Negotiating a Strong Financial Settlement for Your Divorcing Clients

By Christy L. Watkins
Regional Investment Advisory Lead

Key points

- As a divorce attorney, you have a unique opportunity during the divorce process to help prepare your client for future financial independence and success
- Having the right data and a holistic view of your divorcing client's financial picture are important in helping achieve an advantageous settlement
- Remember, once negotiations are complete and a financial settlement is reached, it's very hard to renegotiate for a higher amount

Gathering the proper financial information can help you as a family lawyer negotiate a strong financial settlement for your client. By partnering with the right advisor, you can help your client achieve his or her financial independence.

Obtaining a strong financial settlement for your client

As a divorce attorney, you have a unique opportunity during the divorce process to help prepare your client for future financial independence and success. The question that arises is: How do you build confidence that the settlement you are requesting is going to be enough?

As you approach negotiations, a powerful tool at your disposal is the right data. Specifically, a financial projection based on the requested settlement accounting, as well as the accounting for your client's anticipated cash flow needs.

Having that data can empower you to ask for a settlement that you might not have previously considered. It can also make it very difficult for your counterparts to dispute the amount being requested, since the figures are concrete, which is very powerful.

A key factor in achieving a successful financial settlement request is to have a holistic view of your client's entire financial picture, not just the settlement amount.

The risks of *not* having a full financial picture

Without a deep understanding of your client's full financial picture, your requested settlement may not be enough to meet your client's expected lifestyle.

It would be extremely disappointing—and possibly open the door for a lawsuit—to go through the whole negotiation process only to find out that your client will need to make significant lifestyle adjustments. This could happen as a result of something as simple as not accounting for property or other types of tax, the cost basis of a piece of marital property, or not recording all outstanding debts.

Remember, once negotiations are complete and a financial settlement is reached, it's very hard to renegotiate for a higher amount. Having that full financial picture in advance can help make sure that you're able to win an appropriate settlement for your client.

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Spreadsheets alone are not enough

Spreadsheets are a fantastic tool and have any number of uses. However, spreadsheets are not sophisticated enough to model more complex or real-life situations. In order to handle your client's variables and pull them together in a way that's more consistent with real life, you need a more sophisticated tool.

The tax code is very complicated. Different types of income carry very different tax rates and consequences, and it's difficult to get a spreadsheet to account for a realistic estimate of what tax consequences might be over time, especially as an investment portfolio grows and changes.

Investment returns do not happen in an even and consistent manner. The stock market can be very volatile, and it's unrealistic to apply a single rate of return year after year. Unfortunately, this is exactly what happens when using spreadsheet models alone to try and estimate the growth of a portfolio.

One of the key components in determining whether a financial settlement will be enough to satisfy your client's needs is estimating the growth rate of the portfolio. Since the spreadsheet user has to provide this data, you are probably estimating an amount based upon historical information.

Ask yourself: Is the historical 10-year environment that we just experienced likely to repeat in the future? No one has the ability to predict precisely how markets will move in the future. However, forecasted returns can incorporate more realistic expectations for future economic growth and future interest rates versus relying on historical information.

The importance of a financial analysis

As noted previously, start by taking a look at your client's full financial picture. Working with a wealth advisor, you can put together a list of any assets and liabilities. This includes banking accounts, marketable securities, real estate, and mortgages, to name a few.

Next, account for estimated cash flows. Consider inflows, looking at any income or cash payments your client expects to receive (i.e., alimony, salary, any anticipated social security payments, inheritance, etc.). Then look at estimated outflows. This would be any expenses your client anticipates now or in the future, such as living expenses, education costs, or perhaps any travel being considered. Make sure to account for inflation, as some expenses are likely to increase over time and at a faster rate. For example, education costs and medical expenses tend to increase faster than other living expenses. Be as realistic as possible. Keep in mind that your client's tax situation may also change post-divorce, so understanding any future anticipated tax rates will be important.

Develop an understanding of your client's goals and comfort level with taking risks. Together, these components determine the anticipated growth rate or return for any assets your client expects to receive during divorce. This will impact how successful the financial settlement will be in meeting your client's expected lifestyle.

That said, figuring out an appropriate level of risk can be difficult and it will most often be advantageous to invite an investment professional into the discussion. These conversations should incorporate a sophisticated analysis to account for shocks to the portfolio by looking at what could happen to the portfolio in a really challenging market environment to gauge your client's comfort level with staying invested through difficult market times.

The benefits of a sophisticated financial analysis

After incorporating all of the information into the analysis, the output would likely be a series of reports that provide an estimated forecast into the future. The results would incorporate all assets, liabilities, anticipated cash flows, and tax ramifications.

Returns are not typically even and consistent, so the sophisticated analysis will project thousands of possible scenarios, where the order of the returns that you receive vary, which can have a significant impact on the future outcome of the portfolio. As an example, a big decline in the value of the portfolio at inception, as opposed to many years later, can have pronounced longer-term consequences to the growth of the portfolio. Therefore, it could put at risk the plan or the ability to meet lifestyle needs. Analyzing a range of expected outcomes from running these scenarios can be much more helpful than relying on a single expected outcome from a spreadsheet.

The analysis can also provide the probability that those assets will last and cover all anticipated expenses post-divorce, which can offer a much higher level of confidence, including considering a difficult economic or market situation.

The effectiveness of analytics during divorce negotiations

While a spreadsheet can provide some basic assumptions and also serve as a starting point, sophisticated analytics take into consideration a broader set of outcomes and potential market shocks that better model real-life situations. This could help you determine whether a higher settlement is warranted.

These analytics can arm you with the data to support your financial settlement argument. You should use this analysis when negotiations are still underway, however. Because divorce involves emotional as well as financial transactions,

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introducing new data at the eleventh hour could cause the opposing party to dig in their heels and renege on any agreements reached up to that point.

Things to consider when dividing assets

As the assets are being split between the two parties, there are a number of factors to consider. The first is the titling of the assets. How will those assets be owned? Will they be owned directly, or will they be owned in trust? This is important to understand, and it offers protection that your client is being treated fairly. When dividing marital assets, don't solely focus on equal values in the split. Understand the characteristics of the various investment holdings to make sure that your client is being treated fairly.

For example, a municipal bond and shares of a high growth stock may have the same values, but their characteristics are fundamentally different. One thing to focus on is income production. Are the assets that your client is receiving able to produce regular cash flow or income to help provide for spending needs? The second consideration is, how liquid are those assets? Can they be converted to cash and sold easily at a reasonable value to meet some cash flow needs?

Think about tax implications as well. What is the cost basis of the securities your client is receiving, and is it equivalent or fair to those received by the other party? If the assets need to be sold to either cover cash flow needs or to reposition a portfolio, there is a real expense associated with unrealized gains and associated taxes that may need to be paid, and that may impact the value of the portfolio. In sum, make sure that you're considering these characteristics as assets are split.

Educating your client

In many marriages, one spouse tends to be responsible for all financial matters in the household. Upon divorce, the other spouse must now assume that responsibility for the first time. This can be very daunting for a financially naïve spouse.

Partner with a financial advisor who is equipped to offer some foundational education to the newly divorced client, helping him/her to understand of the basics of investing. For example, he or she must learn the impact of inflation on investments, how helpful the compounding of returns or interest can be, the different asset types, risks associated with investing, and the importance of diversification. Receiving some training on those basic financial concepts is crucial to his or her ability to make decisions about how to invest the financial settlement post-divorce, and working one-on-one with a trusted financial partner can help give a recently divorced individual the confidence needed to move forward.

Encourage your client to ask a lot of questions. Helping your client to better understand his or her financial future, create a realistic budget, and work toward long-term goals can help to prevent your client from living beyond his or her means and depleting the financial settlement.

Finding the right financial advisor

After reaching a financial settlement, a newly divorced individual may seek your guidance in finding the path forward. When searching for a financial partner for your client, consider someone who will be a partner, not just an advisor. A financial partner should be able to provide peace of mind. Your client has gone through a lot and needs someone who will help set a plan for the next stage of life. The right financial advisor will provide guidance specific to your client's situation and not just offer one-size-fits-all general advice.

It is important to find a financial professional who is held to a fiduciary standard versus just a suitability standard. The right financial partner should have deep resources to handle the variety of situations or life challenges that your client may be facing.

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Christy L. Watkins, CFA

Regional Investment Advisory Lead

302.651.1965
cwatkins@wilmingtontrust.com

Christy is responsible for co-leadership of the Investment Advisory team in Family Wealth, as well as serving as a senior investment advisor. Prior to joining the Investment Management team, she served as a trust accountant in the Tax Department. Her experience in taxation allows her to construct portfolio rebalancing strategies utilizing a tax-advantaged approach. Christy holds a bachelor's degree in finance from the University of Delaware, where she graduated magna cum laude. She is a CFA® charterholder, a member of the CFA Institute, and a member of the CFA Society Philadelphia, where she serves on the Women's Advisory Council. Christy volunteers her time with Meals on Wheels.