Employee Benefits Consultants

Cash Balance Plans

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Frequently Asked Questions …

A Cash Balance plan is a type of Defined Benefit qualified retirement plan that has different features than a traditional Defined Benefit plan. Below are some frequently asked questions regarding Cash Balance plans.

Why a Defined Benefit plan? A DB plan provides larger (additional) limits than DC plan (100% of comp, $52,000 for 2014). Sample DB contributions: age 40: $85,000, age 50: $140,000, age 60: $235,000 (Assumes adequate compensation, service and participation to support max dollar benefit).

What is a Cash Balance plan? A Cash Balance plan is a Defined Benefit plan where the benefit for the participant is defined in terms of a "Hypothetical Account Balance" instead of a periodic benefit (as is the case in a Traditional Defined Benefit plan).

How does a Cash Balance plan work? In general terms, the Cash Balance plan document will define Groups of Participants and their "Pay Credit". This Pay Credit might be defined as a percentage of compensation or a dollar amount (or some combination of both). For example, the Pay Credit may be the lesser of 3% of period compensation or $1,000.

In addition to the Pay Credits, the Hypothetical Accounts are credited with interest at the Interest Crediting Rate defined in the plan document. Typical rates include Treasury Rates or a fixed rate (or some combination of both). For example, the Interest Crediting Rate may be the lesser of a fixed rate or an index.

Unlike a DC Plan where investment risk is borne by the Participants; the investment risk and reward in a Cash Balance Plan is borne by the Employer.

How is the Interest Crediting Rate set? By law, the Interest Crediting Rate must not exceed a "market rate". Setting the interest rate is part of the initial plan design; once set, the interest crediting rate definition does not change.

What are the deduction rules? The deductible limit to combined plans (DB and DC) is the greater of 25% of compensation or the minimum required funding amount for the DB plan. Post 2005, the 25% limit does not apply if DC does not exceed 6% of aggregate compensation. When DC contributions exceed 6% of aggregate compensation, only DC contributions over 6% are considered in 25% limit. Effectively, this translates to a 31% limit.

Does a Cash Balance plan make the DC plan obsolete? No. The DC plan is an important part of the design.

Is a Cash Balance plan covered by PBGC? Possibly – Cash Balance plans are DB plans and, therefore, are subject to the same rules as Traditional DB plans when it comes to PBGC coverage. Most DB plans are PBGC covered; however, professional groups with fewer than 26 employees are not.

What does the participant receive each year? The Participant Statement provided to the participant looks similar to a DC statement.

What happens when someone terminates? Distributions from Cash Balance plans are subject to most of the same rules as traditional DB plans. The participant must be offered annuity payment options in addition to the lump sum option. An important distinction is that Cash Balance plans are not subject to the same interest rate rules for determining the amount of the lump sum as Traditional DB plans. This ultimately makes the Cash Balance distributions more easily determined and projected.

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