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Big Options for Small Cash Balance Plans

As more and more small-and mid-size businesses face the hardships of mandated closures and stay-at-home orders, funding cash balance pension plan benefits becomes especially challenging. Read on to find out what our experts have to say about options to help small employers reduce or defer cash balance pension plan contributions.

Mandated closures and stay-at-home orders aimed at curbing the spread of the coronavirus have left businesses around the country struggling to figure out how to rebound from the crisis. Among the millions of employers ordered to close indefinitely in mid-March, it’s the small-and mid-size businesses who are in the greatest lurch.

With the recent unpredictable outlook on the markets and so much unknown around when commercial activity will transition back toward normal, a lot of these smaller organizations are up against unique circumstances when it comes to adequately funding their cash balance pension plan benefits, says CAPTRUST Senior Manager James Stenstrom.

As a result, “We are seeing small employers considering strategies to reduce or defer cash balance pension plan contributions as the COVID-19 pandemic continues to push them into hardship,” he says.

And the fact is, popularity of these plans has more than tripled since the Pension Protection Act went into effect in 2006, particularly among the nation’s small- to mid-size businesses.

Research shows 92 percent of cash balance pension plans are sponsored by companies with fewer than 100 employees. And while these tax-efficient plans are offered by many leading national law firms, hospitals, and medical groups, the dramatic growth in new cash balance pension plans has been driven mainly by small-and mid-size businesses, as shown in Figure One.

Figure One: Cash Balance Plans by Number of Participants

Participants	Number of Plans	Percent of Nation's Total
Over 10,000	246	1.4%
1,000 to 10,000	570	3.3%
100 to 999	597	3.6%
25 to 99	1,997	10.7%
10 to 24	4,544	24.2%
1 to 9	12,498	56.7%

Source: Kravitz Cash Balance Report

Put a Freeze on It

Alex Kuhel, a partner with October Three and a member of the firm's actuarial consulting team, says many of the cash balance plan sponsors he works with are implementing plan freezes. "Somewhere between 30 percent to 50 percent of my clients have frozen their plans for the year, which means that they can forgo contributions for this plan," says Kuhel.

For cash balance plan sponsors considering ceasing benefit accruals or freezing their plans during this time of uncertainty, the window of opportunity is open, but limited, according to Stenstrom.

"To be effective for the 2020 plan year, actions to freeze the plan must be completed before participants have accrued a benefit," he says. In many cases, this occurs once an employee works 1,000 hours. "But over the last several months, many businesses severely impacted by the COVID-19 pandemic are moving to either reduce the amount of hours employees can work or suspend operations altogether," he adds.

Under normal circumstances, for a large calendar-year plan, the deadline for accomplishing a plan freeze would have generally been on or prior to May 1. Small calendar-year plans have until June 1. However, Stenstrom explains, "For plans that have not hit that 1,000-hour mark, the May 1 and June 1 deadlines do not apply."

In fact, he says the organizations most likely to want to take advantage of the freeze option are the same organizations able to extend the timeline because they do not have people working 40 hours a week.

"Small employers have been hit particularly hard by the COVID-19 pandemic and, in most cases, reduced or stopped operations," says Stenstrom. "If your business moves employees from working 40 hours down to 32, that is going to extend the amount of time it takes for employees to reach the 1,000-hour mark and begin accruing a benefit for the year."

Kuhel says the advantage to freezing is simply giving plan sponsors "more flexibility with their cash." As for the disadvantages, he said plan sponsors need to be aware that they will be missing out on a year of retirement contributions and therefore slowing down wealth-building in the retirement accounts.

A few important things plan sponsors should keep in mind is that freezing a qualified retirement plan requires written notice to plan participants in addition to a plan document amendment, in most cases. Also, plans with fewer than 100 participants need to provide a 15-day notice of the freeze. For plans with 100 or more participants, the notification process would need to be completed within 45 days.

If considering either deferring contributions or a service credit freeze, plan sponsors should consult their actuary and, potentially, their legal counsel.

Loosen Funding Requirements

In the current environment, organizations may consider loosening the funding requirements to amortize any shortfall over a longer time frame, moderating short-term capital needs. But there are drawbacks to consider.

"Many partnerships design their cash balance plans to annually maintain a 100 percent funding level, so if any partner leaves the firm, the remaining participants are not left with an associated shortfall to fund," explains Stenstrom. "As a result, any participant who leaves the plan remains entitled to his or her full benefit. This leaves remaining partners at a potential disadvantage."

Kuhel adds that plan sponsors who start to loosen funding requirements also run the risk of not being able to pay a lump sum.

"[Plan sponsors may not] be able to pay a lump sum for the top-paid people because [the plan] won't be funded enough."

Organizations should also understand that funding mechanisms are often memorialized in partnership agreements. While this arrangement serves to protect the partnership, the administrative burden of modifying a partnership agreement can be daunting for some plan sponsors. Another consideration for plan sponsors and employers is actuarial funding shortfalls, as these can expose the plan sponsor to variable rate Pension Benefit Guaranty Corporation (PBGC) premiums.

Take Advantage of the CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act is a $2 trillion stimulus bill that is intended to help with a variety of issues resulting from the COVID-19 pandemic and subsequently expand access to retirement plan assets.

The CARES Act contains relief that allows sponsors to carry forward the previous (year ending before January 1, 2020) adjusted funding target attainment percentage (AFTAP) calculations through calendar year 2020 for the purposes of determining funding-based benefit restrictions.

"The big deal here is that if a plan sponsor has an off-calendar-year plan year, their funding may be lower in 2020 than 2019," says Stenstrom. "This relief from the CARES Act is saying those plan sponsors can just use their 2019 AFTAP," he adds. "And by allowing plan sponsors to use the prior year's funding level, the CARES Act reduces the pressure to contribute in the coming months."

To date, Kuhel has not had any clients decide to go this route, however. "I think most of them have already budgeted for their contribution for the prior year," he says, adding, "They knew they were going to have to make it."

Regardless, Kuhel explains, "I think it could be helpful for a group that is experiencing cash-flow problems."

To find out more about the CARES Act provisions that impact plan sponsors, please see "Coronavirus Aid, Relief, and Economic Security (CARES) Act," by clicking here.

Seek Counsel

An actuary can help shed light on alternative solutions in the cash balance plan arena and working with one can give plan sponsors a deep level of insight into their plans.

"The actuary is going to know the plan very well. They are also going to know the associated rules of what can and cannot be done," says Kuhel. "Sometimes we will hit a point where we want to bring in an attorney, but the actuary is really a great place to start," he adds.

And lean on your advisors. Your financial advisor and actuary can help guide you through the implications of any potential changes to your plan. Working with experienced professionals to adjust alignment between benefit accruals, plan funding, and investment strategy is key to achieving desired outcomes.

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