



# A MODEL FOR RETIREMENT PLANS DESIGN CASH BALANCE PENSION PLANS

## WHERE BUSINESS PLANNING MERGES WITH RETIREMENT PLANNING

A cash balance plan is a hybrid of a traditional defined benefit pension plan and a 401(k) plan, enabling high net worth business owners and partners to maximize retirement benefits.

### A Choice for the Future

Heralded as the most significant pension legislation in 30 years, H.R. 4, referred to as the Pension Protection Act of 2006, is now law. A key element of this law is to strengthen the private pension system to ensure delivery of plan benefits. Not surprisingly, most of the changes are aimed directly at defined benefit retirement plans. One of the controversial areas surrounding defined benefit plans was whether or not cash balance (hybrid) plans were a valid retirement plan in their design and structure. This new law legitimizes cash balance plans on a prospective basis and removes concerns regarding age discrimination.

### What is a Cash Balance Plan?

A cash balance plan is a type of defined benefit plan that operates similar to a profit sharing plan. With a cash balance plan, each participant has a hypothetical account. This account is not allocated within the trust; instead, recordkeeping is done separately by the plan actuary as an accounting function.

The accounts grow in two ways. First, the company contribution is determined by a formula specified in the plan document. It can be a percentage of pay or a flat dollar amount and can be different for each individual class. Second, the account grows with an annual interest credit. The rate of return is guaranteed and is not dependent on the plan's investment performance.

### Key Advantages

- Ability for plan sponsors to define their contribution amounts.
- Ability to make substantially higher deductible contributions than in a defined contribution plan.
- Easily understood and communicated to employees.
- The opportunity to define contributions for different classes of employees irrespective of age.
- Ability to combine the new plan with an existing 401(k) and profit sharing plan.
- Greater flexibility in defining contributions for the total employee group as compared to a traditional defined benefit plan.
- Potentially provide the same contribution level when there are multiple owners at different ages.
- Employee pooled accounts where gains and losses don't affect benefits.

At retirement, participants may have lump-sum distribution options, including an IRA rollover.

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## Who is a Good Candidate?

Good candidates have one or all of the following characteristics:

- Owners or partners who desire to contribute more than \$45,000/year.
- Companies that have demonstrated consistent profit patterns.
- Owners or partners over 45 years old who desire to accelerate their pension savings.
- Companies that already have a cross-tested or New Comparability designed profit sharing and are making 3% contributions for employees.

## Why Cash Balance?

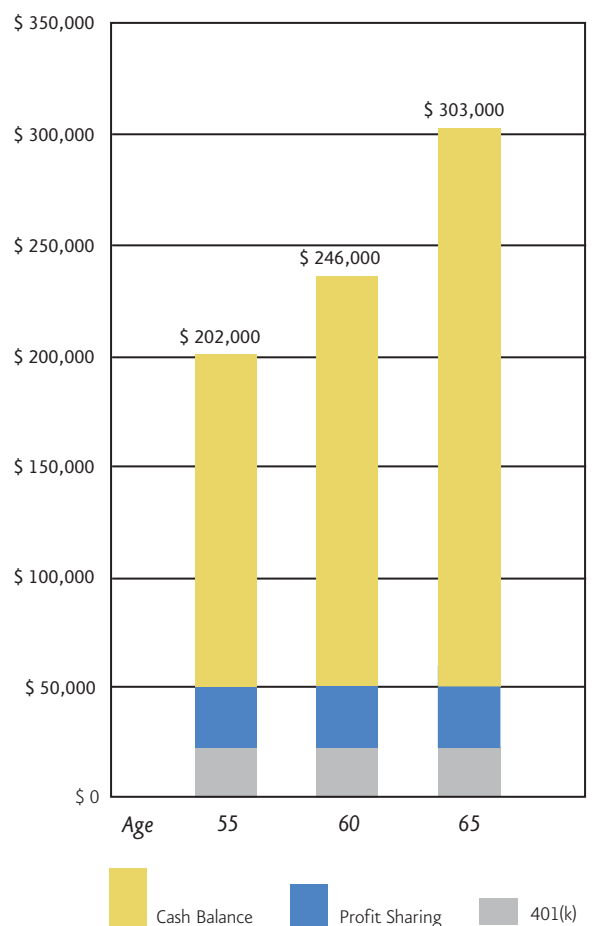
In addition to being a retirement plan, cash balance plans should also be viewed as a business-planning tool. They can provide companies with a business continuation model and can help employers recruit and retain key employees. They build value steadily at the same pace for all employees, regardless of age or how long they have worked for the employer.

A cash balance plan can be an attractive benefit, especially with more mobile employees that do not plan to stay with one employer throughout their careers.

## Case Study #1

Fact Pattern	A medical group with 4 physicians – ages 45, 55, 60 and 65.
Current Plan	401(k) and Profit Sharing (using a comp-to-comp formula)
Total Employees	20
Current Annual Contributions	\$45,000 for each physician
Problem #1	Physicians are unable to make larger pre-tax contributions to meet their retirement needs.
Problem #2	Older physicians want to contribute much higher amounts while younger physicians are comfortable with the status quo.
Solution	Layer a cash balance plan on top of current plans.
Results	Increase contributions for older physicians (as high as \$300,000) with a minimal increase in costs for the plan.

## Cash Balance/ 401(k) Maximum Annual Contributions



## Designing the Right Retirement Plan

This interactive, web-based tool makes plan design simple and easy. Defined benefit/defined contribution parameters can be changed with a click of the mouse. Instantly, the data is recalculated. This makes it easy to evaluate different scenarios.

**JPMorgan** Sample Client
change plan
**our max**

Classes
Owner Data
Non-Owner Data
Contributions
Testing Results
Admin Options
Submit Plan
log out

Name	Age	Pay	PS Pct	Selected Contribution			Reset all Cash Balance amounts to: <span>Default</span> or <span>Minimum</span>			
				Profit Sharing	401(k)	Cash Balance	Cost Adjust	Choose a CB Contribution	Other Amount	Maximum CB Contribution
Owner A	47	\$515,000	Max	\$29,500	\$15,500	\$22,500		10% of Pay		\$101,000
Owner B	56	\$1,030,000	Max	\$29,500	\$20,500	\$112,500		50% of Pay		\$160,000
Owner C	54	\$824,000	Max	\$29,500	\$20,500	\$112,500		50% of Pay		\$144,000
Owner D	42	\$412,000	Max	\$29,500	\$15,500	\$22,500		10% of Pay		\$78,000

**Reset PS Pct**

**Avg Staff 401k Contribution Pct**

**Reset CB Pct**

**Proposed Plan Design – Profit Sharing / Cash Balance**

Calculated Profit Sharing Benefit: 6.75%

Calculated Cash Balance Benefit: 2.90%

Non-Owner Cost: \$100,620

Non-Owner Cost / Non-Owner Total Pay: 8.19%

Owner Deferral Profit Sharing Plan: \$118,000

Owner Deferral Cash Balance Plan: \$270,000

Total Owner Deferral: \$388,000

Total Owner Deferral Including 401k: \$460,000

Cost Efficiency: 82.05%

**Deductible Limit Check**

Eligible compensation: \$2,128,790

25% of eligible compensation: \$532,198

Profit sharing contribution: \$194,187

6% contribution level: ~~-\$127,727~~

Profit sharing contribution subject to limit: \$66,460

Cash balance contribution: **+\$294,433**

Total contribution subject to limit: \$360,893

Excess contribution: (\$171,305)  
(i.e., \$171,305 under the 25% Limit)

**401(a)(26) : Pass   410(b) : Pass   401(a)(4) : Pass   ABPT : Pass   MAAG : Pass   Top Heavy Min : Pass**

View Summary
Generate Proposal
View Data
Recalculate

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## Interest Crediting

Individual participants are not able to direct the investment of their account; plan assets are pooled and invested by the trustee or investment manager.

The key to a successfully funded cash balance plan is to have the earnings match as closely as possible to that of the crediting rate as determined by the plan sponsor. The benefit of achieving this philosophy will minimize large fluctuations in contributions.

## Funding Methods

Our solution to the funding requirement is the Guaranteed Account offered under the UNIFI Retirement Advantage Series<sup>SM</sup>. This product can be designed in most instances to match the Crediting formula selected by the plan sponsor. And, unlike most alternative funding methods, Stable Value and GICs, the Guaranteed Account has an interest rate that is declared up front and guaranteed for one year. This way, the plan sponsor will have a clear measurement of earnings versus crediting rates.

*Guarantee is based on the claims-paying ability of the issuing company.*

## Changing Contributions

Cash balance contributions can change, but with restrictions. Cash balance plans are not profit sharing plans under which contributions can vary each year depending on profitability. However, cash balance plans can be amended periodically to increase or decrease the individual contribution credit, which will affect the overall contributions made to the plan. If an employer's profit is not expected to be able to support the cash balance plan contribution, the plan must be amended before participants complete 1,000 hours of service during a calendar plan year. For most participants, 1,000 hours will be reached in June. Employers may choose to make budget projections by mid-April to make certain they can afford the contribution. Plans may also be frozen or terminated.

## Other Considerations

- Plans are subject to minimum funding regulations.
- Annual discrimination testing applies.
- Certain plans are required to be covered by PBGC.
- Investment risk is borne by the employer.
- Higher set up and on-going administration costs.

## Find Out More

Your UNIFI Companies Retirement Plans' representative can answer your questions and show you how a cash balance plan will work for you. Call today for more information:

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