HOW CASH BALANCE ADD-ON PLANS ARE SAFER THAN REGULAR DEFINED BENEFIT PLANS

Career Average vs. Final Average Pay

Final Average Pay Defined Benefit Plans have a much steeper liability curve since an increase in pay is applied to all years of service. With a Cash Balance Plan, an increase, when contributions are defined as a percent of pay, will only effect the applicable year. For a Cash Balance Plan that defines contributions as a set Dollar amount there is no change in liability due to an increase in pay. This means Cash Balance Plans do not have the potential run-away costs risks of a regular Defined Benefit Plan

Less Investment Risk

Since these are "Add-On" Plans, the riskier and more equity based investments can be made on the Profit Sharing and 401(k) side. This allows the Cash Balance investments to be more on the fixed income side. Alternatively, if most (approximately 80 percent or more) of the liability is for the one key individual, investments can be more aggressive since the rank and file liability is relatively small. So, unlike a regular Defined Benefit Plan, a loss in investments will not force a big make-up contribution for non-owners.

Lump Sum Payout Risk

In a regular Defined Benefit Plan, when a participant leaves, they usually take their payout in a lump sum form instead of a monthly annuity. This lump sum is calculated using Code Section 417(e) rates (based on 30 year U.S. Treasuries). The rate has varied between 6.64% and 4.29% over the last six years. This makes lump sum payouts not only unpredictable, but for many plans that were developed back when the rules were different and interest rates higher, an unexpected additional cost. However, lump sum values for Cash Balance Plans do not vary. What does vary is the accrued benefit that is used to do a payout in the form of an annuity. Since the vast majority of participants do not take an annuity, liability surprises are virtually eliminated at payout time. Of course, if a participant does take an annuity, that annuity can be purchased from an insurance company. Since a lower interest rate means a higher accrued benefit, along with a lower annuity purchase rate, and a higher interest rate means a lower accrued benefit along with a higher annuity purchase rate, the amount to purchase the annuity would only have small fluctuations. Therefore, unlike a regular Defined Benefit Plan, Cash Balance Plans avoid the surprise liability fluctuations at payout.

PBGC-1 Premium Risk

Because Cash Balance Plans avoid liability fluctuations there generally are no variable premiums to pay with the annual PBGC-1 premium forms filing.

Limit Costs for Older Short Service Participants

Regular Defined Benefit Plans, particularly those with a safe harbor formula (i.e. 1.5% of Final Average Salary per year of service for all participants), can have high costs for employees hired at later ages. Cash Balance Plan can avoid this in their design. Add-On Cash Balance Plans can pay a Top Heavy minimum in the profit sharing plan, thereby avoiding participant costs that can be more than 10% of pay for older participants.

Greater Flexibility in a Bad Cash Flow Year

Cash Balance Plans allow you to more easily adjust the minimum required contribution in a bad cash flow year. This is can be done in a regular Defined Benefit Plan, but it is more difficult.

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