



Fulcrum Partners LLC

The Benefits Gap

How it Happens and How to Fix It



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Benefits Restoration Strategies

Is your organization unintentionally shortchanging the key executives it counts on most?

Many companies—and their executives—are surprised to learn that the disability and retirement plans of top leadership fall short in comparison to the plans of other employees within the organization. The typical corporate spend on employer provided benefits, as a percentage of salary, can vary substantially among the different pay groups within the company. The chart below shows examples of how plans often vary by percentage, based on pay scale.

Typical Benefit Spend as % of Salary*	<u>Core</u>	<u>Director</u>	<u>Executives</u>	<u>CEO</u>
	40%	30%	20%	10%

**Based on research by Fulcrum Partners and G. Scott Cahill. 2018-2019 .*

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 can come at a cost to highly compensated employees (HCEs).

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.



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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.

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 is most often excluded from the LTD benefit formula.

Example: Group LTD Short Falls / Income Gap

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

Very Important:

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.

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

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%	\$4,110.00
COO	54	250,000	250,000	\$500,000	10,000	24.0%	15,000	25,000	60.0%	6,191.00
CFO	50	275,000	225,500	\$500,500	10,000	24.0%	15,000	25,000	59.9%	5,409.00
CEO	62	300,000	300,000	\$600,000	10,000	20.0%	20,000	30,000	60.0%	8,130.00
VP	63	230,000	75,000	\$305,000	10,000	39.3%	7,890	17,890	70.4%	3,196.00
VP	42	185,000	92,500	\$277,500	9,250	40.0%	6,650	15,900	68.8%	1,798.00
VP	61	263,000	131,500	\$394,500	10,000	30.4%	10,000	20,000	60.8%	4,077.00
VP	51	200,000	100,000	\$300,000	10,000	40.0%	7,190	17,190	68.8%	2,681.00
Legal	40	225,000	225,000	\$450,000	10,000	26.7%	10,000	25,000	66.7%	3,109.00
VP	36	185,000	46,250	\$231,250	9,250	48.0%	4,480	13,730	71.2%	625.00
		\$2,403,000	\$1,648,750	\$4,051,750						\$39,326.00
(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										

Very Important:

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



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Retirement Plan Restrictions, Limitations and Solutions

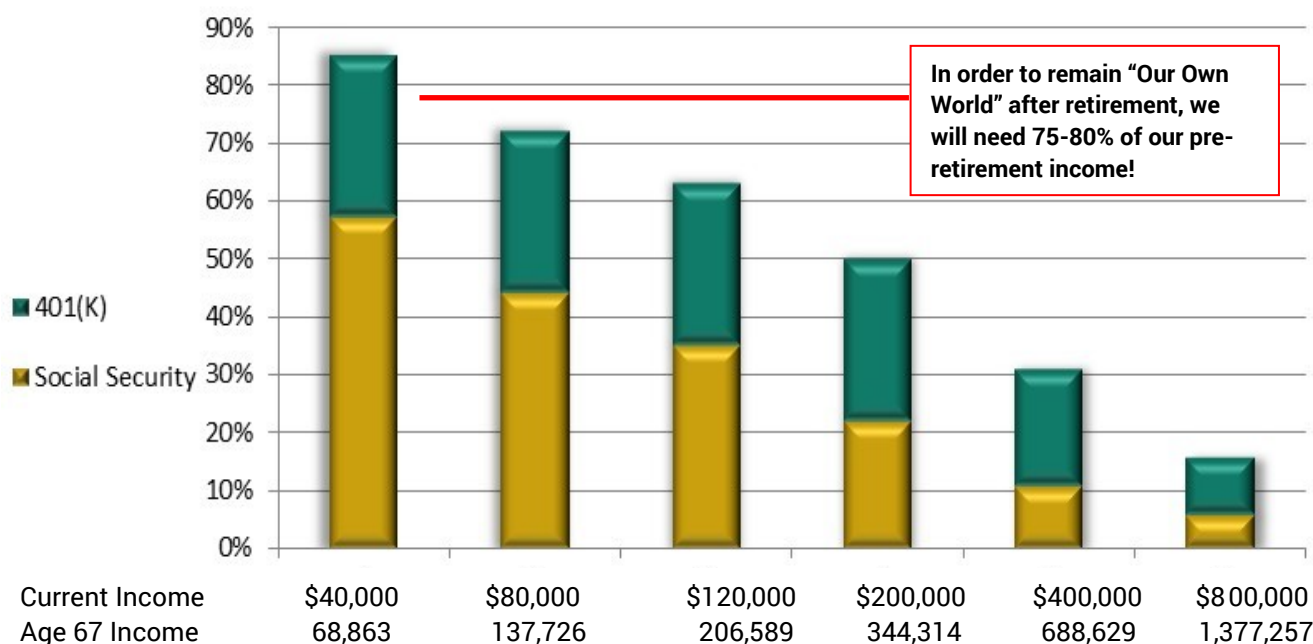
Due to Social Security and IRS limitations, qualified retirement plan contributions are limited. Thus, retirement benefit outcomes are less favorable for executives than for the core population.

- 2020 401(k) deferral limit = \$19,500 + \$6,500 over age 50.
- 2020 eligible income maximum = \$285,000 & Social Security wage base = \$137,700.

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
Salary Inflation = 2.5%	



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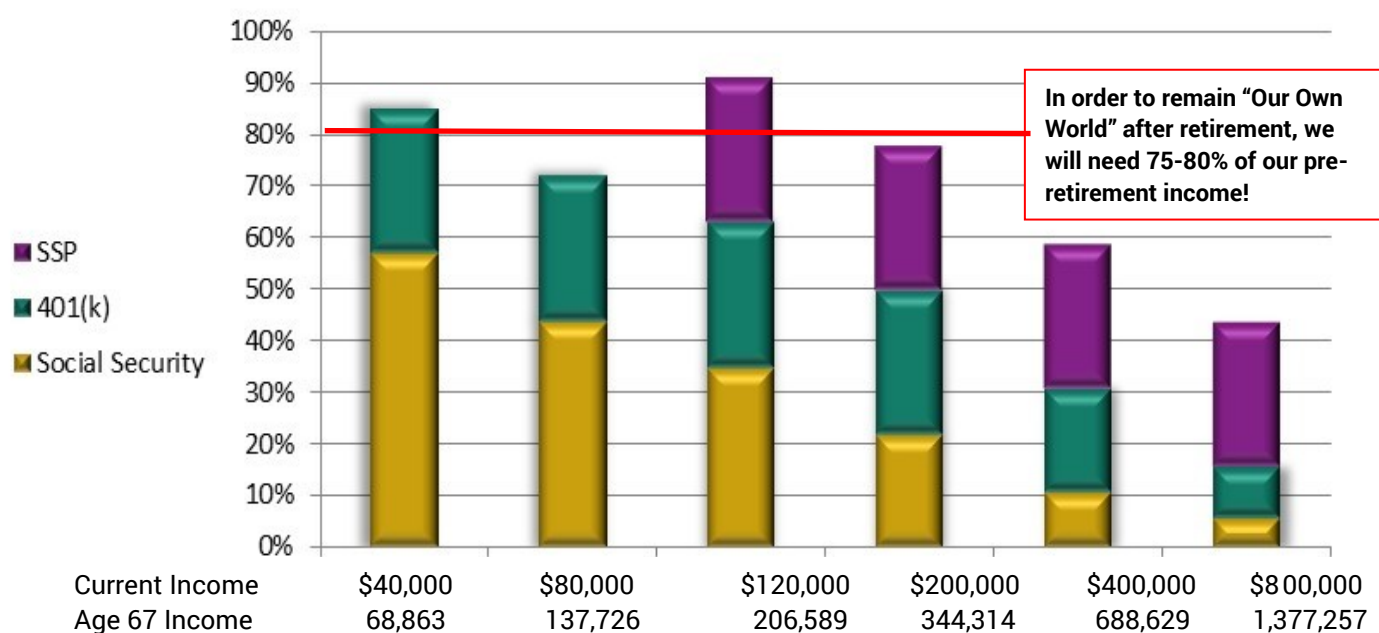


Retirement Income Solution – 401(k) Restoration Plan

The 401(k) restoration plan falls under IRS Section 409A, which governs most forms of nonqualified 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

Retirement Age 67

Employees Saves 6% in 401(k)

HCE Saves 6% in 409A

Salary Inflation = 2.5%

6% Yield during Accumulation (22 years)

5% Yield at Distribution (20 years)

4% Employer 401(k) match

4% Employer 409A match



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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.

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All examples used in this document are hypothetical and are for illustrative purposes only.

ABOUT FULCRUM PARTNERS LLC:

Fulcrum Partners LLC (<https://fulcrumpartnersllc.com>) is one of the nation's largest executive benefits consultancies. A wholly independent, member-owned firm, Fulcrum Partners is dedicated to helping organizations enhance their Total Rewards Strategy. Founded in 2007, today the company has 13 nationwide offices and more than \$7B in assets under management.

Learn more about the Fulcrum Partners executive benefits advisory team at [Fulcrum Partners Managing Directors nationwide directory](#).

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