



Cash Balance Plan

What is a cash balance plan?

There are two general types of pension plans-Defined Benefit Plans and Defined Contribution Plans. In general, defined benefit plans provide a specific benefit at retirement for each eligible employee, while defined contribution plans specify the amount of contributions to be made by the employer toward an employee's retirement account. In a defined contribution plan, the actual amount of retirement benefits provided to an employee depends on the amount of the contributions as well as the gains or losses of the account. A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance.

How do cash balance plans work?

In a typical cash balance plan, a participant's account is credited each year with a pay credit (such as 5 percent of compensation from his or her employer) and an interest credit (either a fixed rate or a variable rate that is linked to an index such as the one-year Treasury bill rate). Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. Thus, the investment risks and rewards on plan assets are borne solely by the employer. When a participant becomes entitled to receive benefits under a cash balance plan, the benefits that are received are defined in terms of an account balance. For example, assume that a participant has an account balance of \$100,000 when he or she reaches age 65. If the participant decides to retire at that time, he or she would have the right to an annuity. Such an annuity might be approximately \$10,000 per year for life. In many cash balance plans, however, the participant could instead choose (with consent from his or her spouse) to take a lump sum benefit equal to the \$100,000 account balance. In addition to generally permitting participants to take their benefits as lump sum benefits at retirement, cash balance plans often permit vested participants to choose (with consent from their spouses) to receive their accrued benefits in lump sums if they terminate employment prior to retirement age. Traditional defined benefit pension plans do not offer this feature as frequently.

If a participant receives a lump sum distribution, that distribution generally can be rolled over into an Individual Retirement Account (IRA) or to another employer's plan if that plan accepts rollovers. See IRS Publication 575 Pension and Annuity Income: Rollovers or Publication 590 Individual Retirement Arrangements (IRAs): Traditional IRAs - Can I Move Retirement Plan Assets?

The benefits in most cash balance plans, as in most traditional defined benefit plans, are protected, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation.

How do cash balance plans differ from traditional pension plans?

While both traditional defined benefit plans and cash balance plans are required to offer payment of an employee's benefit in the form of a series of payments for life, traditional

defined benefit plans define an employee's benefit as a series of monthly payments for life to begin at retirement, but cash balance plans define the benefit in terms of a stated account balance. These accounts are often referred to as hypothetical accounts because they do not reflect actual contributions to an account or actual gains and losses allocable to the account.

How do cash balance plans differ from 401(k) plans?

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Cash balance plans are defined benefit plans. In contrast, 401(k) plans are a type of defined contribution plan.

More about Defined Benefit Plans and Defined Contribution Plans.

There are four major differences between typical cash balance plans and 401(k) plans. Participation. Participation in typical cash balance plans generally does not depend on the workers contributing part of their compensation to the plan; however, participation in a 401(k) plan does depend, in whole or in part, on an employee choosing to make a contribution to the plan. Investment Risks. The investments of cash balance plans are managed by the employer or an investment manager appointed by the employer. The employer bears the risks and rewards 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, 401(k) plans often permit participants to direct their own investments within certain categories. Under 401(k) plans, participants bear the risks and rewards of investment choices. Life Annuities. Unlike many 401(k) plans, cash balance plans are required to offer employees the ability to receive their benefits in the form of lifetime annuities. Federal Guarantee. Since they are defined benefit plans, the benefits promised by cash balance plans are usually insured by a federal agency, the Pension Benefit Guaranty Corporation (PBGC). If a defined benefit plan is terminated with insufficient funds to pay all promised benefits, the PBGC has authority to assume trusteeship of the plan and to begin to pay pension benefits up to the limits set by law. Defined contribution plans, including 401(k) plans, are not insured by the PBGC.

The PBGC may be contacted at:

Pension Benefit Guaranty Corporation

1200 K Street NW

Washington, DC 20005-4026

Tel 202.326.4000

Toll-Free 1.800.400.7242

Is there a federal pension law that governs cash balance plans?

Yes. Federal laws, including the Employee Retirement Income Security Act (ERISA), the Age Discrimination in Employment Act (ADEA), and the Internal Revenue Code (IRC), provide certain protections for the employee benefits of participants in private sector pension and health benefit plans. If your employer offers a pension plan, the law sets standards for fiduciary responsibility, participation, vesting (the minimum time a participant must generally be employed by the employer to earn a legal right to benefits), benefit accrual and funding. The law also requires plans to give basic information to workers and retirees. The IRC establishes additional tax qualification requirements, including rules aimed at ensuring that proportionate benefits are provided to a sufficiently broad-based employee population. The U.S. Department of Labor, the Equal Employment Opportunity Commission (EEOC), and the Internal Revenue

Service (IRS) have responsibilities in overseeing and enforcing the provisions of these laws. Generally, the U.S. Department of Labor focuses on the fiduciary responsibilities, employee rights, and reporting and disclosure requirements under the law, while the EEOC concentrates on the portions of the law relating to age discriminatory employment practices. The IRS generally focuses on the standards set by the law for plans to qualify for tax preferences.

Are there requirements that apply if my employer converts my current plan to a cash balance plan?

Yes; however, employers are not required to establish pension plans for their employees because the private pension system is voluntary. In addition, employers are allowed substantial flexibility in deciding whether to terminate or amend their existing plans. Therefore, employers generally may change by plan amendment their traditional pension plans and the benefit formulas they use. Federal law does place restrictions on plan changes, including amendments that convert a traditional pension plan formula to a cash balance plan formula. For example, a plan amendment cannot reduce benefits that participants Frequently Asked Questions about Cash Balance Pension Plans Page 2 of 5 http://www.dol.gov/ebsa/FAQs/faq_consumer_cashbalanceplans.html 12/11/2008 have already earned. Advance notification to plan participants is required if, as a result of the amendment, the rate that plan participants may earn benefits in the future is significantly reduced. Additionally, there are other legal requirements that have to be satisfied, including prohibitions against age discrimination.

Can my benefits earned under the plan be reduced when the plan benefit formula is converted to a cash balance plan formula?

No. While employers may amend their plans to reduce the rate at which future benefits are earned, they generally are prohibited from reducing the benefits that participants have already earned. In other words, an employee generally may not receive less than his or her accrued benefit under the plan formula at the effective date of the amendment. For example, assume that a plan's benefit formula provides a monthly pension at age 65 equal to 1.5 percent for each year of service multiplied by the monthly average of a participant's highest three years of compensation, and that the plan is amended to convert its benefit formula to a cash balance plan formula. If a participant has completed 10 years of service at the time of the amendment, the participant will have the right to receive a monthly pension at age 65 equal to 15 percent of the monthly average of the participant's highest three years of compensation when the plan amendment is effective. This benefit (including related early retirement benefits) is protected by law and cannot be reduced.

What happens to the assets in a plan when an employer converts its traditional defined benefit plan formula to a cash balance plan formula?

When an employer amends its plan to convert the plan's traditional defined benefit plan formula to a cash balance plan formula, the plan's assets remain intact and continue to back the pension benefits under the plan. Employers cannot remove funds from the plan, unless the plan has been terminated and has assets remaining after payment of all of the benefits under the plan.

Is it possible that I will not accrue any additional benefits under the cash balance plan formula?

In some cases, when your traditional plan formula is changed to a cash balance plan formula, the benefit earned under the old formula may exceed the amount determined to be your benefit under the cash balance plan formula. In this situation, you might not earn any additional benefits until your benefit under the cash balance plan formula exceeds the benefit you had earned under the old formula. This is commonly referred to as "wear away." There are legal requirements that have to be satisfied with respect to benefit accruals, including prohibition against age discrimination. "Wear away" is one of the issues being closely studied by the EEOC, IRS and the U.S. Department of Labor.

How am I affected if I leave my job at a company that just changed its pension plan from a traditional defined benefit formula to a cash balance plan formula?

If you have worked long enough to be vested under the plan, you should receive the sum of: The accrued benefit under the formula in effect before the amendment and additional benefits you earned under the plan formula in effect after the amendment. However, you may have to wait until a retirement age under the plan to receive your benefit.

If my employer gives me a choice of staying with the old formula or converting to the new cash balance plan formula, how do I make the right choice?

The right choice for you and your family may be affected by a wide range of factors. For example, in making this choice you should take into account your retirement expectations, when you intend to begin receiving your benefits, and the chance that your needs might change. In analyzing any choice presented under your plan, you will want to compare all the terms and options available to you under the cash balance package with those currently available to you. It is important for you to consider each option under each plan formula. You will also want to consider the specifics of your retirement benefit, such as how your accrued benefit (including the value of any early retirement subsidy) is defined under each formula, the current value of your accrued benefit under each formula, and its value as an annuity at normal retirement age, or as a lump sum distribution. You may also want to take into account how your choice will affect survivor benefits. Frequently Asked Questions about Cash Balance Pension Plans Page 3 of 5

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You should also compare the value of other related benefits that may be offered under either choice. For instance, some traditional pension plans provide for an offset or subsidy if you retire prior to the age at which your Social Security benefits commence, or offer credit for service also covered by a disability benefit plan. In making your decision, you should pay attention to any time limits that may apply and any waivers you may be requested to sign. Finally, you need to consider how long you have been with your employer and whether or not you expect to stay employed with your current employer or change jobs in the future. You may want to consult a professional advisor for assistance in making your choice.

Will the conversion of my pension plan formula have an effect on my retiree health benefits?

Generally, pension plans and health plans are operated independently and are administered separately. If you have questions about your health benefits you should contact your health

plan administrator. Be aware that, like pension plans, many health plans can be amended or terminated.

What should I do if I believe my benefits under the old formula have been inappropriately reduced or that my rights have been violated?

You should immediately contact the plan administrator and discuss your concerns. Be sure to review your individual benefit statement or the information used to calculate your benefit to determine if it is correct such as employment date, length of service, and salary.

If your concerns are not adequately addressed, or you still have questions about your situation, you should contact one of our benefit advisors, located in 15 field offices nationwide or contact the EBSA office nearest you. In addition, employees who believe that they have been subject to discriminatory treatment because of their age, race, color, religion, sex, national origin, or disability may file a charge of discrimination with the Equal Employment Opportunity Commission (EEOC). There are strict time limits for filing such a charge.

Is my employer required to give me a choice of remaining under the old formula rather than automatically switching me to the new formula?

Neither ERISA nor the IRC requires employers to give employees the choice of remaining in the old formula. Employers have several options, including: Allowing employees to remain under the old formula, while restricting new hires to the new formula; Stipulating that certain employees who have reached a specific length of service or who have reached a certain age may choose to stay with the old formula; and; Providing no choice, replacing the old formula and applying the new formula to all participants. The law permits employers to have such flexibility, but whatever option applies has to satisfy legal requirements. For example, the option may not violate prohibitions against discrimination on the basis of age. Under each of these options, benefits already earned by the participants, as of the effective date of the amendment that converts the old formula to a cash balance formula, may not be reduced.

What information is my employer required to give me to explain the new cash balance plan formula, and when should I receive this information?

Many employers voluntarily provide helpful information about these conversions in advance of the change becoming effective. Make sure you have all the information that the employer has provided. If you are still not sure if you have enough information to understand the plan change, you have a right to contact your plan administrator and ask for more information or help in understanding the change and any choices you have in conjunction with the change. Frequently Asked Questions about Cash Balance Pension Plans Page 4 of 5

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Plan administrators are required to give at least 15 days' advance notice of plan amendments that significantly reduce the rate at which plan participants earn benefits in the future. After the plan is amended, the plan administrator is required to provide all plan participants with a Summary of Material Modifications to the plan or a revised Summary Plan Description. This document will summarize the changes to your plan.

In addition, under the Age Discrimination in Employment Act (ADEA), an employer requiring an employee to sign a waiver of rights and claims when choosing between plans is required to provide enough information to enable the employee to make a knowing and voluntary

decision to waive ADEA rights. In most cases, an employee must be given at least 21 days' to sign the waiver and at least 7 days' to revoke the agreement.