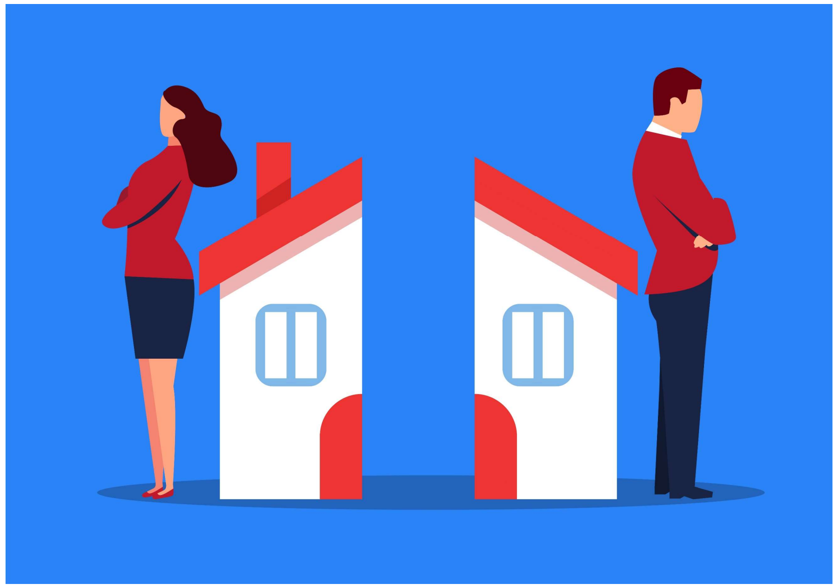
5 Steps to Rebuild Your Retirement Savings After Divorce



Even when divorce is the right decision, it's still disruptive. For example, there's a good chance that you and your ex planned to share retirement expenses and combine your savings. But the divorce divided your retirement funds, and not necessarily 50/50. Now, you're facing retirement with only a portion of the funds you expected.

While divorce certainly throws a wrench into your retirement plans (maybe you won't buy that sailboat), it doesn't necessarily mean that you're going to have to spend your retirement eating grocery store ramen. You can take steps now to rebuild your retirement savings.

1. Understand your settlement (Yours, mine, and what happens if it's ours)

The end of a marriage can trigger extreme financial consequences, even in the most amicable of splits. Only nine states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin[i]) have community property laws. This legislation designates any income or real or personal assets acquired during a marriage as jointly owned property and therefore eligible for an equal split in a divorce. In other states, the division of assets comes down to the courts.

If your spouse is awarded part of your retirement funds or vice versa, your divorce agreement will include a QDRO (Qualified Domestic Relations Order) or a process called a "transfer incident to divorce" detailing the division and payout of retirement benefits[ii].

Regardless of how you split joint assets – including individual 401(k) plans, savings, and investments – you're probably going to have less money in your retirement savings than anticipated.

2. Review your new financial situation

Divorce can be one of the most expensive times of your life. The [average cost of divorce is $15,000 per person](). When the dust settles, you should review your new financial situation. It can take six months or more to get past the initial flurry of divorce-related costs and start to see your adjusted financial position.

Whether you lived on two incomes or your partner was the breadwinner, transitioning to living on a single income can be difficult. You need to calculate your new monthly expenses and compare the total to your income.

3. Set a budget

Once you get a grip on your new household income and new living expenses, you can set a budget. Besides covering your bills, groceries, and fun money, make sure to funnel money into an emergency fund. Now that you're single, if you end up out of work for a while, you won't have a second income to fall back on.

We'll talk about it more in step 5, but you should also consider including increased retirement contributions in your budget. Rebuilding your retirement fund is an important step in preparing for your future.

4. Re-assess your tolerance and capacity for risk

The financial effects of divorce can also change your overall risk appetite. In an ideal financial situation, your risk tolerance (how much volatility you're comfortable with) and your risk capacity (the amount you can take) should align. Divorce can upset this balance, increasing your tolerance but decreasing your capacity. It's probably worth taking a moment to review your position, identify your goals, and determine how much risk you are willing and able to handle.

5. Adjust your allocation, if necessary

Your next step is adjusting your contributions, allocations, and risk profiles. First, where is your money? Have you tucked your savings into an employer-sponsored 401(k), a traditional or Roth IRA, a personal investment portfolio, or a combination of accounts?

Now, compare how much you have in your retirement fund to how much you want. Next, figure out how much you need to save to reach your retirement goal and consider if that number is realistic and achievable.

If you can, you might want to increase your retirement or investment contributions. Or, if your current plan won't get you to your goal fast enough, you could consider opening or expanding your personal investment account.

You also should review your risk profile and rebalance your portfolio allocations wisely. Everyone's situation is unique, and your cash flow could influence your decisions. If you were the breadwinner in your household and are no-longer supporting your ex, you might be able to handle more risk. However, if your income and financial cushion haves decreased, you might be less tolerant of higher-risk investments.

One more financial admin note

While you're updating your retirement and investment accounts, take the time to update your beneficiaries on all of your retirement, savings, investments, and life insurance accounts. Make sure your money and benefits go to the person or people you want to receive them.

In summary

Divorce can change a lot in your life. Be patient with yourself, but take steps to preserve your future. Review your new financial situation, and make the necessary budget and adjustments to give yourself the best chance of living comfortably now and in the future.

References

[i] https://www.investopedia.com/personal-finance/which-states-are-community-property-states/
[ii] https://www.investopedia.com/personal-finance/whats-qdro/