Are Cash Balance Plans an Overlooked Opportunity?

With their significantly higher retirement savings and tax deduction opportunities, cash balance plans may hold appeal for some successful businesses.

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A cash balance plan is a modification to a traditional defined benefit (DB) pension plan and is sometimes referred to as a hybrid plan. Like a pension plan, participants are promised a certain benefit at retirement, but that benefit is an account "balance," hence the name.

HOW DOES A CASH BALANCE PLAN WORK?

In a cash balance plan, each participant has an account which grows in two ways:

- First, the employer makes a contribution each year. This contribution is either a percentage of pay or a flat dollar amount. (Depending on the plan, each participant might receive the same or a different contribution amount.)
- Then, the account receives an interest credit which is typically a guaranteed rate.

Other features:

- Cash balance products are designed to maximize a targeted rate of return.
- An actuary certifies each year that the plan is properly funded.
- At retirement, a participant can choose to annuitize their benefits or receive a lump sum.

Cash Balance Plans are Gaining in Popularity

Traditional defined benefit pension plans may be on the decline, but one type of plan is growing fast: cash balance plans. We believe the flexibility to tailor a plan's design to a business' needs is key to their appeal.

HOW DOES A CASH BALANCE PLAN DIFFER FROM A TRADITIONAL DB PENSION PLAN?

A traditional DB plan uses a fixed (defined) benefit formula, typically based on years of service and compensation. A cash balance plan uses a more flexible plan accumulation formula, typically based on compensation and investment credits.

Another key difference is a cash balance plan is portable. For example, when an employee separates from service, cash balance accounts can be distributed or rolled over to an IRA or another employer-sponsored plan, depending on a number of factors.

HOW DOES A CASH BALANCE PLAN DIFFER FROM A 401(K) PLAN?

The biggest difference? In a 401(k) plan, an employee's retirement benefits depend on the contributions made to the plan by the employer and the employee, the performance of the investment markets and the nature and performance of the investment options available in the plan and selected by the participant. That means that the employee bears the risk of any market downturns and the impact on his or her retirement savings.

With a cash balance plan, however, the amount of money an employee can expect in retirement is "defined." The employer, not the employee, bears this risk. A cash balance plan also allows greater contribution and tax deduction opportunities for employers, compared with some other employer sponsored retirement plans.

The cash balance market may be one of the least understood markets that advisors serve," says Stephen Dopp, National Director, Defined Contribution at Lord Abbett. "Given the contribution limits, potential tax advantages and nuances of the market, it is a way that advisors may be able to add meaningful value to the right clients.

"Plan sponsors can consider cash balance plans as a great way to make a large contribution for any single year," says Charles Rosenberg, Vice President, Intac Actuarial Services Inc, who has been serving pension clients since 1994. "A cash balance plan allows employers to enhance benefits for key employees given the higher contribution limits. Also, a plan can be funded on an annual basis, versus payroll-to-payroll like you see with a 401(k) plan."

"For financial advisors, these plans may represent a promising opportunity to better serve their clients' specific business needs, from a cash flow standpoint," he says.

Flattening the Benefit

Unlike a traditional pension plan, a cash balance plan may help foster a sense equality among employees. "For example, whether a partner is 30 or 50 years old, a business can choose to give them the same flat contribution," says Charles Rosenberg, Vice President, Intac.

"The beauty of a cash balance plan is that it allows you to better cater to certain business' needs," Rosenberg says.

THE POTENTIAL ADVANTAGES OF A CASH BALANCE PLAN FOR PLAN SPONSORS

- Higher contribution limits: When a company establishes a cash balance plan, it enjoys much higher contribution limits than a 401(k) plan. This is helpful when employees need to make sizable catch-up contributions to prepare for retirement. (The contribution limits for cash balance plans are based on age and may exceed $200,000 for some workers age 60 and over.)
- Tax savings: Contributions to a business's cash balance plan reduce the sponsoring employer's adjusted gross income.
- Active investment management: Companies can implement a professionally managed solution that targets a specific rate of return.
- Simpler administration/ participant education: With the right provider relationship, a company may find administration of these plans easier compared with other types of qualified retirement plans, when supported by highly competent actuarial services and responsive plan design support. Cash balances plans may also be easier for participants to understand because contribution and investment decisions are handled on their behalf.
- More predictable costs: Compared to some pension plans and their associated liabilities, costs for cash balance plans may be more predictable and easier to manage for some employers.

WHAT TYPES OF ORGANIZATIONS CAN BENEFIT FROM A CASH BALANCE PLAN?

- **Successful small to medium sized business owners and professional practices**. Business owners who are confident in their earnings and profit outlook and who want to potentially accelerate retirement savings for their employees might find these plans appealing. Bear in mind some entrepreneurs may have neglected their retirement savings opportunities while they built their businesses and may need to catch up on years of missed saving. A cash balance plan allows these owners the opportunity and the flexibility to contribute a certain percentage of partners' and employees' pay.
- **Partners or owners over 40 who want to "catch up" on retirement savings**. The maximum contribution amounts are age-dependent, and the older the participant, the more the higher the contribution limits.
- **Companies with younger populations**. Cash balance plans offer benefits that are evenly spaced over an employee's career and grow over time. Dollars contributed by a company earlier in an employee's tenure have more time to compound. Cash balance plans might be an attractive benefit to use in the recruitment of younger employees.

Is it time for you to take a good look at cash balance plans?
Talk to Lord Abbett.

- Ask your Lord Abbett Retirement Director about how we can assist you in evaluating a cash balance plan solution to best meet the needs of your organization.
- For more information, contact us at **888-522-2388** or visit lordabbett.com.

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GLOSSARY OF TERMS

A **plan sponsor** is a designated party—usually a company or employer—that sets up a retirement plan, such as a 401(k), for the benefit of the employees.

A **401(k)** is a qualified plan established by employers to which eligible employees may make salary deferral (salary reduction) contributions on an aftertax and/or pretax basis. Employers offering a 401(k) plan may make matching or nonelective contributions to the plan on behalf of eligible employees and may also add a profit-sharing feature to the plan. Earnings accrue on a tax-deferred basis.

Traditional IRA contributions plus earnings, interest, dividends, and capital gains may compound tax-deferred until you withdraw them as retirement income. Amounts withdrawn from traditional IRA plans are generally included as taxable income in the year received and may be subject to 10% federal tax penalties if withdrawn prior to age 59½, unless an exception applies.

An **IRA** rollover may involve the application of fees and charges to the investor. A rollover is the process of moving your retirement savings from your retirement plan at work (401(k), profit-sharing plan, etc.) into an Individual Retirement Account (IRA).

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