Cash Balance Plans Gaining Popularity with Employers

July 1, 2014 (PLANSPONSOR.com) – The number of cash balance retirement plans has increased, according to a report from Kravitz, Inc.

The "2014 National Cash Balance Research Report" says cash balance plans now make up 25% of all defined benefit (DB) retirement plans, up from only 2.9% in 2001. The report notes this increase coincides with the steady decrease in the number of traditional DB plans.

The number of cash balance plans increased by 22% versus a 1% increase in number of 401(k) plans. The growth of cash balance plans surpassed industry projections of 15%.

Kravitz points to a number of factors behind the growth of cash balance plans:

- Rising taxes: Higher federal, state and local tax rates have motivated many business owners to maximize tax-deferred retirement savings and take advantage of tax deductions for contributions to employee retirement accounts.
- Hybrid appeal: Cash balance plans combine the high contribution limits of a traditional DB plan with the flexibility and portability of a defined contribution (DC) plan. Cash balance plans are also designed to avoid the common risk factors and runaway costs involved in traditional DB plans.
- Retirement savings crisis: Media coverage of the Baby Boomers' lack of retirement preparedness is prompting older business owners to accelerate savings and maximize qualified plan contributions.

Kravitz says an increased awareness of cash balance plans has also played a role in its growth. The authors of the report cite that as recently as five years ago, many financial professionals were unaware that these plans were even an option. The number of cash balance plans has increased from 5,244 in 2008 to 9,648 in 2012, with a projected total of 11,095 for 2013.

The report also cites a number of reasons why plan sponsors are replacing DB plans with cash balance plans:

- Lower risk: Cash balance plans are designed to remove the interest rate risk that led to constantly changing value of liabilities in DB plans.
- Removing cost volatility: The structure of a cash balance plan is intended to prevent runaway costs for employees nearing retirement age.
- Easier for employees to understand and appreciate: Cash balance plans are similar to 401(k) plans with individual account balances and some plans offering participant websites with daily updates.
- Consistency and fairness: These plans allow for more consistent contributions to employees, rather than uneven age-based contributions.
- Full portability: Account balances can be rolled over to an individual retirement account (IRA), which is a useful option for today's mobile work force in which many employees change jobs every few years.

The report notes that 96% of employers that offer a cash balance plan do so in combination with one or more DC plans. The most common combinations are with either a profit-sharing plan (95.7%) or a 401(k) (85.5%), which allow business owners to maximize contribution levels, flexibility and tax efficiency, Kravitz says.

Cash balance/DC combination plans also offer an advantage to participants in the form of increased employer contributions overall. Specifically, the average employer contribution is 6.3% for a cash balance/401(k) combination versus 2.6% for just a 401(k) plan.

Plan sponsors need to be aware of what testing and compliance issues they may face with the Internal Revenue Service (IRS) if they go with a cash balance/401(k) combination plan, cautions the report. The IRS will require cross-testing to ensure fairness to all employee groups across all compensation levels, so it will be important for the plan sponsor to have an experienced and technically skilled actuarial consultant to design a cash balance retirement program that will achieve the plan sponsor's goals, as well as pass all IRS tests every year.

The report notes that small and mid-size businesses are driving the growth of cash balance plans, with 87% of such plans operating at companies that have fewer than 100 employees. Reasons small and mid-size companies find cash balance plans so attractive include:

- Cost efficiency and tax efficiency: After staff costs, taxes are usually the largest expenditure for small businesses. Cash balance plans are designed to help owners with a significant tax deduction for employee contributions, plus tax-deferred retirement contributions for themselves.
- Asset protection: As with any IRS-qualified retirement plan, cash balance assets are protected in the event of a lawsuit or bankruptcy.
- Catching up on delayed savings: Age-weighted contribution limits allow older owners to squeeze 20 years of savings into 10 years.
- Attracting and retaining talented employees: Defined benefit plans such as cash balance have a greater appeal to many employees than a typical 401(k) plan, and allow small business owners to offer a competitive recruitment advantage.

The report also examines a number of other areas including plans by year established, plans by asset size, interest credit rating chosen by plan sponsors, and regional concentration of plans.

Kravitz, Inc. has been tracking the annual growth rate of cash balance plans since 2008. Its annual reports analyze data from the most recent Internal Revenue Service Form 5500 filings.

The full report can be found here.

Kevin McGuinness
editors@plansponsor.com