CASH BALANCE PLANS:

Pros and Cons for Employers and Employees

As a plan sponsor, if you're looking for an alternative plan that can help associates accelerate their savings, particularly as they age, adding a cash balance plan to your retirement savings options could be helpful.

A cash-balance plan is a defined benefit plan in which investments are professionally managed, and participants receive an account balance based on an accrued benefit amount at retirement.

While a traditional 401(k) plan has maximum employee contribution limits, and account balances fluctuate with market changes, cash balance plans have higher employee contribution limits that increase with age and tend to have steady, conservative returns.[1]

Plan Contribution and Interest Credit

A cash balance plan participant earns an accrued benefit that grows via an employer **contribution or "pay credit,"** which can be a flat dollar amount or a percentage of an employee's pay. The contribution amount must meet participation, coverage and non-discrimination requirements defined in the tax code. The plan's actuarial/administrative consulting firm performs these tests annually. In addition, a participant receives an annual **interest credit**. The rate can either be fixed (at typically no more than 5 percent), or variable, usually equal to the 10- or 30-year Treasury rate and remains constant throughout the year.[2]

Employer Responsibilities

Employers have to amend the plan if they decide to change contribution levels and are generally required to give employees 45 days of advanced notice on plan amendments that significantly reduce the rate at which employees earn benefits in the future.

Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants, so investment risks are solely the employer's responsibility.

Employers have to fund any underfunded amount before the plan terminates. In most cases, because benefits are usually insured by the Pension Benefit Guaranty Corporation (PBGC), if the plan is terminated due to insufficient funds, the PBGC has the authority to assume trusteeship of the plan and start to pay benefits up to the limits set by law.[2] The exceptions are plans sponsored by professional service organizations, such as for CPAs, doctors or dentists. These types of plans are not subject to being insured by the PBGC, so would be required to pay guaranteed benefits to participants.

Cash Balance Plan Pros:[1,2,3,4]

- Employers can offer a combination of qualified retirement plans, such as a 401(k) and a cash balance plan, giving employees the opportunity to maximize their contribution amounts.
- Employees can contribute a much higher amount to these plans compared to traditional plans
- Employee contributions are age-dependent — the older the participant, the more they can contribute.

- The plan is designed to provide steady, conservative growth.
- Employees can take their benefit as a lump sum, which can then be rolled over to an IRA or new employer's plan, if the plan accepts rollovers.
- This type of plan is helpful for high-income earners who may not be able to contribute to other plans or who are capped on traditional plan contributions.
- This plan offers small-business owners an opportunity to "catch up" on their retirement plan contributions if they didn't save as much while building their businesses.

Cash Balance Plan Cons:[4]

- Cash balance plans require employers to pay an additional cost — they must have an actuary certify annually that the plan is properly funded.
- These plans don't offer investment choices — at the end of the year, employees receive an account balance statement.
- Fund balances are professionally managed by the employer or a sponsoring investment firm, so employees cannot choose how funds are invested.
- Since returns are conservative, employees may need to include growth investments as part of their retirement savings strategy.
- While the employee can receive his/her benefit in the form an annuity and employers are required to offer an annuity option, it's not recommended and not common, because the plan would be terminating in the foreseeable future.

Consult With Your Retirement Plan Solutions Advisor

Cash balance plans provide an alternative to traditional pension plans that can be costly to fund over time. For more information on how a cash balance plan might fit with your firm's benefits, consider consulting with a Mariner Wealth Advisors Retirement Plan Solutions advisor.

Sources:

[1] https://www.emparion.com/cash-balance-plan-pros-cons/

[2] https://bit.ly/32hEkUV

[3] https://www.cashbalancedesign.com/resources/cash-balance-101/

[4] https://smartasset.com/retirement/what-is-a-cash-balance-plan