

CDFA Case Studies:

YOU CAN LEAD A HORSE TO WATER

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STATE OF AFFAIRS

Wren and Donald have been married for 12 years and have two children. Wren would really like a divorce. Donald does not. Wren is not sure that she can afford to be on her own. She has indicated that if she decides to divorce that they would have 50/50 custody of their children and that she would like them all to live in close proximity. Wren wants this to be an amicable process for the couple and hopes that they can remain friends.

To date, Wren has been able to pursue her passion, which pays very little. Wren is currently looking for a full-time job and anticipates that she will make approximately \$50,000 per year starting out.

Donald is an executive and has a base salary of \$225,000 plus bonus potential as well as stock options. Donald also received a signing bonus from his current employer in the form of a forgivable loan which will vest over four years.

A large part of Donald's compensation at his last company was in the form of non-qualified Class A stock options. Donald was granted 17,500 shares that were to vest at 20 percent per year for five years. Donald was able to exercise 7,000 shares for \$5.50 per share while still employed. The shares were purchased by the company at \$100.74 per share. When Donald left the company, his separation agreement stated that the remaining 10,500 shares would be purchased by the company as they vest for \$100.74 per share. Considering the exercise cost of \$5.50, the net benefit will be \$1,000,020. The options are not transferable. If Donald dies prior to the stocks being exercised, Donald's heirs can exercise the shares.

The couple has cash and investments of approximately \$450,000. This includes the \$100,000 signing bonus/forgivable

loan. They have retirement assets of approximately \$200,000.

The marital home has approximately \$600,000 in equity and a mortgage balance of \$350,000. Wren would like to stay in the marital home.

The couple has approximately \$20,000 in debt. However, the forgivable loan, technically is an asset with a corresponding liability that will either be forgiven over Donald's employment with the company or perhaps paid by a new employer if Donald makes another career move.

WREN'S POTENTIAL OUTCOME

From an asset and liability perspective, Wren's outcome is good. She should receive approximately \$1,150,000 in assets less liabilities. Wren will also receive child support and should receive alimony for some period of time. Calculating Donald's income is a bit complicated as he has only been at his new company for a few months. In reviewing past tax returns, Donald has consistently made \$350,000 for the last four years. This is the number that was used to calculate child support and alimony.

There are concerns about standard of living and expenses. The marital home is a large older home that has been remodeled, but is still expensive to maintain. The children's expenses are also very high.

The recommendation is made that Wren consider allowing Donald to remain in the marital home and for her to look for something that she will be able to more comfortably afford on her anticipated salary, understanding that alimony will only be for a few years and child support will go away in 10 years.

NEGOTIATIONS

Feeling confident that she could make it on her own, Wren told Donald that she wanted a divorce. Wren did decide to allow Donald to stay in the marital home. However, Wren purchased a

new home before a settlement was reached, and it will result in monthly payments of over \$3,000 per month. In order to secure a loan, Wren was able to get her father and step-mother to co-sign the loan. On an expected \$50,000 salary, this is not the best decision.

Wren also indicated that Donald was not comfortable with child support and alimony being calculated on \$350,000. Donald wanted credit for paying many of the children's expenses directly. The child support and alimony were recalculated using Donald's base salary with Donald paying the children's tuition, insurance, and extracurricular expenses directly.

Donald did not want the non-qualified stock options included on the marital balance sheet, and Wren was content to agree with that. Since this asset represented almost half of Wren's settlement, it was of grave concern. The company had a history of paying the stock options and so a value was easily calculated. In addition, Donald's separation agreement specifically stated that the company would purchase the options.

Wren was strongly encouraged to seek the advice of a lawyer who specializes in employee benefits relative to divorce and she has declined. It is not known if Wren's interest will be protected when the stock options are paid to Donald.

One way to protect Wren would be to note in the settlement agreement that Donald must provide Wren with tax returns and substantiating W-2s and 1099s until all options are repurchased by the company. Because Donald would pay Wren for her half of the options net of taxes, this would allow her to see what that tax liability was. Another option would be to have Donald execute a promissory note for Wren's share of the options that would be payable based on the vesting schedule net of taxes. The promissory note could be secured by a lien against Donald's home (the former marital home) to ensure payment is made.

In addition, it would be important to ensure that if Donald dies prior to the options being repurchased that Wren would inherit half of the stocks and be free to exercise them. To be fair to both sides, there could be protection for Donald. The balance of the promissory note would be null and void if the company become financially insolvent.

Because Donald was going to be staying in the marital home, it was agreed that as part of the settlement that he would owe Wren \$200,000. He was comfortable taking \$100,000 from a home equity line of credit that would be in Donald's name only. Donald wanted to pay the balance after his alimony obligation

ended. It was suggested that a promissory note be executed and Wren secure this note with a lien against the marital home and she declined.

TAKEAWAYS

This case had a disappointing outcome in several ways. In helping clients to understand their financial situations, we want to ensure their equitable settlement and set them up for future success. In Wren's case, despite advice to the contrary, she made decisions that put her financial future in jeopardy. From a financial perspective, Wren is leaving a very comfortable and secure situation. Wren believes that Donald will be amenable to partnering with her going forward for the sake of their children and their friendship. That may be the case. However, it is our role to hope for the best and plan for the worst. The concern is that as the dynamics of their relationship change and the new reality sets in that:

- Wren will struggle to make ends meet.
- Donald may not pay Wren what she is owed on the stock options, and Wren will have no way of knowing when they are paid to Donald.
- Donald may not pay Wren the balance of the amount he owes her for the equity in the marital home.

Wren certainly has the option of pursuing legal recourse if problems ensue, but legal actions are costly and emotionally draining. Potential future problems can often be avoided if addressed more adequately in the settlement agreement. We can lead a horse to water, but we cannot make them drink. Ultimately, the decisions are the client's, but it is important in situations like this that you document and communicate your concerns.



About the Author

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After 20 years in corporate finance and achieving the Chief Financial Officer (CFO) position, Wendy became a CDFA® professional and founded Mitchell Hayes. The corporate environment prepared Wendy to exercise her talent for analyzing complex situations and developing creative financial solutions that her clients utilize to move forward after divorce. For more information, visit www.mitchellhayes.net.