

Preparing Executives for Retirement: A Decision Making Timeline

By Lisa Brown

Lisa Brown explains a well-reasoned retirement planning timeline that indicates a general time frame in which executives should consider major decisions regarding their retirement income strategies and other important decisions. This approach allows time for careful consideration of these decisions so that the retiring executive feels secure in the decisions and the overall plan.

For executives of public companies, noncash incentive compensation plans (stock options, restricted stock) and company provided benefits will become the most important building blocks for their wealth. To ensure these benefits are maximized as the executive nears retirement, it is important to build a year-by-year strategy to capture their value. Managing the income tax implications is critical as incentive compensation plans become a major source of the long-term retirement investment strategy.

As you help your executive clients plan for retirement, the transition strategy should ideally begin at least five years out from their target retirement date. Your clients will be faced with a wide variety of decisions they will need to make before retirement, and helping them think through these decisions is imperative. For instance, what pension payment should they elect for the rest of their and their spouse's

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lifetimes? Should the executive take the group life insurance policy and pay the higher premiums or shop around for an individual policy? What about changing any previously elected deferred compensation payout dates? Consider the following timeline as you develop and monitor the complete strategy.

Beginning at least five years before the executive's target retirement date, request pension calculations

from their benefits department (if the company still offers a defined benefit plan). Selected executives often receive benefit equalization plans and supplemental executive retirement plans which

are a form of nonqualified pension plans. Next, map out their other income streams in retirement. For example, does the deferred compensation balance begin to pay at age 65 for 10 years, while Social Security could begin at age 62? Planning to support a larger portion of their living expenses in the first few years of retirement with company-based income sources could make a significant impact on the success of the investment portfolio. If markets are performing less than favorably during those early years, the emotional impact of taking portfolio withdrawals

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when their account is decreasing, while knowing no future paychecks will be coming could cause them to panic and lose faith in the long-term strategy.

Next, look into securing a long-term care insurance policy either through their company or with an individual carrier. Many large corporations offer group long-term care insurance options with reasonable premiums; however, a group policy may not provide the same level of benefits as an individual policy. This type of insurance adds another layer of protection around the investment portfolio in retirement.

Finally, design a stock option exercise plan with strategic exercise dates and prices. If you and your client understand the target price of the stock that will allow them to meet their retirement funding goal, the decision of when to exercise and sell becomes easier, and less emotional. It will be important to read each stock option and restricted stock agreement to understand what happens upon retirement. Do all options vest? Do retirees have the full exercise period before the options expire? What about incentive stock options converting to nonqualified stock options three months after retirement, as it relates to their income tax planning? Finally, be careful your client does not elect a retirement date that will cause them to forfeit unvested options, if they could have otherwise postponed retirement by a few months, or even days, to avoid forfeiture.

When retirement is three years away, revisit the retirement income plan compared to their current living expenses. The general rule of thumb that a retiree will need 70 percent of his or her preretirement income is unlikely to be accurate in my experience, as it is rare that a client's expenses decrease the day they retire. In fact, many clients have more time to travel which may mean their expenses are substantially higher!

Next, to plan for the first few years of cash flow needs, consider advising your clients to stop deferring their bonuses. Instead, use those funds to pay down debt or add to their cash and fixed income positions. And, keep exercising stock options and restricted stock, while adding the net proceeds to the investment portfolio.

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their family. Or, do they need a supplemental policy to cover them until Medicare begins at age 65? Begin discussing retirement consulting opportunities. Clients often push out their retirement date for fear of not knowing how to occupy their time. However, if a future retiree has a part-time job or other meaningful activity to look forward to, anticipation will often overcome their fears. Many times the executive's current employer will offer them a consulting role, given all of the knowledge they've acquired over the years. The day-to-day familiarity of the people and the organization can make the transition less dramatic.

Finally, one year prior to retirement, look at company guidelines for announcing one's retirement date, and whether it makes financial and tax sense to delay that date a few months. Many covenants require that you announce your retirement no less than 90 days out, in order to provide the company adequate time to hire a replacement. Also, consider retiring on Jan. 1 rather than Dec. 31 of the previous year to postpone income taxes on lump-sum retirement benefits for another twelve months.

If you have not done so already, begin to consolidate the executive's investment accounts and make sure you have an IRA opened to receive his or her 401(k) rollover at retirement. Determine the level of after-tax dollars in the 401(k) and be prepared to transfer that money to a non-IRA brokerage account at retirement. While you can roll the entire balance to an IRA, the after-tax employee contributions will be distributed out of the IRA on a pro-rata basis. Finally, if your client has low basis, highly appreciated employer securities in his or her 401(k), an "in-kind" lump-sum distribution strategy may need to be considered. The reason is that the appreciation on the stock will be taxable as capital gain. Only the basis of the stock is taxed as ordinary income. You lose this tax advantage if you transfer the stock to an IRA.

Most importantly, as you walk with your executive clients towards the retirement finish line, be sure to consult with their other advisors as this lifestyle change could impact their estate planning, insurance, and income tax plans. The peace of mind they'll have in knowing a solid strategy was executed with precision, allowing them to meet their financial goals, will leave you with a client for life.

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