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High Earners Face Retirement Challenges

More money can help employees get ahead financially, but even a hefty income won't secure a successful retirement. High earners relying solely on qualified plans and Social Security to generate income in retirement will face savings shortfalls. However, there are several important opportunities high earners can leverage to avoid a potential income gap.

The words *highly compensated employee* have a wonderful ring to them—kind of like being known as chief something officer, c-suite executive, or having the word partner or president next to your name.

But for these high-ranking individuals in the top decile of U.S. earners, the prestige also brings some heady challenges around saving for retirement—or whatever you call what comes after a career. And the higher an individual's compensation, the more severe the potential retirement income gap can be.

Generally speaking, a highly compensated employee needs to save above and beyond the maximum 401(k) or 403(b) contribution limits—along with other options, including health savings accounts (HSAs) and individual retirement accounts (IRAs)—to maintain his or her current lifestyle in retirement.

"Part of being highly compensated is the inherent challenge of saving enough to replace 70 to 80 percent of your working income in retirement," says CAPTRUST Defined Contribution Practice Leader Scott Matheson. "High earners need to look at other ways of saving outside of traditional retirement plans. It's much more complex than just maxing out your 401(k)."

According to a recent study, 51 percent of investors who have total investable assets of $500,000 or more report concern about being financially secure in retirement, and 46 percent are worried their portfolios are not properly tax optimized.[1] In fact, research from Urban Institute reveals one in 10 high-income families have no retirement savings at all.[2] Further, a Nielsen study confirms 25 percent of families making $150,000 a year or more are living paycheck to paycheck, and 59 percent of those with six-figure salaries reported having consumer debt, such as carrying balances on credit cards.

We all know more money can help employees get ahead financially, but what everyone doesn't seem to know is that even a hefty income won't let them secure a successful retirement.

Don't Go Belly-Up Keeping Up

The trend of keeping up with the Joneses can affect high-income people just like anyone else. It should come as no surprise that living above your means is a bad habit, no matter the amount of yearly income you're working with.

"People tend to have comparable margins for spending as a percentage of their compensation, but they don't seem to have an expanding relative margin of saving," says Matheson. "Which means when they make more money, they're buying the bigger house. Make more money, join the country club. Make more money, they're buying the more expensive car and taking the kids from public to private school, and so on."

This trend can condition high-ranking employees to believe that a consumption-based lifestyle afforded through high earnings is expected or even necessary. But showing the world that you've made a success of your personal life and career can come with a big cost.

"I've worked with families who are trying to keep up with other families who make double, triple, or more each year, and it's a recipe for disaster, no matter how much you earn," says CAPTRUST Financial Advisor Mike Molewski. "A high income can leave you more wiggle room, but it shouldn't be used as an excuse to go out and buy yourself whatever you want and just completely fly blind."

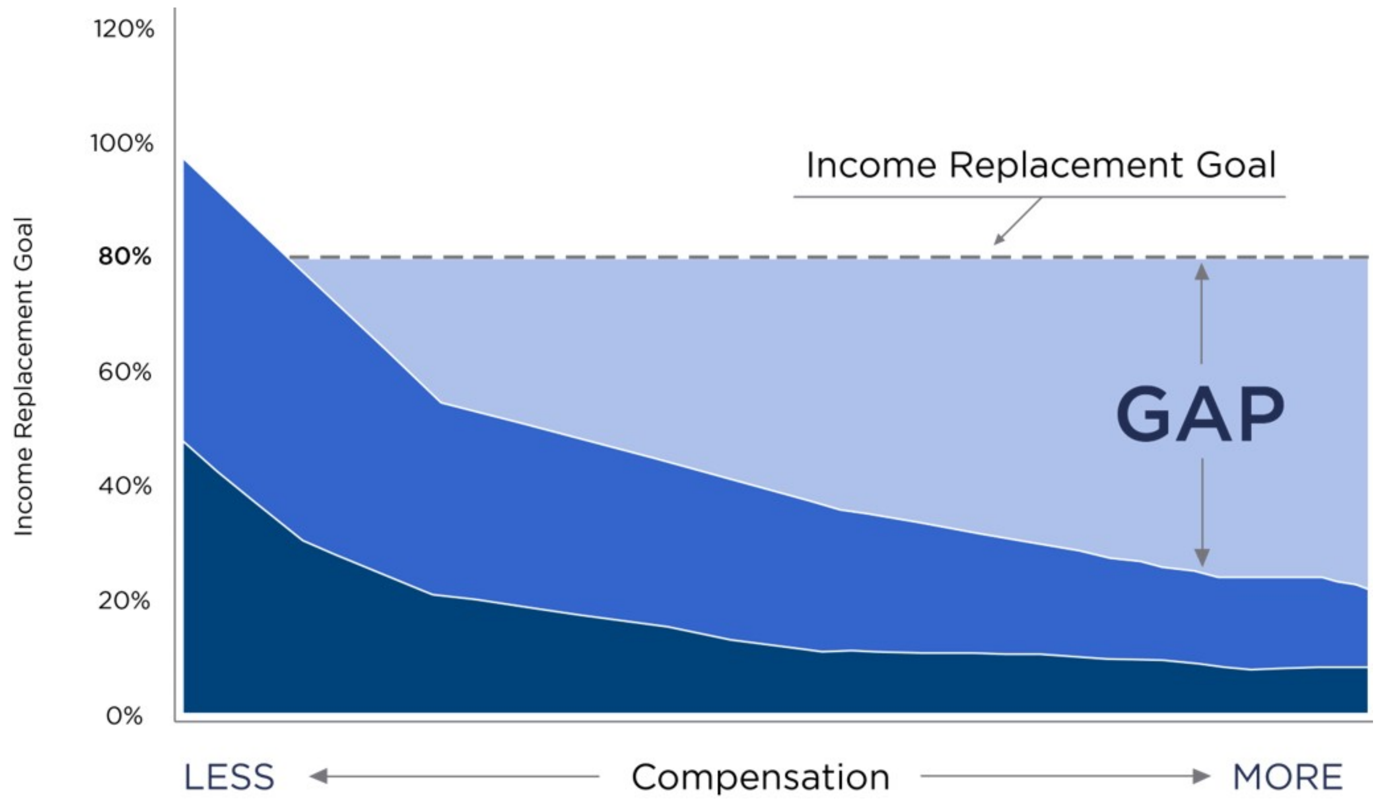
According to Molewski, people at every income level can have money problems, especially if they are trying to keep up with others who are in a higher earnings bracket. "It's the same for high earners; they just have more at stake," says Molewski. "Failure to make a realistic budget and stick to it will hurt you regardless of your income."

That is why it is so important that high earners accurately assess all potential streams of income and maximize every opportunity available to build up long-term savings.

Retirement Plan Jenga®—Stack 'Em Up!

The combination of qualified retirement plan benefits and Social Security retirement benefits fall quickly as income rises. In fact, an individual earning more than $200,000 a year cannot maintain his or her standard of living in retirement by relying on Social Security benefits and qualified retirement plan savings opportunities alone.[3] Unless high earners find a way to save the additional funding necessary to approach a 70 to 80 percent income replacement rate in retirement, they risk retirement savings shortfalls, as shown in Figure One.

Figure One: Retirement Income Gap



Source: CAPTRUST Research, 2018

To attain the recommended retirement income replacement rate, high earners can utilize a combination of other savings programs, such as health savings accounts, nonqualified deferred compensation plans, stock purchase or stock option plans, and personal after-tax savings.

Layering benefit plans is a great way to maximize retirement savings and put away more money on a tax-favored basis. For example, higher-income employees looking for further tax-favored saving should consider using an HSA. Participants can contribute up to $3,500 to an HSA if they have single coverage or up to $7,000 for family coverage in 2019. Those age 55 or older anytime in 2019 can contribute an extra $1,000.[4] And, if you still have an HSA balance after the age of 65, you can take withdrawals from the account for non-medical expenses, penalty free.

“I can’t stress it enough to my clients, how important healthcare costs are for a couple retiring today,” says Molewski. “Maxing out an HSA and having those funds earmarked for healthcare expenses is a big deal and not something you want to pass up.”

Additionally, those who have maxed out 401(k), 403(b), if available, and HSA contributions but still want to save more for retirement or other goals, could benefit from using their company’s nonqualified plan. This type of plan offers high earners pre-tax savings proportionate with their income.

“These plans are often used by employers as an added executive retirement benefit because 401(k) plans are inadequate, by themselves, for high earners,” says Matheson. “This attraction and retention vehicle is more like an agreement between employee and employer to defer a portion of the employee’s annual income until a specific date in the future. Depending on the plan, that date could be in five years, 10 years, or in retirement.”

Stock awards and stock options provide an added layer of long-term savings for high earners that can complement a stack of retirement plans. Executives, successful sales professionals, and business owners often receive stock purchase or stock option plans that can be used to supplement existing retirement accounts.

"While many recipients of equity compensation intend to use it to boost their savings and lifestyles, many of them do not see it in the bigger picture of retirement savings and post-retirement withdrawal plans," says Matheson. "Employees need a reminder to view these assets as a way to build up their long-term retirement nest egg."According to a recent Fidelity Investments survey of 1,448 stock plan participants, only 9 percent of those surveyed who sold their company stock reinvested the proceeds toward retirement accounts.[5]

"The data tells us that equity compensation plan participants need advice around using this kind of compensation to help them prepare for retirement and guidance around knowing when to exercise or sell their equity awards," says Matheson.

Possibility of Disability

Long-term financial planning is not just about saving; it's also about managing risk.[6]

One big risk to your ability to save is the possibility of disability. The frightening reality is more than one in four of today's 20-year-olds will become disabled before reaching retirement age.

Further, a Social Security Administration report projects that a 20-year-old has a 26.8 percent chance of being disabled for at least 12 months before reaching age 67. Once you become disabled, the Council for Disability Awareness reports that the average long-term disability absence lasts 34.6 months—nearly three years!

"Key employees acknowledge that their income is important, but they frequently misjudge the value of insuring it as an important asset," says Matheson. "Adequate income protection, like disability and life insurance, can help ensure financial obligations are met in the event of a disability or death."

Many employers offer short- and long-term disability insurance options as a benefit to employees. Most commonly, these plans provide 60 to 70 percent of gross income in the event of disability. But, according to Molewski, the coverage employer-sponsored disability policies provide is not enough for high-income earners because their base salary and incentive payments often end up exceeding the maximum policy coverage.

"In many cases we have seen companies identify a shortfall and develop supplemental disability and life insurance plans that can help solve for these problems. Often at a minimal cost to the employer," says Molewski.

Between lost income and increased healthcare expenses, the financial strain a disability causes can create a serious retirement savings shortfall. A supplemental disability insurance plan and life insurance can help mitigate the risk of income shortfalls due to disability or death.

Tools and Advice Unique for C-Suite

Integrating corporate benefits, equity compensation, and retirement risk management requires time and expertise that many busy professionals do not have. In fact, a nationwide survey of 1,000 equity compensation plan participants found only half of those who responded said they were confident in their ability to make the right decisions about their equity compensation plan on their own.[7]

Setting objectives, developing a clear picture of financial assets, understanding your risks and time horizon, and measuring progress toward goals are key pieces of the wealth planning process for everyone. But employers, more and more, are finding ways to initiate financial advice and education that caters to the complex planning needs of high earners.

For any company expecting executives or partners to retire at a certain time, it makes sense to consult with these key employees five or 10 years before that date to gauge how retirement plans are going. Executives may learn that they've fallen behind on their goals and may benefit from help with financial planning. Some high earners don't even realize how much they may have amassed.

"Oftentimes even those earning significant salaries don't know they can retire because they have limited knowledge of their consolidated wealth. Not surprisingly, since it might be in four or five different places," says Molewski. "The tools and resources available to high earners are lacking when it comes to being comprehensive and properly accounting for all of their assets."

"A comprehensive program that looks at all the different layers of compensation is critical for high earners because it consolidates an employee's full financial profile," says Nick DeCenso, senior manager at CAPTRUST. "As a core of the offering, the services need to overlay advice on top of the employee's entire existing pool of assets, regardless of where they are held or who may have recommended the specific investment."

"What we see is that the vast majority of retirement plan services fall short of providing adequate advice for executive-level needs," says DeCenso. "It's important that the tools and advice address more complicated payment packages that can include benefits like bonuses, partnership distributions, retirement contributions, and restricted stock units. This type of customized financial advice for executives is fairly unique in the industry."

One way to position executives favorably against the possibility of a retirement income gap is to have these individuals complete a retirement needs calculation that truly encompasses their full financial picture.

This exercise will help high earners determine how much they have amassed in different accounts and what they need to save to meet their goals. Armed with this crucial information, they may be motivated to save more, take advantage of other company-sponsored savings programs, and more accurately calibrate their retirement expectations.

The bottom line is high earners need to keep in mind that big paychecks don't necessarily translate into high savings rates. While a high income gives people a distinct advantage when it comes to building wealth, that advantage can only take them so far. Customized advice and planning, enhanced risk protection strategies, and optimization of benefit and savings opportunities can make a big difference when trying to bridge a potential retirement income gap.

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