split or transfer the annuity. You should always confirm with the annuity provider if they will allow an annuity to be split, transferred to a new owner, or allow for lump sum cash-outs. The insurance company should be contacted early in the divorce process to determine what options, penalties, expenses or taxes will be incurred.

Concepts to Consider:

- Do your homework (call the company and get detailed policy information in writing)

- Try to offset the annuity with other assets of equivalent value in the property division (you will need proper actuarial valuation)
- Try not to split the annuity
- Explore sharing the income stream from the annuity in the future (if used for income)
- Know when a QDRO is required to avoid tax disasters upon distribution

An annuity is a complex financial asset and one that can be irreparably harmed by uninformed parties seeking to divide, transfer or cash out in divorce. Insurance and investment companies do not make it easy for you to execute terms of your divorce agreement if instructions are unspecific or unclear and contrary to their own policies. Act early and do your homework to better understand your annuity.

The key takeaway is you must have a roadmap for protecting wealth and meeting financial goals post-divorce during retirement years. This can be best accomplished during the divorce process when you still have all options available for negotiating your fair share of retirement assets. ◊