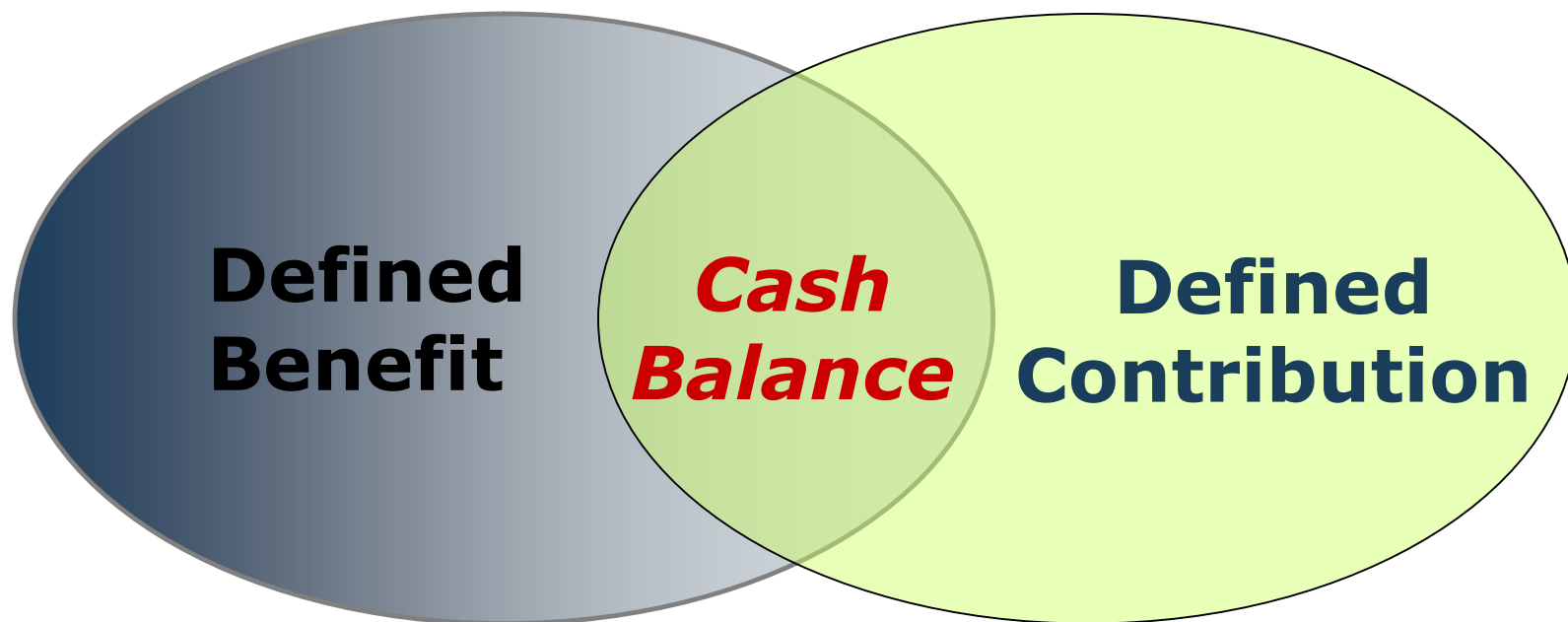
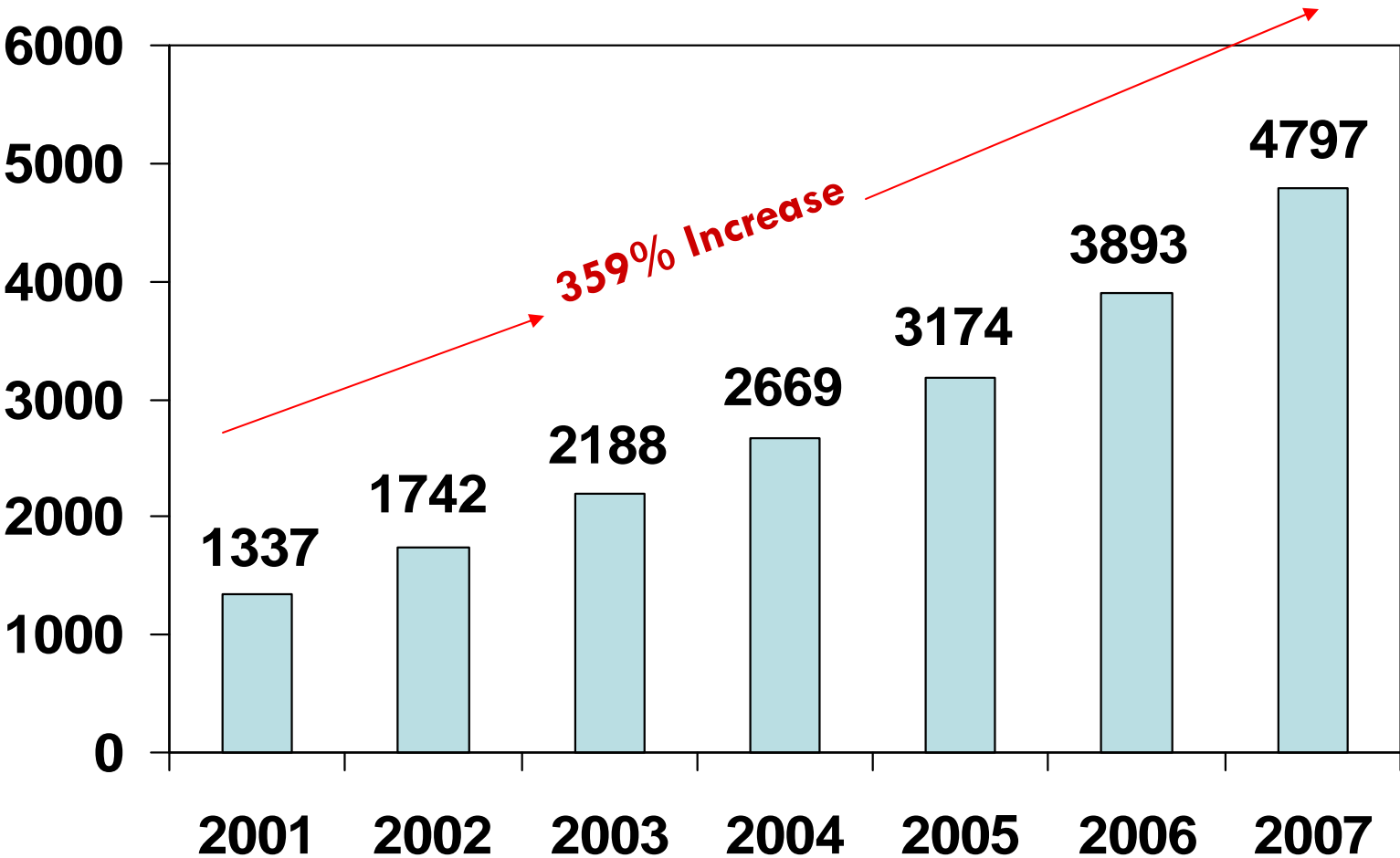


## Cash Balance Pension Plans

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# New Cash Balance Plans



## Cash Balance Market Analysis

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**80%** of Cash Balance plans have less than 100 employees

**63%** have fewer than 36 participants

**34%** are sponsored by medical and dental groups

**79%** are combined with a Defined Contribution plan.

# Today's Topics

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- ✓ Important component of Financial Planning
- ✓ Why use Qualified Plan / Cash Balance?
- ✓ How does a Cash Balance plan work?
- ✓ Real Life... Real Solutions

Questions





## The Retirement Equation

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$$\text{Retirement Plan} = \text{Savings Plan}$$

### Retirement Plan:

- Retirement Date
- Income Target
- Probability of Success

### Savings Plan:

- Current Savings
- Future Savings
- Investment Strategy

# Why use a Tax-qualified Plan?

---

- **Tax-Deferred Savings**
  - ✓ Short-term – Reduce Current Taxes
  - ✓ Long-term – Increase Accumulations
- **Creditor Protection**
- **PBGC Guarantee** (unique to Cash Balance)
- **Contribution Requirement** = Savings Discipline

## Value of Tax-deferred Savings \$100,000 – 1 year later (5% return)

---

	“After-tax”	“Pre-tax”
Income	<b>\$100,000</b>	<b>\$100,000</b>
Pay tax (40%)	\$(40,000)	
Amount Invested	<b>\$ 60,000</b>	
Investment Income (5%)	\$ 3,000	
Pay tax (40%)	\$ (1,200)	
Amount Invested	<b>\$ 61,800</b>	
Pay tax (40%)	n/a	
<b>Distribution</b>	<b>\$ 61,800</b>	

## Value of Tax-deferred Savings \$100,000 – 1 year later (5% return)

---

	“After-tax”	“Pre-tax”
Income	<b>\$100,000</b>	<b>\$100,000</b>
Pay tax (40%)	\$(40,000)	n/a
Amount Invested	<b>\$ 60,000</b>	<b>\$100,000</b>
Investment Income (5%)	\$ 3,000	\$ 5,000
Pay tax (40%)	\$ (1,200)	n/a
Amount Invested	<b>\$ 61,800</b>	<b>\$105,000</b>
Pay tax (40%)	n/a	\$(42,000)
<b>Distribution</b>	<b>\$ 61,800</b>	<b>\$ 63,000</b>

# Tax-deferred Advantage Compounds

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## Accumulation after 1 year:

- After-tax: \$61,800
- Tax-deferred: \$63,000



**Advantage**  
“Tax-deferred”  
\$1,200 or 2% increase



---

## Accumulation after 30 years:

- After-tax: \$146,000
- Tax-deferred: \$259,000



**Advantage**  
“Tax-deferred”  
\$113,000 or 77% increase

## What if Tax Rates Change?

---

Tax Rates **DECREASE** from 40% to 35%:

- After-tax : \$146,000
- Pre-tax: \$281,000



**Advantage**  
“Tax-deferred”  
\$135,000 or 92% increase



---

Tax Rates **INCREASE** from 40% to 45%:

- After-tax : \$146,000
- Pre-tax: \$238,000



**Advantage**  
“Tax-deferred”  
\$92,000 or 63% increase

## What if After-tax is at Capital Gains Rates?

---



### Capital Gains Treatment for After-tax investment:

- After-tax: \$200,000
- Pre-tax: \$259,000



**Advantage**  
“Tax-deferred”  
\$59,000 or 30% increase

## Why adopt a Cash Balance Plan?

---

Qualified Retirement Plan with higher annual Deductible Limits!

Age	Defined Contribution	Cash Balance
45	\$49,000	
50	\$54,500	
55	\$54,500	
60	\$54,500	
65	\$54,500	

## Why adopt a Cash Balance Plan?

---

Qualified Retirement Plan with higher annual Deductible Limits!

Age	Defined Contribution	Cash Balance
45	\$49,000	\$86,000
50	\$54,500	\$112,000
55	\$54,500	\$147,000
60	\$54,500	\$192,000
65	\$54,500	\$200,000

## Is your Defined Contribution Plan running out of time?

---

<b>Projected Accumulation of Maximum Contributions</b>		
<b>Years to Retirement</b>	<b>5% Return</b>	<b>10% Return</b>
15	\$1,320,000	
10	\$750,000	
5	\$320,000	

Assumes 1.5% annual inflation for limits.

---

## Is your Defined Contribution Plan running out of time?

---

<b>Projected Accumulation of Maximum Contributions</b>		
<b>Years to Retirement</b>	<b>5% Return</b>	<b>10% Return</b>
15	\$1,320,000	\$1,970,000
10	\$750,000	\$970,000
5	\$320,000	\$360,000

Assumes 1.5% annual inflation for limits.

---

## Comparison of Projected Accumulation

---

1. Cash Balance is the best (only) way to catch-up
2. Combo Plans – some can use both

Years to Retirement	Defined Contribution	Cash Balance
15	\$1,320,000	\$3,000,000
10	\$750,000	\$2,800,000
5	\$320,000	\$1,300,000



Assumes 1.5% annual inflation for limits.

---

## Comparison of Projected Accumulation

---

1. Cash Balance is the best (only) way to catch-up
2. Combo Plans – some can use both

Years to Retirement	Defined Contribution	Cash Balance
15	\$1,320,000	\$3,000,000
10	\$750,000	\$2,800,000
5	\$320,000	\$1,300,000



Assumes 1.5% annual inflation for limits.

# What is a Cash Balance Plan?

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1. Qualified Retirement Plan
2. Defined Benefit Plan



**BUT**.....

## Looks like Defined Contribution Plan to Participants

- Individual (hypothetical) accounts
- Annual credits
- Annual interest credits (no individual investment direction)
- Plan benefits = value of individual's account

## How Does a Cash Balance Plan Work?

---



### Year 1

### A/C

Beginning Balance	\$ 0
Interest Credit	\$ 0
Cash Balance Credit	<u>\$100,000</u>
Ending Balance	<b>\$100,000</b>

### Year 2



Beginning Balance	\$100,000
Interest Credit	\$ 5,000
Cash Balance Credit	<u>\$100,000</u>
Ending Balance	<b>\$205,000</b>

# Interest Crediting - Options

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- **Fixed rate**

  - **New!** 5% Safe Harbor

  - Approved Fixed Income Indices (30-year Treasury, Bond rates)

- **Equity-based rates**

  - Based on return of RIC (Mutual Fund)

  - Not significantly more volatile than broad “market”

- **Actual return on plan assets**

  - Employer directed pooled account

  - Diversified investments to minimize the volatility of returns

## How Does a Cash Balance Plan Work?

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### Year 1

### A/C

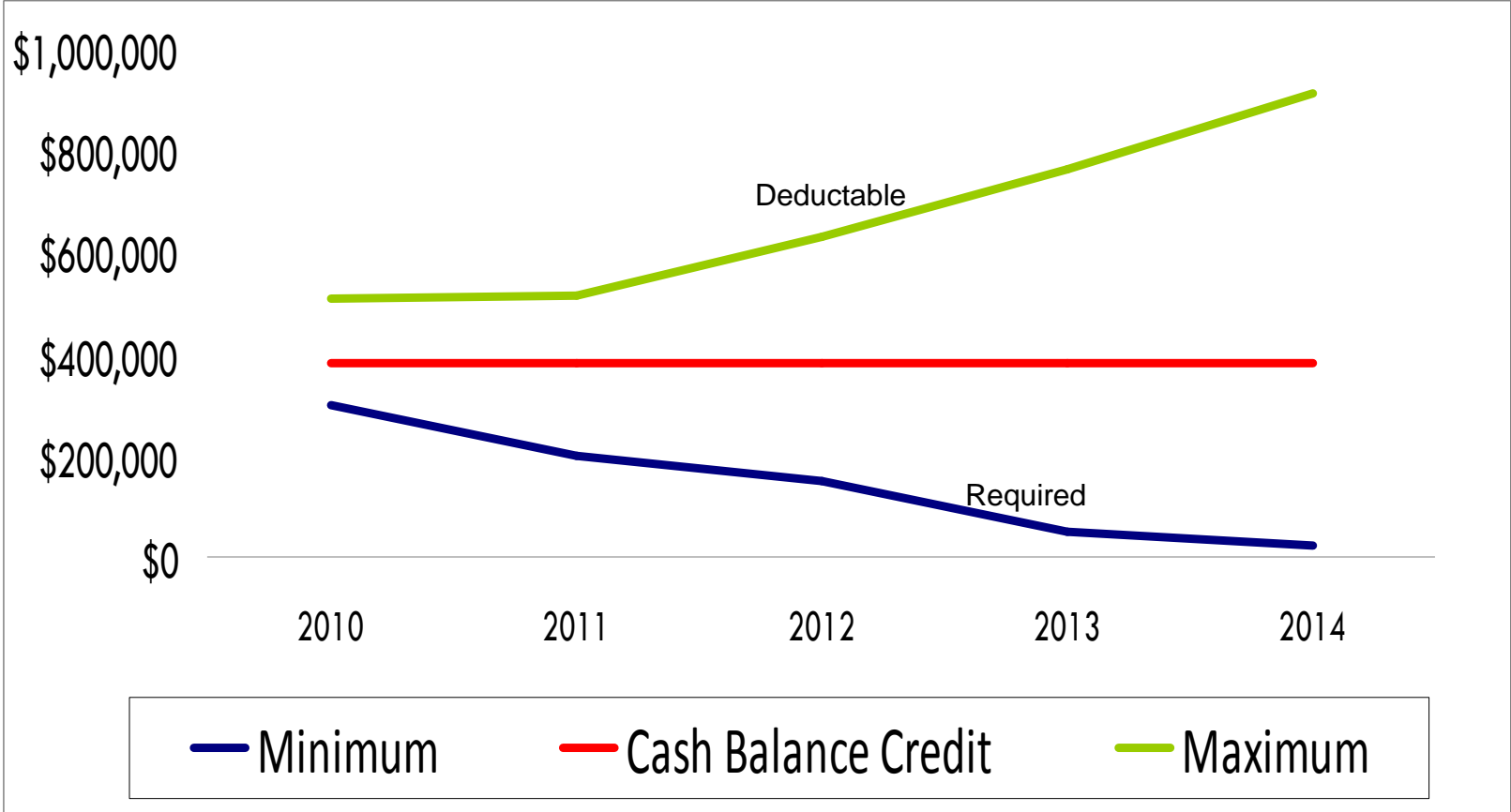
Beginning Balance	\$ 0
Interest Credit	\$ 0
Cash Balance Credit	<u>\$100,000</u>
Ending Balance	<b>\$100,000</b>

### Year 2



Beginning Balance	\$100,000
Interest Credit	\$ 5,000
Cash Balance Credit	<u>\$100,000</u>
Ending Balance	<b>\$205,000</b>

# Cash Balance Credits



# Real Life... Real Solutions

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Case 1: Sole Owner/Employee



Case 2: Small Hi-Tech Firm



Case 3: Medical Group with Multiple Partners



# Sole Owner/Employee

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## Background:

- Sole proprietor -- Age 52
- Established steady income approx. \$250,000/year
- Maximizes SEP contributions each year = \$49,000

## Client Objective:

- Increase retirement contributions to \$100,000 - \$125,000
- Some flexibility from year to year

## Sole Owner/Employee

---

### Maximum Contributions - Cash Balance Plan

Age at Plan Inception	Cash Balance
40	\$65,000
45	\$85,000
50	\$110,000
55	\$145,000
60	\$190,000
65	\$200,000

## Sole Owner/Employee

---

Maximum Contributions - Cash Balance AND 401(k)/PS TOO!

Age at Plan Inception	Cash Balance	401(k)/PS	Total
40	\$65,000	\$30,000	\$95,000
45	\$85,000	\$30,000	\$115,000
50	\$110,000	\$35,000	\$145,000
55	\$145,000	\$35,000	\$180,000
60	\$190,000	\$35,000	\$225,000
65	\$200,000	\$35,000	\$235,000

## Sole Owner/Employee AFTER REDESIGN

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Age	401(k)/ Profit Sharing	Cash Balance	Total
52	\$0 - \$35,000	\$100,000	\$100,000- \$135,000

## Sole Owner/Employee

---

	Before	After	Increase
Low	\$49,000	\$100,000	\$51,000
High	\$49,000	\$135,000	\$86,000

Estimated\*  
Tax Savings

\$20,400 -  
\$34,400

\* Based on an assumed 40% combined income tax rate



## Sole Owner/Employee

---

### Client Objective:

- Increase retirement contributions to \$100,000 - \$125,000
- Some flexibility from year to year

### Cash Balance Solution:

Increased annual savings:	<b>\$ 51,000 – \$86,000</b>
Reduction in annual tax:	<b><u>\$ 20,000 – \$34,000</u></b>
<b>Annual after tax cost:</b>	<b>\$ 31,000 – \$52,000</b>

### Funding flexibility within 401(k)/PS plan

## Case 2: Owner with Employees

---



### Background

- Successful High Tech Company--- Owner (Age 56)
- Long Term Professionals
- Generous 401(k) Safe Harbor / Profit Sharing Plan

### Client Objectives

- Maximize tax deductible contributions for Owner
- Minimize employee cost increases

## Owner with Employees BEFORE

---

	401(k) / Profit Sharing
Owner	\$54,500
10 Employees	\$30,000
<b>Total</b>	<b>\$84,500</b>

**Owner: 65%**

## Owner with Employees AFTER

---

	401(k) / Profit Sharing	Cash Balance	Total
Owner	\$54,500	\$155,000	\$209,500
10 Employees	\$45,000	\$10,000	\$55,000
<b>Total</b>	<b>\$99,500</b>	<b>\$165,000</b>	<b>\$264,500</b>

**Owner:  
79%**

## Owner with Employees Comparison

---

	Before	After	Increase
Owner	\$54,500	\$209,500	\$155,000
Employees	\$30,000	\$55,000	\$25,000
<b>Total</b>			<b>\$180,000</b>

Estimated  
Tax Savings:  
**\$72,000**

Current Savings  
Net of EE Cost  
Increase:  
**\$47,000**

\* Based on an assumed 40% combined income tax rate

---

## Case 2: Owner with Employees

---

### Client Objectives:

- Maximize tax deductible contributions for Owner
- Increase staff cost as needed

### Cash Balance Solution:

Increase annual savings to over **\$200,000**

Increased annual savings	\$155,000
Reduction in annual tax	\$ (72,000)
Increase in staff cost	<u>\$ 25,000</u>
<b>Net cost:</b>	<b>\$108,000</b>



## Case 3: Multiple Owners

---

### Background:

- Medical Practice
- Four equal partners with substantial incomes
- 2 staff members
- 20% (Maximum) Profit Sharing Plan

### Client Objectives:

- Increase partner contributions
- Vary by partner needs



## Multiple Partners BEFORE

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	Profit Sharing
Partners	\$196,000
Employees	\$54,000
Total	\$250,000

**Owners: 78%**

*Note: Each partner contributes \$49,000/yr*

---

## Multiple Partners

## AFTER

	401K/ PS	Cash Balance	Total
Partners	\$77,000	\$380,000	\$457,000
Employees	\$62,500	\$0	\$62,500
Total	\$139,500	\$380,000	\$519,500

**Owners:  
88%**

*Partners' cash balance contributions:*

1: \$120,000

2: \$ 90,000

3: \$ 90,000

4: \$ 80,000

**\$380,000**

## Multiple Partners

## Comparison



	Before	After	Increase
Partners	\$196,000	\$457,000	\$261,000
Employees	\$54,000	\$62,500	\$8,500
Total			\$269,500

Tax Savings:  
**\$107,800**

Current Savings  
Net of Staff Cost:  
**\$99,300**

## Case 3: Multiple Partners

---

### Client Objectives

- Increase partner contributions
- Vary by partner needs

### Cash Balance Solution:

- Allow opportunity for maximum contributions but accommodate savers vs. spenders



## Back to the Future

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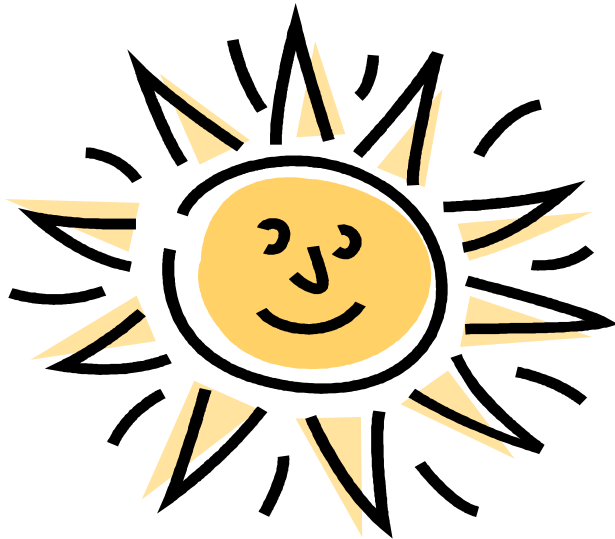
Defined Benefit Programs



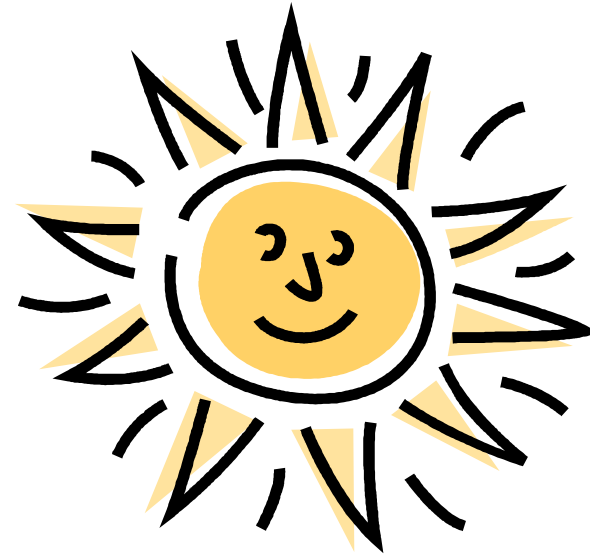
Defined Contribution Programs

## Back to the Future

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Cash Balance Programs



Defined Contribution Programs

# Recap

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1. Qualified plans accelerate net asset growth
2. Cash Balance Plan can defer more than a DC plan alone
3. Cash Balance assets are protected from creditors
4. Contribution commitment encourages disciplined savings
5. Cash Balance benefits insured with PBGC
6. Cash Balance has flexibility to meet client objectives; e.g.
  - ✓ Maximize tax deferral to principals
  - ✓ Maximize estate accumulation
  - ✓ Vary benefits by principal
  - ✓ Fund corporate/partnership buyout



# Cash Balance Plans are Good for...

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## Your clients

- Maximize tax deferral goals
- Efficient estate accumulation tool
- Discipline of programmed savings

## Your Business

- Enhances your client relationship
- Additional revenue channel



# Why Cash Balance with ADS?

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**Local – No “middle man”**

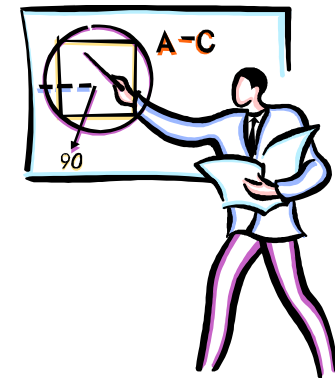
**Help profile & qualify potential Cash Balance prospects**

**Plan Design Expertise**

Our core competency

Target your client’s specific objectives

Keep plan on track to achieve client’s goals



**Implementation / Professional administration**

Experienced actuarial/consulting staff

Personalized and customized plans

Avoid future funding/compliance surprises

