



### **Retirement Issues: Balancing the Risks of an Unfunded Plan**

Unfunded retirement plans are unique to professional firms. They are essentially a promise to pay partners a retirement benefit from the firm's future profits.

Unfunded retirement plans do offer firm partners some advantages, including the ability to maximize current income as well as the potential for substantial returns at retirement.

But there is some downside, including the possibility that the money may not be there when partners retire. In addition, the presence of unfunded plans can be a deal-breaker in acquiring another firm (or becoming a merger candidate yourself).

#### **Limiting the Risks**

Therein lies the challenge: How do you limit the firm's exposure to the obligation an unfunded plan generates? Some strategies to consider:

**Cap it.** Consider capping the total amount of retiree payments to a percentage of current earnings. Likewise, consider capping the individual retirement payments in any one year (this serves to protect the firm's cash flow if several partners retire within a short period of time).

**Shift it.** Shift unfunded obligations to funded plans for partners under a cutoff or grandfathered age (e.g., 45 to 55) on a graduated basis. In other words, the more time a partner has to accumulate assets in a funded plan, the less vesting in the old, unfunded plan he or she will have.

**Buy them out.** In good years, use cash to buy out the obligations of retirees—on a voluntary basis and at a reasonable discounted net present value. This allows the firm to reduce its future obligation and provides the retiree with security in exchange for the discount.

**Require notice.** Require partners to provide a two-year notice before retiring to give your firm ample time to plan for the payout.