Qualified Term

ASSESSMENT GUIDE

Qualified Term (Qt) indicates the number of years a client could live on their current qualified retirement assets at their current lifestyle if neither changed.

Elements®
Financial Planning System

Qualified Term

Assessment Guide

What is it?

Description: Qualified Term (Qt) indicates the number of years a client could live on their current qualified retirement assets at their current lifestyle if neither changed.

CALCULATION

Retirement Assets

÷ Annual Living Expenses

Qualified Term

5.1
Qt
Qualified Term

Retirement assets include accounts that have the potential for a tax penalty upon early or nonqualified withdrawal. These accounts include:

- Roth and Traditional IRAs
- Roth and Traditional 401(k)s
- SIMPLE IRA
- SEP
- 529

- Profit Sharing Plans
- Defined Benefit Plans
- Health Savings Accounts (HSA)
- 403(b)s
- Annuities
- Minor Roth and Traditional IRAs

Example: Assuming a client has a traditional IRA worth $50,000, a 401(k) worth $100,000 and a Roth IRA worth $36,000 and they spend $100,000 annually. Their Qualified Term is about 1.9.

Why is it important?

Generally, a client who maximizes retirement plan contributions each year in the right plan will end up with a lower tax liability and will have more cash to save over their career.

Psychologically, clients also tend to frame qualified retirement accounts as being earmarked for long-term objectives. This results in better, more consistent long-term investment behaviors.

While a client who is maximizing qualified retirement contributions may have higher savings rates and better investment behaviors, finding balance between retirement accounts and liquid accounts is critical. There are certainly times where clients might need to focus on building liquid assets over qualified retirement assets to provide greater flexibility.

How do I use it?

The following process can be used to assess whether a client's Qualified Term is appropriate or if they need to make improvements:

1. **Accuracy:** ensure the accuracy of the Qualified Term inputs.
2. **Assessment:** assess whether the given Qualified Term is appropriate.
3. **Improvement:** Identify areas of improvement

STEP 1

Score Accuracy

To calculate Qualified Term all you need is an up-to-date net worth statement and an accurate spending number. For details on ensuring the accuracy of these inputs, reference the Burn Rate (for spending) and Total Term (for net worth) assessment guides.

STEP 2

Score Assessment

Note: While it's important to understand a client's Qualified Term by itself, all Term scores are typically best assessed together to be able to compare total asset mix, holistically. See the Total Term assessment guide for more details.

Generally, age is the only clear factor that correlates directly with a client's Qualified Term because as clients age, their retirement accounts will grow from investments and additional savings contributions.

STEP 3

Score Improvement

Consider the following questions for employees and business owners as you identify steps to make improvements:

For employees:

- What retirement plan options are available?
- Is the client maximizing the employer benefits?
- Do they have old plans that are "closed" that can be rolled over?

For business owners:

- Considering cash flow, staffing, and savings rate, does the client have the proper retirement plan in place?
- Is the client's current TPA meeting their needs?

What are the client's liquidity needs?

- Should they focus their savings on growing liquidity or qualified retirement assets?

Should the client contribute more to retirement accounts to reduce their overall tax liability?

Case Study

Let's look at the following example and apply the principles presented above. This case study assumes you've already ensured that you have a good estimate.

Example: Given the following Elements scores and additional information, you begin your assessment of whether a client's Qualified Term is appropriate.

Lt = 1.7	Qt = 4.1	Rt = 5.6	Bt = 6.0	Tt = 17.4

Tax Rate	**High**
Liquidity Needs	**High**
Age	**Mid-40s**
Future Retirement Income	**Social Security**

Step 1 - Score Assessment: Considering just the high tax rate, you may determine that this client's Qualified Term is low because a higher tax rate generally necessitates higher pre-tax contributions. However, also considering their need to increase liquidity, you decide to allocate some cash flow toward increasing Liquid Term as well

Step 2 - Identify Improvements: You'll first focus on improvements to the client's Savings Rate in order to increase both Elements score.

After this, you resolve to build the client's after-tax and pre-tax investments equally. This will allow you to reduce their current tax liability and build their liquidity as well.