PRIVATE WEALTH MANAGEMENT

Retirement Plan Services

Understanding Cash Balance Plans: Is it Right for Your Business?

As business owners look for ways to set aside more money for retirement, the marketplace has seen a significant surge in cash balance plans. An often misunderstood retirement tool, cash balance plans are a form of the traditional pension plan, also known as a defined benefit plan, but look more like defined contribution plans. Instead of promising a monthly annuity at retirement, cash balance plans reflect a hypothetical account balance that is credited every year with a specified contribution and "interest credit." The interest credit is guaranteed and not subject to market fluctuations like a 401(k) plan.

The popularity of cash balance plans has soared since 2001, with double-digit annual growth. These plans provide a way for many business owners to maximize tax-deferred retirement savings while taking advantage of tax deductions for contributions. Unlike the traditional pension plan, account balances upon termination of employment are fully portable and can be rolled over into an IRA.

According to a 2014 cash balance research report conducted by Kravitz, Inc., small to mid-size businesses have driven a significant amount of the growth. The highest growth over the past five years has been in companies with fewer than 25 employees and 87 percent of plans are sponsored with companies having fewer than 100 employees.

A cash balance plan resembles a defined contribution plan because it determines the value of benefits for each participant based on individual accounts. The individual accounts are hypothetical because the plan's assets are not actually segregated into individual accounts, as they are in a true defined contribution plan. With a cash balance plan, the assets of the plan remain in a single investment pool like the traditional defined benefit plan.

At any point in time, the plan's total assets may be more or less than the sum of all of the hypothetical account balances. For funding purposes, a cash balance plan is still a defined benefit plan, and the employer is responsible for making adequate contributions to the plan so that sufficient assets exist to pay all benefits.

Rather than reflecting your pension benefits as a monthly amount payable at retirement, as is customary in a traditional defined benefit plan, your benefits in a cash balance plan are based on the value of your hypothetical individual account. The individual accounts provide a way for you to more easily understand the value of your benefits and how much money you have accumulated for your retirement.

Participant accounts grow annually in two ways:

- The company contribution, a percentage of pay or a flat dollar amount, is determined by a formula specified in the plan document.

- An annual interest credit where the rate of return is guaranteed and is independent of the plan's investment performance. That rate changes each year but is usually equal to the yield on 30-year Treasury bonds, which has hovered around five percent in recent years.

When participants terminate employment, they are eligible to receive the vested portion of their account balance.

Cash balance plans are often offered in conjunction with a 401(k) plan. The objective is to maximize deductible contributions for the owners and/or key executives while still providing meaningful benefits to participants.

Is a cash balance plan right for your business?

It may be ideal for your company if it falls into any of the following categories:

1. Highly profitable companies of all types and sizes
    - Usually indicated by the owner's desire for a larger tax deduction
    - Principals earning more than $250,000 per year
2. Family businesses
    - Can be used as a component of succession planning
3. Closely held businesses
    - Several owners want a greatly enhanced retirement plan
4. Law firms of all sizes
    - Tax deferral and asset protection attractive, along with highly competitive retirement package to help attract and retain top talent
5. Medical groups of all sizes
    - Tax deferral and asset protection attractive
6. Professional firms of all types
    - CPAs, engineers, architects, financial services firms, management consultants and others
7. Older owners who have delayed saving for retirement
    - Need to make up for years of nonsaving in a short time
8. Those who highly value asset protection
    - ERISA protects all qualified plan assets from creditors in the event of bankruptcy or lawsuit
9. Those who want an enhanced benefits package for executives
    - To attract and retain high caliber employees

10. Sole proprietors with income exceeding $250,000 per year
    - All entity-types apply

CIBC's Retirement Plan Services Group can help you determine whether a cash balance plan makes sense for your company. Contact us at 312.564.3806 for more information.

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