Cash Balance Plans 101

OVERVIEW, ADVANTAGES AND DISADVANTAGES

Milliman

CASH BALANCE PLANS 101

A cash balance plan is a hybrid retirement plan, blending the features of a traditional pension plan with the look and feel of a 401(k)/profit-sharing plan

It is a qualified plan and all contributions to the plan are made on a tax-deferred basis by the employer. A cash balance plan is a defined benefit plan subject to all the requirements of such plans. As a defined benefit plan, the benefit under a cash balance plan is determined based on formulas in the plan document. Cash balance accounts grow with contributions known as Pay Credits and Interest Credits. Each participant has a benefit that resembles a 401(k)/profit-sharing plan account balance. The benefits are supported by a pooled fund; however, the amount of money in the fund is not used in determining the amount of the benefit. Cash balance plans are insured by the Pension Benefit Guaranty Corporation (PBGC) unless the employer meets one of the coverage exceptions.

PAY CREDITS

Pay credits can be a flat dollar amount or a percentage of salary, or a combination of the two. In addition, the plan can be designed such that the pay credits vary by age. Older participants can receive larger pay credits in a cash balance plan than younger participants due to the time value of money. Larger pay credits are permitted for older participants as they have less time to accumulate funds prior to retirement.

Here are the 2024 maximum contribution amounts by age:

Age	401(K) With Profit Sharing	Cash Balance	Total	Tax Deferral*
70	$76,500	$409,000	$485,500	$179,635
65	$76,500	$329,000	$405,500	$150,035
60	$76,500	$318,000	$394,500	$145,965
55	$76,500	$248,000	$324,500	$120,065
50	$76,500	$193,000	$269,500	$99,715
45	$69,000	$150,000	$219,000	$81,030
40	$69,000	$117,000	$186,000	$68,820
35	$69,000	$91,000	$160,000	$59,200

* Assumes the 37% tax bracket. This chart does not, and is not intended to, provide legal, tax or accounting advice, and readers should consult your tax advisor. These values are maximums and not specific to any plan. Assumes all 401(k) deferrals are on a non-Roth basis. FICA "savings" are permanent with W-2 employees.

INTEREST CREDITS

The interest credit can be a fixed rate (up to 6%), a bond-based rate (e.g., the 10-year Treasury yield) or based on the return on plan assets.

The interest credit is independent from the actual return on the plan's assets (although plans can be designed to take the plan's asset return into account). If the plan's interest credits follow actual returns (and allow for negative returns), cash balance plans have a "preservation of capital" requirement such that the hypothetical account balance can never be less than the sum of earned pay credits.

CANDIDATES

- Employers that want contributions in excess of the limits allowed under defined contribution plans for owners, partners or key employees.
- Employers that want to have increased deductions over several years.
- Employers that have the resources to make the required contributions.
- Employers that generally are not affected by economic volatility.
- Employers that can contribute 5-10% of compensation for their employees.
- Older owners with younger staff.

ADVANTAGES

- Permits tax-deferred contributions beyond 401(k) annual caps.
- Enables tiered benefit levels for unique participant credits, subject to IRS nondiscrimination tests.
- Shields participants from investment risk with a set plan interest rate.
- Aims to invest assets to outperform the set interest rate, with the sponsor retaining risk.
- Designs can align the plan's interest rate with the trust's return to minimize sponsor risk.
- Offers creditor protection for benefits, including from legal costs.
- Provides a clearer benefit structure for participants, improving satisfaction over traditional plans.

DISADVANTAGES

- Must meet Internal Revenue Code funding rules, possibly needing cash contributions in less ideal years.
- Except for minor benefits, must provide payment options beyond lump sums due to its defined benefit nature.
- Generally covered by PBGC, necessitating yearly premiums.
- Features faster vesting schedules relative to traditional defined benefit plans.
- May be more complex for participants to grasp than 401(k)/ profit-sharing plans due to numerous defined benefit plan rules.

PBGC PREMIUMS

The PBGC is a government agency that insures defined benefit plans. Almost all defined benefit plans are covered by the PBGC and plan sponsors must pay premiums for this coverage; however, certain plans for small professional services firms and plans covering only substantial owners are exempt. PBGC premiums consist of a flat rate premium and a variable rate premium. The flat rate premium is a per participant annual fee of $101 in 2024. The variable rate premium fee is $52 per $1,000 of unfunded vested benefits in 2024. All plans are subject to the flat rate premium, but only plans with unfunded vested benefits are subject to the variable rate premium.

TIME COMMITMENT

Because this is a defined benefit plan, the plan would need to follow the Internal Revenue Service (IRS) rules regarding permanency. The company would need to commit to funding the plan for more than a few years (i.e., generally no fewer than five years), unless there is a legitimate business reason for freezing or terminating the plan (such as sale of the business or bankruptcy).

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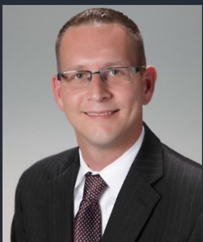
KEY CONTACT



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