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TheStandard®

Cash Balance Plans

Benefits, Implementation and Management

The Standard®

June 11, 2020

What We'll Cover

Cash Balance Basics

How Cash Balance Plans Work

Plan Design and Administration

Investment Strategies

Managing a Plan Through a Business Hardship

Why Cash Balance?

- 33% of all ERISA pension plans are cash balance plans ($1 trillion in assets)[1]
- Greater retirement savings potential
- Reduced current tax obligation
- Predictable
- Age-neutral cost for employees in the plan
- Easy to understand for employees
- Portable

[1]EBSA, Private Pension Plan Bulletin Abstract of 2015 5500 Annual Reports, February 2018

Cash Balance Plan Advantages

- Much higher contribution limits than a DC plan
    - For a 55-year old the limit is $207,900, in addition to the $63,500 DC plan limit.
- Significant tax savings opportunity
- Additional tax savings can more than offset additional employee costs.
- Combined plan nondiscrimination testing can significantly leverage the total employer contribution (CB + PS) towards the owner or favored group.

Best Candidates for Cash Balance Plans

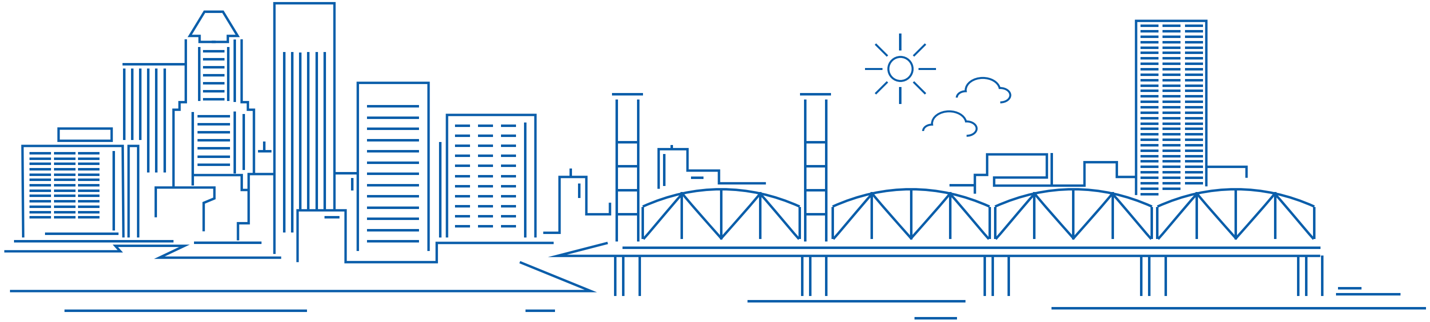
Business owners who:

- want to increase their annual tax-deductible contributions.
- are over age 50.
- have high compensation ($280,000).

Best Candidates for Cash Balance Plans

Businesses that have:

- a professional workforce (doctors, dentists, lawyers, financial advisors, etc.).
- some younger rank and file employees (under age 35).
- no more than 10 – 15 employees per owner.
- consistent profits year to year.
- contributions of 5%+ to employees in 401(k) plan
- a new comparability 401(k) plan



How Cash Balance Plans Work

Consider this Example

- Hybrid defined benefit plan with the participant's benefit defined as an account balance.
- Cash Balance Account:

Beg. Balance + Interest Credit + Contribution Credit = Ending Balance

	Beginning Balance	Interest Credit	Pay Credit	Distribution	Adjustments	Ending Balance	Vested Percent	Vested Amount
. Owner								
Cash Balance								
Cash Balance	306,000.00	12,240.00	150,000.00	0.00	0.00	468,240.00	100	468,240.00
Grand Total:	$306,000.00	$12,240.00	$150,000.00	$0.00	$0.00	$468,240.00		$468,240.00

- A participant's lump sum distribution equals the CB account balance. No government interest rates / adjustments required - not subject to IRC Section 417(e).

Funding

- Accounts are solely employer funded
- No individual participant brokerage accounts
- Defined benefit plan IRS funding rules apply

Cash Balance Plan Contribution (“Pay Credit”)

- Typically a percent of pay or a flat dollar amount
- Participant is typically required to work 1000 hours in the plan year
- Pay credits can be credited monthly, quarterly, annually
- Contribution formula for owners and employees determined during plan design
- Can be amended

401(k) and Cash Balance Plans Integration

Cash Balance & 401(k) Profit Sharing Plans
2020 Contribution Limits

Age	Cash Balance	401(k)/Profit Sharing*	Total	Potential Tax Savings**
70	$297,500	$63,500	$361,000	$151,620
65	$277,000	$63,500	$340,500	$143,010
62	$294,800	$63,500	$358,300	$150,486
60	$266,800	$63,500	$330,300	$138,726
55	$207,900	$63,500	$271,400	$113,988
50	$162,100	$63,500	$225,600	$94,752
45	$126,400	$57,000	$183,400	$77,028
40	$98,700	$57,000	$155,700	$65,394

* $19,500 401(k)
$6,500 401(k) Catch-up if age 50+
$37,500 Profit Sharing

** Tax savings estimate based on a 42% combined rate for Federal and state taxes. Taxes are deferred.

Plan Design Considerations

What to Consider

- Multiple owners: Individual owners can decide on different contribution levels, including $0
- Certain employees or employee groups may be excluded.
- Questions for owners:
  - How much would you like to contribute annually in a “normal” year?
  - How much can you commit to if you had a “down” year?

Nondiscrimination Testing

- Employees typically need a pay credit contribution between 2.5% - 3.5% of pay to pass IRC 401(a)(26) – participation and meaningful benefits.
- Combo plan arrangement - Cash balance plans that significantly favor ($) a specific group (owners, management, etc.) are typically combined with the 401(k)/PS plan in order to pass nondiscrimination testing for the benefits provided. The employee cost is less expensive due to testing advantages.
- Employees typically need 5% - 7.5% profit sharing to pass combo plan testing. Includes 3% safe harbor.

Interest Crediting Rate Options

- A fixed rate of up to 6%
- A Treasury yield rate (ex. 30-year Treasury bond rate)
- Actual rate of return on the plan assets
- Interest credit is part of a participants benefit and is therefore guaranteed by the employer
- Low interest crediting rate discussion with owners

Investment Strategies

Investment Strategies for Cash Balance Plans

Fixed Interest Credit Strategies

Interest rates go up.
Projected balance at retirement is unchanged; liability goes down.

Interest rates go down.
Projected balance at retirement is unchanged; liability goes up.

- Interest rate risk is primary risk to contribution volatility
- Set plan up with low interest credit
- Invest conservatively to target interest credit
  - Stable Value / Money Market
  - High quality corporate bonds
  - STRIPS
  - Treasuries

Investment Strategies for Cash Balance Plans

Floating Interest Credit Strategies

Interest rates go up.
Projected balance at retirement goes up; present value factors go down.

Interest rates go down.
Projected balance at retirement goes down; present value factors go up.

- Interest rate exposure reflects net impact of discount rates and crediting rates
- Funded status more complicated
- Perfect portfolio would address interest rate, credit spread and crediting rate risks
  - Stable Value / Money Market
  - High quality corporate bonds
  - STRIPS
  - Treasuries
  - Interest rate derivatives

401(k) and Cash Balance Plans Integration

	Age	Total Comp	Plan Comp	401(k)	Profit Sharing	Cash Balance	Total Contribution	Tax Savings w/CB	Tax Savings w/o CB
Owner	60	600,000	280,000	25,000	37,000	**250,000**	312,000	131,040	26,040
Owner	55	600,000	280,000	25,000	37,000	**160,000**	222,000	93,240	26,040
Owner Total		1,200,000	560,000	50,000	74,000	**410,000**	534,000	224,280	52,080
Employee	50	125,000	125,000	10,000	9,375	**3,125**	22,500	9,450	8,138
Employee	50	100,000	100,000	5,000	7,500	**2,500**	15,000	6,300	5,250
Employee	44	80,000	80,000	4,000	6,000	**2,000**	12,000	5,040	4,200
Employee	37	65,000	65,000	3,250	4,875	**1,625**	9,750	4,095	3,413
Employee	32	60,000	60,000	3,000	4,500	**1,500**	9,000	3,780	3,150
Employee Total		430,000	430,000	25,250	32,250	**10,750**	68,250	28,665	24,150
Total		1,630,000	990,000	75,250	106,250	**420,750**	602,250	252,945	76,230

7.50% of pay total contribution rate to employees
Tax rate of 42% combined Federal and State

Cash Balance Plan with 401(k) Profit Sharing Plan Owner's Annual Contribution Flexibility

Cash Balance Plan	401(k) / Profit Sharing Plan			Total
Not Discretionary	Not Discretionary	Discretionary	Discretionary	All
Pay Credit	3% Safe Harbor*	Profit Sharing	401(k) Deferral	Sources
$100,000	$0	$37,500	$26,000	$163,500

Discretionary	$63,500
Not Discretionary	$100,000
Total	$163,500

*Safe Harbor to NHCE's only.

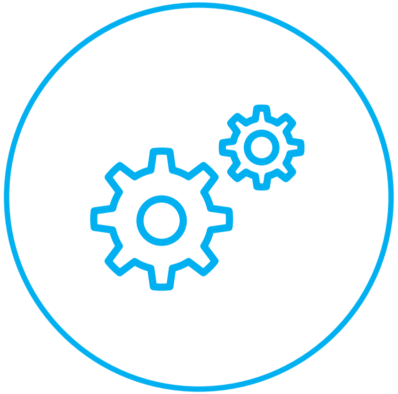
Managing Plan Through a Business Hardship

Freezing Pay Credits and New Entrants

- Typically eliminates most if not all of the annual contribution requirement.
- Cannot freeze guaranteed interest credits. The cash balance accounts continue to grow with interest.
- Plan amendment required. 15-day advance participant notice (45 days for large plan).
- Once a participant has worked 1,000 hours in the plan year they have earned their pay credit contribution for the year
- Plan still subject to all annual administration requirements
- Combo plans will need combined plan nondiscrimination testing if any benefits are earned during the year in the cash balance plan.

Terminating the Plan

- Reasons to Terminate:
  - Increasing contribution costs
  - Adverse business conditions
  - Retirement of owner
  - Sale / merger of business
- PBGC covered plan needs to be 100% funded (i.e., assets at least equal to total cash balance accounts).
- Non-PBGC covered plans may be able to reduce benefits on a pro-rata basis per the plan (IRS) provisions.



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Terminating the Plan

- All participants must be made 100% vested.
- Advance written notice to participants required.
- Must file plan termination with the PBGC (if plan covered by PBGC).
- May file the plan termination with the IRS – request a favorable determination letter (FDL).
- All participants with a lump sum greater than $5,000 must be offered all distribution options, including annuity. It is rare that an annuity is selected by active or terminated vested participants.
- If plan has retirees receiving payments, annuities are purchased.
- Annuities can be significantly more expensive than the lump sum (approx. 20% increase).
- Cash balance interest credits apply until assets distributed. If variable crediting rate, use 5-year average.

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Questions?

Thank you!