

Give your HCEs some TLC



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Effective plan design strategies

Are your most vital employees saving enough for retirement? Do they utilize your qualified plans to their maximum potential? Can they meet their retirement goals under your current plan design? These are all questions that need to be addressed to ensure that the retirement plans you sponsor are effective and attractive to high-value employees.

Unfortunately, the answer to the first question is often no. In some cases, lower wage employees do not take part because they are constrained by cash flow needs. However, highly compensated employees should be able to save. Their reasons for non-participation are more often related to a lack of understanding of the value and effectiveness of qualified plans like 401(k) and Cash Balance plans.

The power behind these plans is the impact of compound returns and tax deferral. While it is possible that a financial advisor has shown these employees examples of how much money saved each month can accumulate over time, this is a message that cannot be repeated and stressed enough.

Take an employee contribution of \$1,000 per month, made each month for 20 years. This adds up to \$240,000. However, if the account earns 6% annually, it will accumulate to \$454,000 after 20 years. This realistic return doubles the amount available for retirement.

When this sort of compounding effect is leveraged on money going into a tax-deferred account instead of taxable savings, the additional amount of retirement income generated is remarkable.

This example illustrates the point: a 45-year-old executive is promoted and now has the resources to start actively saving for retirement. She has not saved anything toward retirement so far because she was focused on saving for her children's education. She expects to work another 20 years and retire at 65. Her marginal tax rate now is 39.6%; at retirement, she expects it will be 33%. Her financial advisor has told her to plan for 25 years of payments in retirement. Additionally, her advisor says she can expect to earn 6% in the years prior to retirement, but should switch to a more conservative portfolio earning 4% once she begins taking money out of the account.

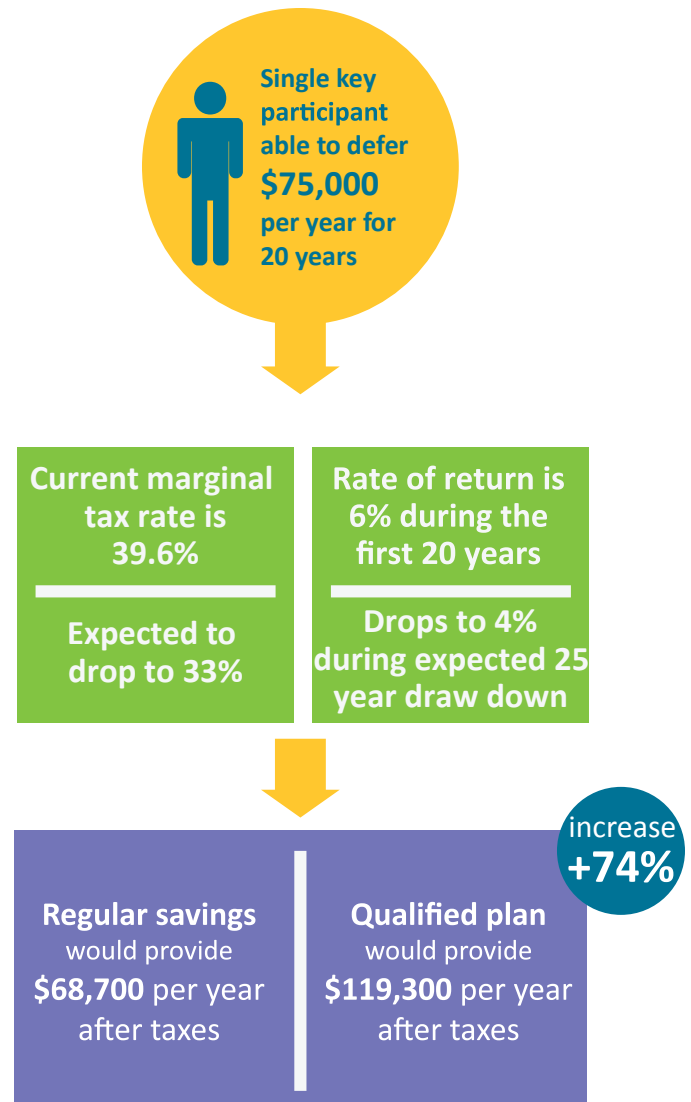
Based on all of those assumptions, contributions of \$75,000 a year put into a taxable account would yield a total of \$1.257 million after 20 years. That account, earning around 4% on average during the 25-year payout period, will provide a retirement income of **\$68,700** a year after taxes.

Contrast that retirement income to \$75,000 a year put into a qualified plan. Contributions to that plan are not taxed and earnings accumulate tax-free. At the end of 20 years that account



will be worth \$2.840 million. Assuming that balance either stayed in the plan or was rolled into an IRA, it could provide an annual retirement income of **\$119,300** after taxes, assuming the same 4% return during retirement. This is an increase of nearly 74% every year for all 25 years. After taxes, that is \$1.265 million more available to make her retirement more comfortable.

Every situation is, of course, unique. Changing investment returns, marginal tax rate assumptions and the accumulation and payout periods in cases like these examples could raise or lower the additional retirement income provided by a qualified retirement plan. However, years of evidence show that the tax deferrals, uniquely available through qualified retirement plans, can add a substantial amount to retirement income. If Plan participants are educated to understand both the impact of compound returns and the power of tax deferrals, they will be more likely to take maximum advantage of the plans available to them. Once engaged, their next question is: can I save enough in the qualified plan to meet my retirement goals?



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