Financial Planning Lessons Learned from the Recent Bank Failures

Nancy L. Anderson, CFP,® Regional Planning Director

The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Media coverage of the recent failure of several financial institutions and the intervention of the Federal Deposit Insurance Corp. (FDIC) focused on the risk and protections for the customers who invested their savings with the banks. But the fallout also may have led you to question whether certain benefits you have from your own company are subject to risk. Inadequate planning for these potential risks can derail your financial security and future goals. Financial planners look at ways to reduce risk in reaching financial goals.

Following are a few benefits you should review:

Deferred Compensation

Unlike a qualified plan such as a 401(k), deferred compensation plan funds are assets of the company and are subject to creditors in the event of bankruptcy. They don't have the same protections as qualified accounts. Individuals who have a big portion of their retirement in nonqualified deferred compensation plans could lose the entire account balance if the employer files for bankruptcy.

Key takeaway – Deferred compensation plans are assets of the company, so be cautious not to overfund deferred comp. Consider maximizing 401(k) type plans first and deferred compensation second. At retirement, consider withdrawing deferred compensation assets first and 401(k) funds afterward.

401(k) Retirement Plans

Defined contribution plan assets are not assets of the company. A 401(k) is a defined contribution plan that falls under the protection of the Employee Retirement Income Security Act of 1974 (ERISA), which set federal standards for private industry retirement plans. Federal law requires that retirement plans keep 401(k) plan assets separate from the employer's business assets. The funds must be held in trust or invested in an insurance contract. Importantly, the employer's creditors cannot make a claim on 401(k) retirement plan funds.

In a 401(k) plan, your personal contributions are immediately vested but the employer contributions have a vesting schedule. However, in bankruptcy, the employer contributions are immediately vested. Your

funds are held separately, as with all of the investment accounts, but it is prudent to review your statements at least quarterly to make sure any additions are being credited correctly.

Key takeaway – 401(k) plan assets are held in a separate account and are not subject to creditors of the company. Your contributions and vested employer contributions are your assets, not assets of the company.

Pension Plan

Pension money must be kept separate from the employer's business assets, similar to 401(k) assets. These funds are not a source of repayment for creditors of a failed company. Many workers who have this type of plan have some form of protection from the Pension Benefit Guaranty Corp. (PBGC).

According to the Department of Labor, "If a [defined benefit] plan is terminated because an employer has financial difficulty and cannot fund the plan, and the plan does not have enough money to pay the promised benefits, the PBGC will assume responsibility for the plan. The PBGC pays benefits after termination up to a certain maximum guaranteed amount." The guaranteed amount is determined at the time of termination.

Not all pension plans are insured by the PBGC. How do you know if your plan is protected? Review the summary plan description provided by your employer. An alternative is to search on the PBGC's website for employers paying premiums. The URL is Search for Plans Paying PBGC Premiums | Pension Benefit Guaranty Corporation.

Key takeaway – Pension plans have protections from the Pension Benefit Guaranty Corporation in case of employer bankruptcy and termination of the plan. However, the payout may be reduced in that case.

Employer Stock Concentration

Because of concentration risk, financial planners recommend not having more than 10% of assets in one company in a portfolio. This rule of thumb seems reasonable for some, but it's not always easy to execute. Professionals often have executive compensation packages tied to the performance of their company stock, including traditional stock options and restricted stock units.

Stock options can be a major portion of compensation and are vested over time. It is not uncommon for employees to have a high concentration in their company stock, putting them at risk for meeting their personal financial goals. And don't forget, there also could be company stock owned within the 401(k) account that should be considered as part of the stock concentration.

Stock concentration risk is obvious as underperformance could put a drag on gains and an unexpected event such as bankruptcy could result in a total loss. Consider reviewing your financial plan for stock concentration capacity. Determine the amount of company stock you can carve out of your plan and still meet your goals.

Key takeaway – Create a diversification plan. As stock options vest and become available, reinvest in a diversified portfolio. Review your financial plan to determine your target amount of employer stock to maintain.

We can't eliminate risk from our financial lives, but we can take steps to mitigate it. Know what plan and benefits you have that have potential risks if a company has financial difficulties.

For more information, please contact your advisor.

About the Author

As a Regional Planning Director for Key Private Bank, Nancy proactively advises clients on the development of a personalized, comprehensive financial plan that creates a financial roadmap so they can make more informed, confident decisions.

Nancy is a highly experienced professional who works closely with the relationship team to understand a client's personal situation and goals and develop an integrated, customized set of strategies to help them reach their objectives. She is also well-versed in sophisticated planning strategies to help clients address complex issues. Nancy is a member of Key Private Bank's Wealth Institute which provides commentary and advice on current topics and issues that impact our clients' wealth management planning. A nationally recognized expert in retirement planning, Nancy has penned a popular personal finance column on Forbes.com since 2012.

Prior to joining Key, Nancy served as Director of a national boutique financial advisory firm, providing retirement planning and tax advice for executives of Fortune 500 companies to provide in-depth analysis of every aspect of the client's financial situation and customized recommendations designed to help each client attain their financial goals in the most efficient manner possible. She has provided guidance and advice to high net worth clients since 2001. Nancy is a Certified Financial Planner (CFP®) and has a Bachelor's degree from the University of California, Davis. She is a member of United Way's Women United Organization and the Utah Financial Planning Association.

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