

Cash Balance Plans – What Everyone Needs to Know



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Your Co-Hosts

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After the Webinar

- Please join us for a brief educational session on how to find more information on today's topic on ERISApedia.com.
- At the conclusion of the webinar, you will be presented with a short Google Forms survey. Please let us know how we are doing. Completion of the survey is not a requirement for CE credit but we very much appreciate your feedback!
- Slides and recordings will be available on ERISApedia.com webcast tab.



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Your Presenters Today



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As cash balance plans continue to grow in popularity more practitioners are entering the cash balance arena and others are expanding their cash balance practices.

Whatever your experience level it's always valuable to see how cash balance plans fit in the retirement plan space, how they work and how they can meet the needs of your clients.

This presentation is designed to fill in the blanks for practitioners already familiar with cash balance plans and to provide a firm grounding for those who are new to the area.



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Why CB?

- Opportunities for Plan Sponsor
 - To provide additional tax-favored retirement benefits beyond the 401k plan
 - To focus these additional benefits on favored groups of principals & staff
 - To attract & retain staff

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Why CB?

- Benefits for Participants
 - Accumulation of retirement savings
 - Employer paid benefit
 - Tax-favored portion of compensation package
 - Reason to continue with the employer

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Example

	AA RA		Compensation	Cash Balance		401(k)	3% SH		Profit Sharing		Total	Employer	% of ER
				\$	%	\$	\$	\$	\$	%		\$	
OWNER	57	65	250,000	112,500	45.0	27,000	7,500	5,000	2.0		152,000	125,000	95.1
EMPLOYEE	35	65	75,000	1,500	2.0	4,500	2,250	2,625	3.5		10,875	6,375	4.9
			325,000	114,000	35.1	31,500	9,750	7,625	2.3		162,875	131,375	100.0

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What is a CB Plan?

- Hybrid plan
 - Is really a DB plan subject to DB rules
 - But looks like a DC plan

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What is a CB Plan?

- It actually is a “statutory hybrid plan” as defined by PPA
 - Lump sum based benefits
 - Formula does not provide greater benefits to similarly situated younger employee
 - Interest credit not greater than “market rate of return”
 - Preservation of capital rule
 - 3 year vesting and conversion rules

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➤ **Is really a DB plan subject to DB rules**

- Required contributions
 - Not just a pumped up profit sharing plan!
 - Not appropriate for client who cannot commit to make the required contribution each year
 - Schedule SB signed by actuary is required

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➤ **Is really a DB plan subject to DB rules**

- Deduction limits
 - DB deduction limits apply
 - Allows for advance funding in good years which will allow for lesser contributions in leaner years

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➤ **Is really a DB plan subject to DB rules**

- Funding requirements
 - Actuarial valuation/certification required
 - Basic funding equation: $B_{\text{enefits}} = C_{\text{ontributions}} + i_{\text{nterest (earnings)}}$
 - Low returns = higher future contributions
 - High returns = lower future contributions

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➤ **Is really a DB plan subject to DB rules**

- Funding requirements
 - May be designed so that annual funding contribution is expected to be about equal to sum of the CB contribution credits, but no guarantee

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➤ **Is really a DB plan subject to DB rules**

- Participant notices/benefit restrictions
 - If plan's funded status (Adjusted Funding Target Attainment Percentage or AFTAP) falls below 80%/60%, restrictions on payout/accrual of benefits applies
 - Participants must be notified if restrictions apply

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➤ **Is really a DB plan subject to DB rules**

- PBGC coverage
 - DB/CB plans are covered by the PBGC unless they meet a specific exemption
 - Most common exemptions:
 - plans covering only substantial owners
 - plans of professional svc employers with less than 26 active participants

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➤ **Is really a DB plan subject to DB rules**

- PBGC premiums for 2022
 - Flat rate: \$88 per participant
 - Variable rate: \$48 per \$1,000 of underfunding
 - Capped at \$598 per participant
 - Rates adjusted with COLA increases each year

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➤ **Is really a DB plan subject to DB rules**

- Good News / Bad News
 - PBGC Exempt:
no PBGC premiums/requirements but combined deduction limit of IRC 404(a)(7) applies (generally limits DC deduction to 6% or combined deduction to 31%)
 - PBGC Not Exempt:
PBGC premiums/requirements but no combined plan deduction limit

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➤ **Is really a DB plan subject to DB rules**

- DB 415 limits
 - Defined in terms of annual benefit payable at NRA
 - \$ limit = \$200,000 (as indexed), reduced 1/10 for Yr Of Participation
 - % limit = 100% of 3 yr avg comp, reduced for Yr Of Service
 - Adjustments apply to NRA other than 62, etc.
 - For CB plans, CB account balance is converted to equivalent annuity and compared to DB 415 limit

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➤ **Is really a DB plan subject to DB rules**

- DB 415 limits
 - Limit applies to participant's career/entire benefit; not on year by year basis

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➤ **Looks like a DC plan**

- Account balance
 - Benefits are defined in terms of a hypothetical account balance
 - Hypothetical account balance is a bookkeeping device and does not reflect an actual account or call on specific plan monies

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➤ **Looks like a DC plan**

- Contribution credits
 - Determined based on the plan's benefit formula, which must be "definitely determinable"
 - Most usually a % of compensation or flat \$ amount
 - Could also be lesser/greater of % of compensation or flat \$

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➤ Looks like a DC plan

- Contribution credits
- May be different for different classes
 - Classes must be clearly defined in the plan document to meet the definitely determinable requirement
 - Usually defined in terms of ownership, job title or similar criteria
 - Cannot define separate class for each participant and then decide on the amount to each class each year

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➤ Looks like a DC plan

- Interest credits
- Part of plan's benefit formula, *NOT* simply asset return
- "Market rate of return" within certain defined parameters
- Safe harbors:
 - Fixed rate (up to 6%)
 - Segment rates (as defined in IRC 430)
 - Bond related or equity related

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➤ Looks like a DC plan

- But....
 - Assets do not automatically equal the sum of the account balances
- In a perfect world, they would match perfectly
- Can you make them match perfectly?
- Is it worth trying to make them match perfectly?
- Should you even care?

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DB Plan & CB Plans – the same but different

- It's all a matter of style...
 - Both DB & CB are subject to the same rules & are designed to provide retirement benefits – they just look different
 - And sometimes one style works better than the other

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DB Plan & CB Plans – the same but different

- Traditional DB Plans
 - Benefits defined in terms of monthly benefit in the normal form payable at the normal retirement age
 - Benefit formula based on compensation, service or some combination of both
 - Benefits are earned (accrued) over the participant's career

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DB Plan & CB Plans – the same but different

- Traditional DB Plans
 - Participants will receive benefits in the form of QJSA annuity unless they elect one of the alternate forms offered by plan
 - Lump sum payment is often available
 - If lump sum elected, may be rolled over to an IRA or other qualified plan (same rules as DC plans)
 - Works well for owner only plans

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DB Plan & CB Plans – the same but different

- Cash Balance Plans
 - Benefits defined in terms of hypothetical account balance
 - Account balance developed by accumulating principal credits and interest credits
 - Principal credits are sometimes referred to as CB credits, employer credits, etc

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DB Plan & CB Plans – the same but different

- Cash Balance Plans
 - Minimum vesting = 3 year cliff
 - All other provisions applicable to traditional DB plans apply
 - Required contributions, QJSA = default payout, need to elect a lump sum, etc

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DB Plan & CB Plans – the same but different

- Cash Balance Plans
 - Works well for plans with multiple partners, different benefit levels for different groups, when combined with a DC

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DB Plan & CB Plans – the same but different

- It's all a matter of style...
 - DB designs
 - can automatically provide for 415 maximum benefits without need for periodic amendments
 - can easily provide benefits based on average rather than current compensation
 - can easily provide benefits for past service (service prior to DB effective date)

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DB Plan & CB Plans – the same but different

- It's all a matter of style...
 - CB designs are transparent
 - Everyone is familiar with account balance style of expressing value
 - Easy for employer to see cost of each participant's benefit
 - Easy for participants to understand the benefits they are receiving
 - CB statements look like 401k statements

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DB Plan & CB Plans – the same but different

- It's all a matter of style...
 - CB designs are convenient for combo testing
 - Principal credit treated in a similar manner to PS contribution for testing purposes
 - Relatively easy to run multiple iterations of the testing if needed

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DB Plan & CB Plans – the same but different

- It's all a matter of style...
 - CB participant reports/statements look like 401k reports/statements so easy to sum CB & DC balances to see total benefit
 - DB participant statements usually report monthly benefits payable at retirement which are harder for the average participant (or plan sponsor to understand)

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CB Design Basics

- CB usually paired with a DC plan
 - Aggregated with DC for non-disc testing
 - Plans often referred to as combo plans/designs
- Combos look like cross-tested plans
 - Different contribution levels to different groups
 - Can focus benefits on favored groups, often HCEs
 - May need to provide additional benefits to NHCEs to support benefits to HCEs

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CB Design Basics

- More \$ than DC only
 - More contribution buckets
 - CB buckets subject to different rules
- Less flexibility than PS only
 - Must provide CB credits per CB formula
 - Must provide sufficient \$ to NHCEs to pass aggregated testing, which effectively makes PS contributions to NHCEs required

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CB Design Basics

- Who might be interested in a CB?
 - Principals who are max'd in 401k/PS and looking for add'l retirement savings
 - Employer who is looking to provide add'l tax-favored compensation to some/all employees
 - Multi-partner businesses with partner with different goals/needs

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Example – Professional Practice

Class	Last Name	First Name	AA	RA	Compensation	Cash Balance		401(k)	3% SH	Profit Sharing		Total	ER	% of
						\$	%	\$	\$	\$	%	\$	\$	ER \$
A	OWNER	DOCTOR	58	62	305,000	256,200	84.0	27,000	9,150	7,625	2.5	299,975	272,975	39.9
B	OWNER	DOCTOR	56	62	305,000	219,600	72.0	27,000	9,150	7,625	2.5	263,375	236,375	34.6
C	OWNER	DOCTOR	44	62	305,000	109,800	36.0	20,500	9,150	7,625	2.5	147,075	126,575	18.5
H	NONOWNER	DOCTOR	39	62	150,000	0	0.0	12,000	4,500	0	0.0	16,500	4,500	0.7
M	STAFF	MANAGER	47	62	90,000	1,800	2.0	5,400	2,700	3,600	4.0	13,500	8,100	1.2
N	STAFF	MEDICAL	41	62	75,000	0	0.0	3,750	2,250	3,375	4.5	9,375	5,625	0.8
N	STAFF	MEDICAL	64	68	55,000	0	0.0	2,750	1,650	2,475	4.5	6,875	4,125	0.6
N	STAFF	MEDICAL	31	62	50,000	0	0.0	2,500	1,500	2,250	4.5	6,250	3,750	0.5
N	STAFF	MEDICAL	43	62	50,000	0	0.0	2,500	1,500	2,250	4.5	6,250	3,750	0.5
N	STAFF	MEDICAL	50	62	50,000	0	0.0	2,500	1,500	2,250	4.5	6,250	3,750	0.5
O	STAFF	OFFICE	31	62	36,000	720	2.0	1,080	1,080	1,440	4.0	4,320	3,240	0.5
O	STAFF	OFFICE	34	62	32,000	640	2.0	0	960	1,280	4.0	2,880	2,880	0.4
O	STAFF	OFFICE	62	66	32,000	640	2.0	960	960	1,280	4.0	3,840	2,880	0.4
O	STAFF	OFFICE	67	71	30,000	600	2.0	900	900	1,200	4.0	3,600	2,700	0.4
O	STAFF	OFFICE	28	62	30,000	600	2.0	0	900	1,200	4.0	2,700	2,700	0.4
Owners					915,000	585,600	64.0	74,500	27,450	22,875	2.5	710,425	635,925	93.0
Non-Owner/Staff					680,000	5,000	0.7	34,340	20,400	22,600	3.3	82,340	48,000	7.0
Grand Total					1,595,000	590,600	37.0	108,840	47,850	45,475	2.9	792,765	683,925	100.0

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Example – Small Business

Class	Last Name	First Name	AA	RA	Compensation	Cash Balance		401(k)	3% SH	Profit Sharing		Total	ER	% of
						\$	%	\$	\$	\$	%	\$	\$	ER \$
A	OWNER	FATHER	57	65	305,000	183,000	60.0	27,000	0	40,500	13.3	250,500	223,500	85.5
B	OWNER	SON	29	65	90,000	1,800	2.0	2,700	0	3,600	4.0	8,100	5,400	2.1
M	STAFF	MANAGER	48	65	75,000	1,500	2.0	4,500	2,250	3,000	4.0	11,250	6,750	2.6
N	STAFF	TECHNICAL	41	65	65,000	1,300	2.0	3,250	1,950	2,600	4.0	9,100	5,850	2.2
N	STAFF	TECHNICAL	52	65	55,000	1,100	2.0	2,750	1,650	2,200	4.0	7,700	4,950	1.9
N	STAFF	TECHNICAL	31	65	50,000	1,000	2.0	0	1,500	2,000	4.0	4,500	4,500	1.7
N	STAFF	TECHNICAL	51	65	50,000	1,000	2.0	2,500	1,500	2,000	4.0	7,000	4,500	1.7
O	STAFF	OFFICE	31	65	35,000	700	2.0	1,050	1,050	1,400	4.0	4,200	3,150	1.2
O	STAFF	OFFICE	34	65	32,000	640	2.0	960	960	1,280	4.0	3,840	2,880	1.1
Owner + Son					395,000	184,800	46.8	29,700	0	44,100	11.2	258,600	228,900	87.5
Staff					362,000	7,240	2.0	15,010	10,860	14,480	4.0	47,590	32,580	12.5
Grand Total					757,000	192,040	25.4	44,710	10,860	58,580	7.7	306,190	261,480	100.0

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A Few Reminders

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For Further Study

Joanne Pecina will demonstrate how to find more information on today's topic from the ERISApedia.com resources.



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