# PORTFOLIO

# Cash-Balance Plans Surge

## The popularity of these retirement plans has been rising following a favorable IRS ruling.

**By Miriam Rozen**

A recent favorable IRS ruling has generated some buzz on cash-balance retirement plans, and advisors should expect their popularity to rocket among business-owning clients and other highly paid professionals.

These plans allow highly compensated participants to accelerate tax-deferred savings at a much higher rate than is possible with more common 401(k) plans.

While 401(k)s, like other defined-contribution plans, can help clients shelter compensation from taxes, the plans must follow federal limits for participants' annual pretax contributions: $18,000 in 2015 for those under age 50 and $24,000 for those above.

In contrast, participants in cash-balance plans, which have defined benefits, need not adhere to any government-set maximums for their annual pretax contributions. Instead, maximum pretax contributions are calculated for each participant based on age and earnings, and according to a preset targeted return on the plan's assets.

What does that mean for a client who owns a professional practice or small business? With a cash-balance plan, an older, highly compensated practice-owning doctor, lawyer or business owner can park more than $250,000 a year in the pretax account – even as the costs of sponsoring and administering the plan for employees remain below those of a 401(k) plan.

The tax-deferral benefits apply as long as the plan ensures "proportionate benefits are provided to a sufficiently broad-based employee population," according to the U.S. Department of Labor's Employee Benefits Security Administration.

### GROWING POPULARITY

"I have a couple of clients who have gone [the cash-balance] route, and others who have thought about trying it," says Dusty Wallace, director of financial planning at Dallas-based Lee Financial. When she advises her clients about structuring such plans, Wallace seeks help from Keith Pyle, a lawyer with Niles Lankford Group, pension consultants in Plymouth, Ind.

"Over the last couple of years, we have seen big growth in the popularity of these plans," says Pyle.

Advisors' business-owning clients "are becoming more aware of these plans on their own," he continues. "In addition to hearing about them from their financial advisors, I think they are hearing about them at their professional conferences and meetings they go to, and I think their accountants are talking to them about it," says Pyle.

When the IRS issued a long-awaited ruling last September that gave added leeway to the ways asset managers may set targeted returns for the plans, it further boosted their popularity.

Specifically, the new IRS ruling allows plan sponsors (the business-owning employers) broader options for choosing what's known as the interest-crediting rate for their cash-balance plans. According to the IRS rule, a cash-balance plan's ICR cannot exceed "a market rate of return" on plan assets.

Before 2010, the IRS had interpreted market rate to mean that achieved with

30-year Treasuries, then around 3%. But with its recent ruling, the agency broadened its interpretation to allow for ICRs to match "actual rate of return" estimates, permitting as much as 6%.

The new IRS regulations also allow sponsors to preset different ICRs for different groups of participants – paving the way for more aggressive investing for employees in younger age groups, which could reduce overall costs by lowering the size of cash deposits required to meet the plan's obligations.

**MARKET BOOST**

Both the recent IRS ruling and the equity market's bullish performance have multiplied interest in the cash-balance plans.

"A year like [2014] is a perfect example of why plan sponsors are looking at something like this," says Robert DiMeo, the managing director of Chicago-based DiMeo Schneider & Associates, a financial consulting firm serving many top law firms. He adds, the "vast majority" of these firms have cash-balance retirement plans.

"When a cash-balance retirement plan is run well, it's really neat," says Joseph Moynihan, a financial advisor with Wells Fargo Advisors in Birmingham, Mich. Moynihan says he has, in the past few years, helped three to five company-owning clients develop cash-balance plans; about 20 of the 100 retirement plans for which his team manages assets are structured as cash-balance ones.

"When we see that the demographics are right, we typically show clients these, and there is a sale," says Moynihan. What defines the "right" demographics? The retirement plan must not cover an overwhelming number of older employees, since a sponsor's costs rise with participants' ages. The best scenario from a sponsor's point of view: a few highly compensated older employees and anywhere from a few to 100 younger lower earners.

Not all advisors are waiting for clients to raise the issue. "It hasn't been clients coming and asking us about these," says Sean Deviney, a retirement plan specialist and financial advisor at Provenance Wealth Advisors, an independent Raymond James firm in Fort Lauderdale, Fla.

Instead, his team initiates discussions about these plans "during our regular reviews," he says, with advisors asking clients, "Are you looking to get more money tax-deferred into a retirement plan?" Three years ago, Deviney says, that question prompted some "hesitancy." Now, he says, "they are adopting cash-balance plans."

**NOTES OF CAUTION**

Yet some advisors "are waiting for further interpretation and comfort" from the IRS before jumping on the higher ICR bandwagon, says DiMeo.

And others recommend caution for other reasons. Moynihan warns: Before advisors seize the new IRS ruling opportunities and start a cash-balance plan stampede, they should ensure that clients understand the potential for liabilities.

Unlike a 401(k) plan, the risks of a cash-balance plan's investments fall squarely on the shoulders of the business owners – not the participants or employees.

As the DOL's Employee Benefits Security Administration website states: "The employer bears the risks of the investments. Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. By contrast ... Under 401(k) plans, participants bear the risks and rewards of investment choices."

If a cash-balance plan's ICRs are set too high, and the investments fail to deliver targeted returns, the shortfall will eventually come out of the pockets of business owners (or, say, the partners in a law firm or medical practice). This will not make for happy clients, Moynihan forecasts.

At present, he says, "the wind has been at your back" in the equity markets – but after weathering 2008 and 2009, he knows that is not always the case.

"There are going to be times when the market performs poorly, and if it performs very poorly, that has a profound impact on these plans," he says. With cash-balance plans, the liability for any funding deficits falls on the sponsor, the company owner. "These are fraught with danger if it is not designed well up front," he says.

Pyle agrees that the higher ICRs could lead to more risks. There is also a downside for an investment advisor overshooting the ICR, he points out: Doing so consistently could create a funding surplus and reduce the maximum tax-deferred compensation that participants may park in the retirement plan in future years.

"As an actuarial firm, we want to see the most predictable [results], not the highest return," Pyle says. When he talks to advisors who come to his firm for guidance, "We tell them we don't want to maximize returns, we want to hit the interest crediting rate. That's what makes these work." FP

**Miriam Rozen, a *Financial Planning* contributing writer, is a staff reporter at *Texas Lawyer* in Dallas.**

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