PROTECTING INCOME, RETIREMENT, and WEALTH FOR YOUR KEY PEOPLE

Benefit Restoration Strategies

The term "Executive Benefits" often brings to mind thoughts of something special or a golden parachute. This type of reward sometimes is the case in large public companies. However, for the small to mid-market, properly designed executive benefit plans are used to restore benefits to the highly compensated, which are most often the key employees.

The typical corporate spend on employer provided benefits, as a percentage of salary, will vary significantly by the different pay groups:

	Core	Director	Executives	CEO
Typical Benefit Spend as % of Salary	40%	30%	20%	10%

Companies generally spend 20% more, as a percentage of salary, on benefits for the core population than they spend on benefits for the executive group. This disparity in spending comes at a cost to highly compensated employees (HCE).

The cost is a form of inadvertent reverse discrimination that results from insurance carrier limits and IRS restrictions. HCEs can find themselves in financial crises if they experience a disability, and/or they arrive at retirement without intentional planning.

Employer sponsored plans often provide the best resolution for the challenges of this unintended but real form of reverse discrimination. Strategically designed disability income restoration plans and 401(k) restoration plans (nonqualified deferred compensation plans under IRS Section 409A) offer a viable solution for employers and highly-compensated key employees.

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Disability Income Insurance Limitations and Restoration Opportunities

Many HCEs are unaware that they have insufficient income protection due to definition limitations and the benefit caps on group long-term disability income (LTD) insurance.

A typical group coverage formula will be 60% of salary up to a maximum benefit of $10,000 to $15,000 per month.

- Definition of disability in group coverage is typically "inability to work in any occupation" vs "inability to perform the material and important duties of your occupation."
- Many HCEs have 25% or more of their cash compensation in the form of bonus or long-term incentive, which often is excluded from the LTD benefit formula.

Example: Group LTD Short Falls / Income Gap

	Cash Comp	LTD	Benefit
Base Salary	$200,000	60%	$120,000
Annual Bonus 35%	70,000	NA	NA
Long-term Incentive 50%	100,000	NA	NA
Total Compensation	$370,000	32%	$120,000
Should be	370,000	60%	222,000
Income Gap		28%	$102,000

Most executives are unaware that their full income is not insured.

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Example: Income Protection Solution – Disability Benefit Restoration

Below is an example of a supplemental disability income plan (exclusively for the top hat group) that is designed to restore this important disability benefit to the HCE. Plans with this design allow individual disability income contracts to sit on top of the group LTD to provide income replacement ratios similar to those received by the core population.

Position	Age	Salary	Target Bonus	Total Cash Compensation	Current (1) Monthly Group Benefit	Replacement Ratio(2) of TCC	Individual Monthly Disability Benefit	Total (3) Disability Benefits	Replacement Ratio of TCC	Annual Premium
EVP	52	$290,000	$203,000	$493,000	$10,000	24.3%	$14,650	$24,650	60.0%	$4,110
COO	54	250,000	250,000	$500,000	10,000	24.0%	15,000	25,000	60.0%	$6,191
CFO	50	275,000	225,500	$500,500	10,000	24.0%	15,000	25,000	60.0%	$5,409
CEO	62	300,000	300,000	$600,000	10,000	20.0%	20,000	30,000	60.0%	$8,130
VP	63	230,000	75,000	$305,000	10,000	35.0%	7,890	17,890	70.0%	$3,196
VP	42	185,000	92,500	$277,500	9,250	34.5%	6,650	15,900	69.0%	$1,798
VP	61	263,000	131,500	$394,500	10,000	30.5%	10,000	20,000	61.0%	$4,077
VP	51	200,000	100,000	$300,000	10,000	34.5%	7,190	17,190	69.0%	$2,681
Legal	40	225,000	225,000	$450,000	10,000	26.6%	12,500	25,000	66.7%	$3,109
VP	36	185,000	46,250	$231,250	9,250	48.0%	4,480	13,730	71.3%	$925
		$2,403,000	$1,648,750	$4,051,750						$39,626

(1) 60% of salary capped at $10,000 per month
(2) Group Benefit Ratio to Total Cash Compensation (Salary + Target Bonus)
(3) Group & Individual Benefit

The cost of this individual, portable own occupation disability contract usually costs 1 to 1.5% of covered payroll.

Very Important

Disability medical underwriting is challenging.

If the group is 10 participants or greater, Guarantee Issue (GI) facilities are available.

Retirement Plan Restrictions, Limitations, and Solutions

Due to Social Security and IRS limitations, qualified retirement plan contributions are limited. Thus, retirement benefit outcomes are less favorable for executives than for the core population.

2018 401(k) deferral limit = $18,500 + $6,000 over age 50.
2018 eligible income maximum = $275,000 & Social Security wage base = $128,700.

Studies consistently show that we will require 70-80% of our final earnings to live comfortably in our retirement years.

Typical Replacement Ratio at Retirement

Income Salary	$40,000	$80,000	$120,000	$200,000	$400,000	$800,000
Social Security	57%	44%	35%	22%	11%	6%
401(K)	28%	28%	28%	28%	20%	10%
	85%	72%	63%	50%	31%	16%

Assumptions

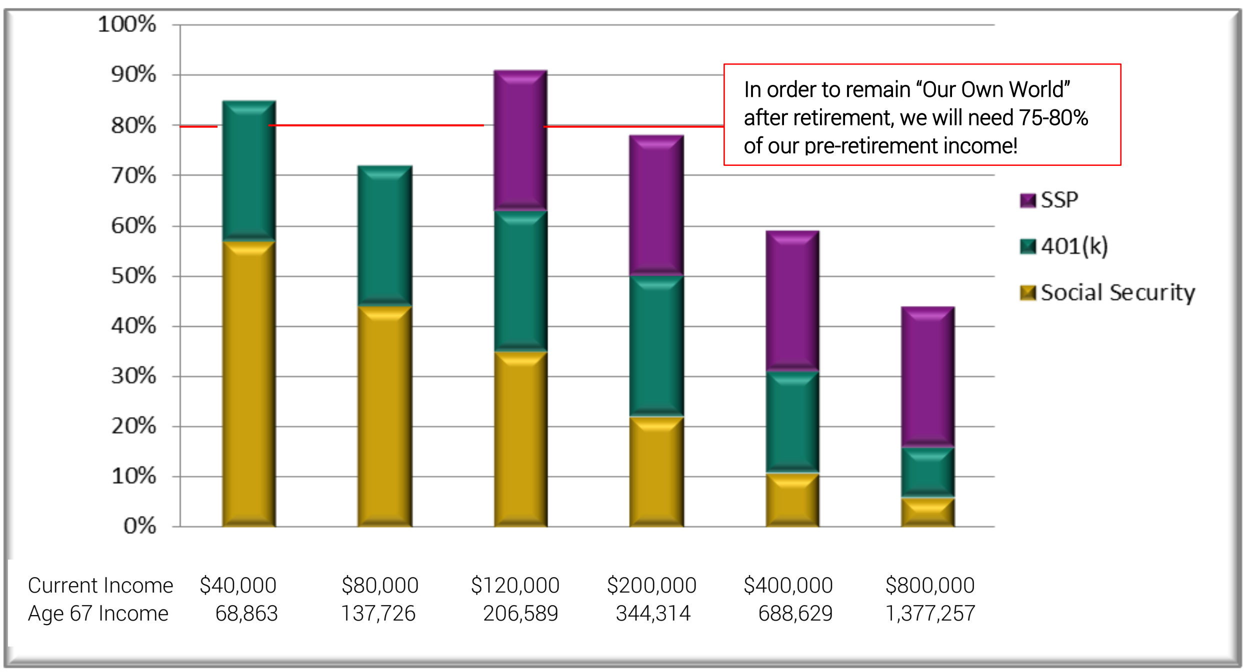
Employment Age 45	6% Yield during Accumulation (22 years)
Retirement Age 67	5% Yield at Distribution (20 years)
Employees Saves 6% in 401(k)	4% Employer 401(k) match

Retirement Income Solution – 401(k) Restoration Plan

The 401(k) restoration plan falls under IRS Section 409A, which governs most forms of non-qualified deferred compensation. By following the 409A rules, and deferring tax deductions, an employer can allow eligible participants to defer, on a pre-tax basis up to 100% of compensation.

Typical Replacement Ratio at Retirement with a 401(k) Restoration Plan

Income Salary	$40,000	$80,000	$120,000	$200,000	$400,000	$800,000
Social Security	57%	44%	35%	22%	11%	6%
401(k)	28%	28%	28%	28%	20%	10%
SSP	0%	0%	28%	28%	28%	28%
Totals	85%	72%	91%	78%	59%	44%



Assumptions

Employment Age 45	6% Yield during Accumulation (22 years)
Retirement Age 67	5% Yield at Distribution (20 years)
Employees Saves 6% in 401(k)	4% Employer 401(k) match
HCE Saves 6% in 409A	4% Employer 409A match

SUMMARY

The sample disability restoration plan comes in at a cost of 1% of covered payroll and protects the total cash compensation of the key employees. The sample 401(k) restoration plan (nonqualified deferred compensation plan) match comes in at a cost of 4% of covered compensation. There are also some administrative costs for the deferred compensation plan; typically, there is an annual base fee of $10,000 +/- plus approximately $125 per participant. Based on these assumptions, a 15-person plan may cost in the range of $11,875 +/-. Lastly, the employer will delay the tax deduction for compensation deferred.

By investing a portion of the benefit spend differential (between the core population and HCE), an employer can dramatically enhance the recruiting and retention features of its total rewards offering. In this case for 5 to 6% of covered payroll, an excellent benefit platform can be established.

G. Scott Cahill
Fulcrum Partners, LLC
801 N. Orange Ave, Suite 820
Orlando, FL 32801
scott.cahill@fulcrumpartnersllc.com
407/841-2480

Bruce H. Brownell
Fulcrum Partners, LLC
814 A1A North, Suite 307
Ponte Vedra Beach, FL 32082
bruce.brownell@fulcrumpartnersllc.com
904/296-2563