BEST MONTHLY WEBINAR

Cash Balance Plans

Presented by:
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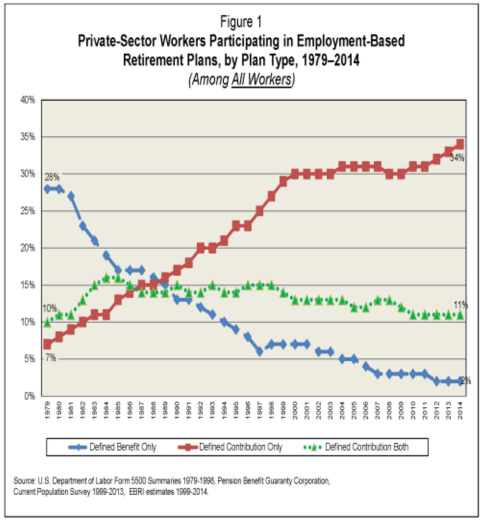
Our Agenda

- Describe the industry trends of qualified retirement plans: DC vs. DB plans
- Determine the fundamental differences between a DC vs. DB plan
- Understand the role of Cash Balance plans vs. Traditional DB plans
- Identify the basic fundamentals of Cash Balance plans
- Apply Cash Balance plan applications and designs

Industry Trends of Qualified Retirement Plans

Qualified Retirement Plans

- Defined Contribution plans
- Defined Benefit plans



Source: U. S. Dept. of Labor
https://www.ebri.org/publications/benfaq/index.cfm?fa=retfaq14

Defined Contribution (DC) Plans

- Accrued benefits equal account balances:
  - Annual contributions plus investment earnings
  - Employer contributions generally allocated as a percentage of compensation
    - Possible contribution sources: employer profit sharing and/or employer matching contributions.
- IRS limits the contribution and deduction limits:
  - $55,000 ($61,000 if age 50 or older and the plan includes a 401(k) feature that permits catch-up contributions) OR
  - 100% of pay (up to $275,000)
- Employer deduction limit is 25% of aggregate compensation of covered participants.

Types of DC Plans

- 401(k) Plans
- Profit Sharing Plans
- Money Purchase Plans
- Target Benefit Plans

Defined Benefit (DB) Plans

- An ER sponsored qualified retirement (pension) plan that guarantees a specified benefit level at the plan participant's NRA
  - Fully funded by ER and set up as a single account. ER assumes all responsibility
- Contributions are subject to minimum funding requirements based on plan benefit formulas, actuarial assumptions, plan assets, etc.
- Potential maximum annual benefit to be funded is $220,000 (indexed) or the annual benefit base on the plan benefit formula and assumptions (IRC § 415)

Defined Benefit Plan

Illustration of Contributions to Fund Maximum Benefits in Defined Benefit Plan (2018)

Age	Amount[1]
35	$51,000
45	$83,000
55	$135,000
60	$172,000
64	$210,000

[1] The limits for a defined benefit plan are expressed as limits on benefits. A maximum contribution can be computed using the assumptions outlined below regarding the contributions needed to fund the benefits. The amount is determined without regard to the deduction limit that may be applicable.

Hypothetical mathematical illustration only. Illustration assumes no mortality, no withdrawals and no inflation. An interest rate of 5% is solely used to derive the maximum contributions needed to fund ONLY the first year's worth of maximum benefit at age 65, assuming the benefit max remains at the same level of *$220,000* at the year of retirement.

Hybrid DB Plans

- Cash Balance Plans
- Pension Equity Plans
- Life Cycle (Retirement Bonus) Plans; and
- Floor-Offset Pension Plans

Cash Balance (CB) Plans

- The fastest-growing part of the DB pension universe[1]:
  - The number of CB plans increased 17% compared with just 3% growth in 401(k) plans in 2016. There are 17,812 plans and annual contributions were $29.3 billion in 2016.
  - 92% of CB plans are in place at firms with fewer than 100 employees. Firms with 1 to 9 employees now account for 57% of all CB plans. Medical and dental groups account for 40% of all CB plans nationally.
- Reasons for growth of Cash Balance Plans:
  - Pension Protection Act of 2006 [IRC § 411(a)(13)(A)]
  - Legislative changes and broader options for plan sponsors;
  - Hybrid appeal;
  - Tax planning (IRC § 199A)

Source: [1] Kravitz 2017 National Cash Balance Research Report; https://cdn.cashbalancedesign.com/wp-content/uploads/2017/08/NationalCashBalanceResearchReport2017.pdf

Traditional DB vs. Cash Balance Plan

Census Data			Traditional DB Plan		Cash Balance Plan	
Position	**Age**	**Annual Pay**	**Cost Allocation**	**% of Pay**	**Cost Allocation**	**% of Pay**
Owner A	55	$275,000	$162,250	59%	$159,500	58%
Owner B	50	$275,000	$132,000	48%	$115,500	42%
EE 1	50	$75,000	$47,250	63%	$13,500	18%
EE2	55	$50,000	$39,000	78%	$9,000	18%
EE 3	35	$40,000	$10,000	25%	$7,200	18%
EE 4	30	$35,000	$6,650	19%	$6,300	18%
EE 5	25	$30,000	$4,500	15%	$5,400	18%
		Owners	$294,250	**73% to Owners**	$275,000	**87% to Owners**
		Employees	$107,400		$41,400	
		Total	$401,650		$316,400	

[1]Assumes a benefit based on 10% of average monthly compensation multiplied by a maximum of ten years of participation, and a Target Normal Cost calculated using mandated segment rates.

Cash Balance Plan Fundamentals

- A cash balance plan is a DB plan that maintains hypothetical individual employee accounts like a DC plan
  - Allows for company contributions that are based upon a percentage of pay or a flat dollar amount that receive an annual interest credit to each participants balance.
- While contributions are skewed toward older participants including the owner, all employees will receive contributions and benefit from the plan.
  - In fact, depending on the calculations, employers may be expected to contribute between 5 percent and 8 percent of employee compensation.
- Provide large deductible contributions for owners similar to a traditional DB plan.

Cash Balance Plan Fundamentals (Con’t)

- The plan sponsor (owner) can set different “classes” and contribution levels for employee groups
- Benefits are more easily understood by the participant when compared to traditional DB plans
  - Participant receives an annual statement that shows an account balance
- Contribution credits for the staff (as a % of pay) can be the same (but don’t have to be)
- Participant is entitled to account balance on termination (IRA Rollovers)
- Plans must be established by fiscal year-end, generally Dec. 31

Eligible Compensation

Compensation Quick Reference Chart

Entity Type	Source of Income	Compensation for Plan
Corporation	W-2 Income	W-2 Income
S-Corporation	W-2 + Schedule K-1	W-2 Income only
Sole Proprietorship	Schedule C (net profit	Earned Income (calculated)*
Partnership	Schedule K-1 (net profit)	Earned Income (calculated)*

Earned income only • W-2 income, not K-1 or net profit • Limited Liability Company (LLC) — compensation for plan depends on how LLC is taxed. (See Corporation or Partnership above.)

Case Study: ABC Company

- Joe Smith owns a distribution company with 4 associates
- ABC Company has had five years of solid business growth
- Joe wants to put aside more to fund his retirement benefits
- Joe wants to reduce his taxes

Case Study: ABC Company

	Pay	Contribution Credit	% of Pay
Joe	$275,000*	$41,250	15%
Staff	$30,000	$4,500	15%
Staff	$30,000	$4,500	15%
Staff	$30,000	$4,500	15%
Staff	$30,000	$4,500	15%
		$18,000	

- This is a common approach:
  - Joe gets a contribution credit of $41,250 → 15% of his $275,000 compensation
  - All staff also get 15% of pay

This is a hypothetical illustration only. Results will vary from case to case. This is intended for general information purposes only. Broker Educational Sales & Training, Inc. is not responsible for any errors or omissions herein.

*** The maximum amount that can be considered under IRS rules for 2018.**

Case Study: Is the plan valuable to Joe?

- Should ABC Company contribute to this plan?
  - Benefit for Joe = $41,250 contribution
  - Cost for Joe = $18,000 staff contribution
- How can we make the plan more valuable for Joe?
  - Increase the size of Joe's contribution (72%)

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Case Study: What if the contribution for Joe is increased?

	Age	Pay	Cash Balance Contribution	% of Pay
Joe	63	$275,000	**$198,000**	72%
Staff	25	$30,000	$4,500	15%
Staff	50	$30,000	$4,500	15%
Staff	23	$30,000	$4,500	15%
Staff	30	$30,000	$4,500	15%

How does this satisfy the non-discrimination rules?

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Calculating Joe's Retirement Benefit

	Age	Pay	Cash Balance Contribution	Projected Acct. Bal. Age 65	Projected Benefit Age 65	Projected Benefit %
Joe	63	$275,000	$198,000	$218,295	$14,156	5.1%

This is a hypothetical mathematical illustration only that uses a 5% interest rate in the accumulation period, Scale AA of the GAR mortality table & 2.95% interest rate for the projected benefit. Results will vary from case to case. This is intended for general information purposes only. Broker Educational Sales & Training, Inc. is not responsible for any errors or omissions herein.

Case Study: Calculating the Retirement Benefit

	Age	Pay	Cash Balance Contribution	Projected Acct. Bal. Age 65	Projected Benefit Age 65	Projected Benefit %
Joe	63	$275,000	$198,000	$218,295	$14,156	5.1%
Staff						
1	25	$30,000	$4,500	$31,680	$2,054	6.9%
2	50	$30,000	$4,500	$9,355	$607	2.0%
3	23	$30,000	$4,500	$34,927	$2,265	7.6%
4	30	$30,000	$4,500	$24,822	$1,610	5.4%

This is a hypothetical mathematical illustration only that uses a 5% interest rate in the accumulation period, Scale AA of the GAR mortality table & 2.95% interest rate for the projected benefit. Results will vary from case to case. This is intended for general information purposes only. Broker Educational Sales & Training, Inc. is not responsible for any errors or omissions herein.

Case Study: General Test – Meeting the Ratio Percentage Test

- In order to allow more to be contributed for Joe, the plan must pass the Ratio Percentage Test:

70% or more of staff have a *projected benefit percentage* equal to or greater than the HCE's *projected benefit percentage*

Case Study: Ratio Percentage Test

Projected Benefit Percentage

	Age	Pay	Cash Balance Contribution	Projected Acct. Bal. Age 65	Projected Benefit Age 65	Projected Benefit %
Joe	63	$275,000	$198,000	$218,295	$14,156	5.1%
Staff						
1	25	$30,000	$4,500	$31,680	$2,054	✓ 6.9%
2	50	$30,000	$4,500	$9,355	$607	2.0%
3	23	$30,000	$4,500	$34,927	$2,265	✓ 7.6%
4	30	$30,000	$4,500	$24,822	$1,610	✓ 5.4%

Conclusion: Joe can increase his contribution to the Cash Balance plan

This is a hypothetical mathematical illustration only that uses a 5% interest rate in the accumulation period, Scale AA of the GAR mortality table & 2.95% interest rate for the projected benefit. Results will vary from case to case. This is intended for general information purposes only. Broker Educational Sales & Training, Inc. is not responsible for any errors or omissions herein.

Case Study: Summary

- A Cash Balance plan may allow Joe to:
  - Receive a contribution credit in excess of $55,000 for his retirement
  - Reduce his taxes because the contribution is tax-deductible
  - Receive a larger contribution than his staff as long as non-discrimination rules are not violated

[1] 2018 IRS maximum limit for defined contribution plans ($61,000 if age 50 or older and the plan includes a 401(k) feature that permits catch-up contributions)

Results will vary from case to case. This is intended for general information purposes only. Broker Educational Sales & Training, Inc. is not responsible for any errors or omissions herein.

Case Study: Rules of Thumb When Testing Retirement Benefits

- The amount of benefit any contribution can provide decreases with age because there is less time for the account to accumulate
- Therefore, larger contributions are required to fund the benefits for older employees
- Therefore, if HCEs are older than Staff, the plan may be able to provide larger contributions for HCEs

Investments in CB Plans

- Assets are pooled and trustee directed
- Interest credit is specified under the Plan's provisions
- For employer
  - Investment gains: decrease contributions
  - Investment losses: increase contributions

Managing Investment Risk

- Manage investments to assist Plan Sponsor in managing fiduciary obligations and to:
  - Match the Plan’s interest credit rate
  - Match the Plan’s Investment Policy Statement
  - Match the Plan’s risk tolerance
- Investment risk on employer
  - Promised benefits must be delivered regardless of actual investment performance (both contribution credits plus interest credits)

Investment Strategies

- Cash Balance investment strategies involve:
  - Plan demographics
  - Cash flow
  - Risk tolerance
- Investment strategy is coordinated with plan actuary
- Role of Financial Advisor is key

Combination ("Combo") Plans

- IRC § 414(x) allows an eligible small employer to maintain both a DB plan and a DC plan.
  - An eligible employer is a small employer who employed an average of fewer than 500 employees during the preceding calendar year [IRC § 414(x)(2)(A)].
- IRC § 414(x)(6)(A) requirements applicable to DB plans with separate participant accounts, do not apply to eligible combined plans.
- Combination ("Combo") plans allow small business owners to optimize tax efficiency and maximize retirement savings.
  - Combines a CB and Safe Harbor 401(k) Profit Sharing Plan.

SH 401(k) Profit Sharing Plan

- Owner is required to make annual contributions to the plan on behalf of employees
- Owner contributes:
  - 3% of salary for Safe Harbor (SH) 401(k) to all participant accounts
  - Between 2% - 5% of salary for profit sharing
- Owners and employees can defer a portion of their salary each year into the 401(k) plan.
- SH Plan must be set up by October 1. If not, the owner's deferrals will be limited to 5% for the year.
- Participants must be fully vested after 3 years.

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Contribution Limits for Combination Plans

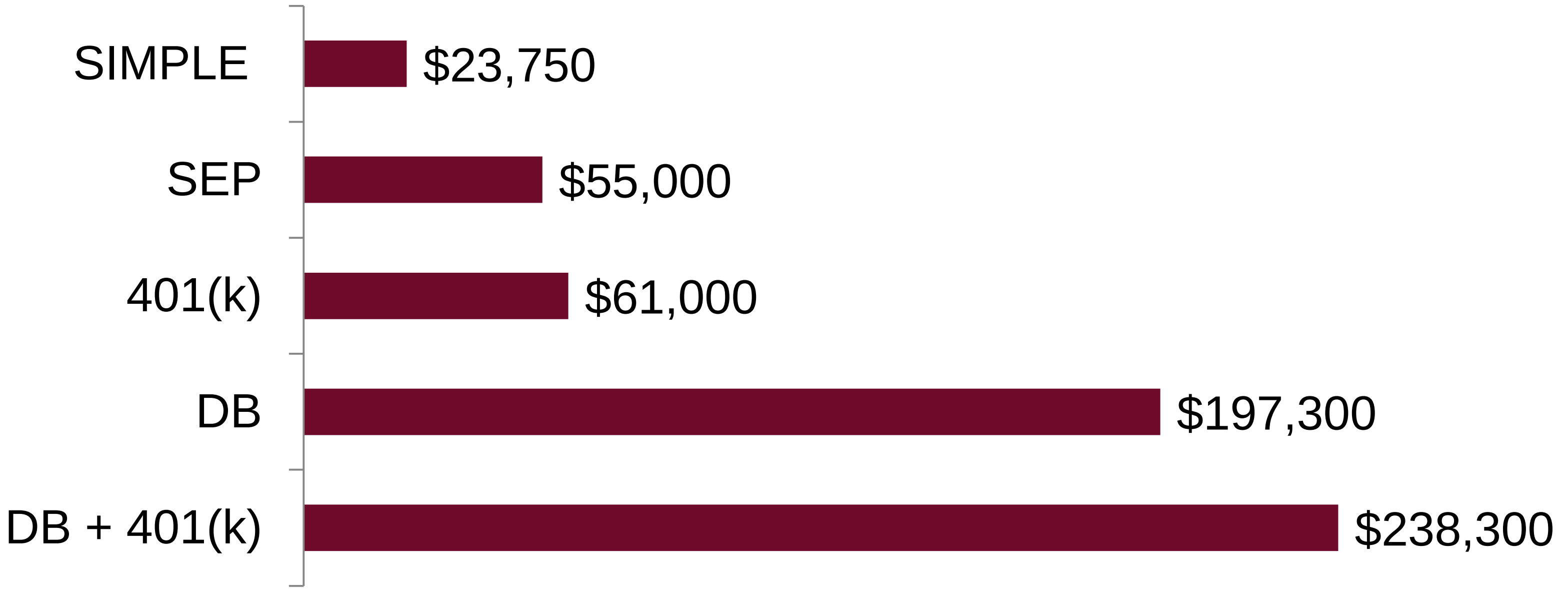
Age	Cash Balance[1]	+	Defined Contribution[2]	=	Total Contribution
35	$51,000		$55,000		$106,000
45	$83,000		$55,000		$138,000
55	$135,000		$61,000		$196,000
65	$220,000		$61,000		$281,000

[1] The limits for a defined benefit plan are expressed as limits on benefits. A maximum contribution can be computed using actuarial assumptions regarding the contributions needed to fund the benefits. The amount is determined without regard to the deduction limit that may be applicable. Numbers will vary, based on different actuarial assumptions and plan design.
[2] Based on 2018 IRS limits.

Case Study: Combination Plan

Census Data			Safe Harbor 401(k)/Profit Sharing Plan				Cash Balance Plan		Combined Total
Position	Age	Annual Pay	Salary Deferral	3% SHNEC	Cross-Tested PS	Total % of Pay	Cost Allocation	% of Pay	
Owner A	55	$275,000	$24,500	$0	$8,250	3%	$148,500	54%	$181,250
Owner B	50	$275,000	$24,500	$0	$8,250	3%	$148,500	54%	$181,250
EE 1	50	$75,000	$0	$2,250	$3,750	8%	$1,500	2%	$7,500
EE 2	55	$50,000	$0	$1,500	$2,500	8%	$1,000	2%	$5,000
EE 3	35	$40,000	$0	$1,200	$2,000	8%	$800	2%	$4,000
EE 4	30	$35,000	$0	$1,050	$1,750	8%	$700	2%	$3,500
EE 5	25	$30,000	$0	$900	$1,500	8%	$600	2%	$3,000
		Owners	$49,000	$0	$16,500		$297,000		$362,500
		EEs	$ 0	$6,900	$ 9,500		$4,600		$ 23,000
		Total	$49,000	$6,900	$26,000		$301,600		$385,500
								Percent to Owners	**94%**

DB Plans Potentially Allow Client to Contribute More



Hypothetical example: Maximum annual contribution limits in 2018 for a business owner age 52, earning $275,000 W-2 income annually, retiring in 10 years. Assumes 5-7% funding rate for Defined Benefit Plans

Good Candidates for CB Plans

- Partners who want to contribute more than $55,000
- Firms with consistent profit patterns
- Firms that can contribute 4-5% to the plan for employees and are willing to do so regularly
- Partners over 40 who desire to increase contributions or wish to catch up on pension savings

[1] 2018 IRS maximum limit for defined contribution plans ($61,000 if age 50 or older and the plan includes a 401(k) feature that permits catch-up contributions)

Ideal Clients for Combination Plans*

Characteristic of owner or business

- Highly profitable business with 1-10 employees
- Owner wants to reduce taxes
- Owner wants to make large contributions for him/herself and minimize contributions on behalf of employees
- Owner is willing to commit to a program for 5+ years
- Employees are likely to be stable, not a lot of turnover

Type of business

- Medical or Dental Practice
- Law Partnerships
- Consultants
- Building Contractors
- Real Estate
- Architects
- Farms
- Engineering
- Funeral Homes

*Combination Plans: Cash Balance plan with Safe Harbor 401(k) Profit Sharing Plan

Items to consider for Plan Sponsors

- Administrative costs can be higher
- Minimum required contribution
- Plan may be required to pay PBGC premiums


The End

Survey

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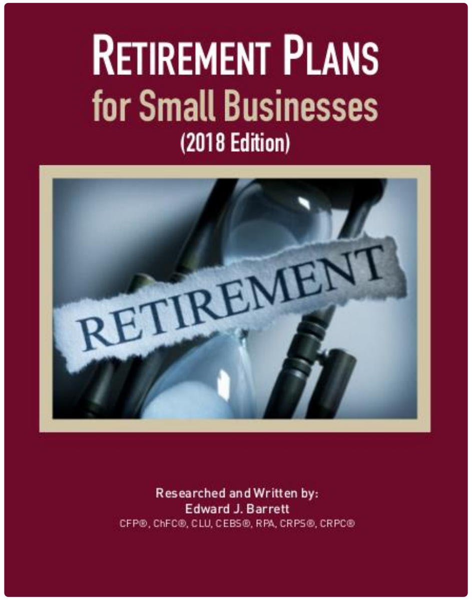

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