Fisher Investments®

401(k) Solutions

Fisher Investments 401(k) Solutions Guide to Cash Balance Plans

A Cash Balance Plan can be a good retirement savings vehicle for owners of successful businesses with steady revenue. While there are certain risks to consider, participants can expect benefits that other retirement strategies can't offer—including significant tax deductions and accelerated savings.

This guide is designed to answer your questions about the risks and benefits of a Cash Balance Plan to help you decide if a Cash Balance Plan is right for your firm.

Q. What is a Cash Balance Plan?

According to the U.S. Department of Labor, there are two general types of retirement plans: defined benefit plans and defined contribution plans. A Cash Balance Plan is a defined benefit plan that acts in some ways like a defined contribution plan. Because it incorporates elements of both, it is sometimes called a "hybrid" plan.

A defined benefit plan provides a specific benefit at retirement for each eligible employee. A defined contribution plan specifies the amount of contributions to be made in an employee's retirement account. A Cash Balance Plan is a hybrid of the two in that it guarantees a specific benefit at retirement for each participant, but the benefit is based on ongoing—and fixed—annual contributions. The advantage? The hybrid format of a Cash Balance Plan allows for the larger tax deductions and accelerated retirement savings of a defined benefit plan, while maintaining some of the flexibility and portability of a defined contribution plan.

Q. What are the benefits of a Cash Balance Plan?

A Cash Balance Plan can help business owners to **accelerate their retirement savings** and **realize significant annual tax deductions**, primarily because the annual contribution limits for a Cash Balance Plan are higher than a 401(k) Profit Sharing Plan. For example, the annual maximum contribution for a 401(k) Profit Sharing Plan is limited to $56,500 ($62,500 for age 50 and older) for 2020, while the maximum contribution for a Cash Balance Plan can be as high as $336,000. The table *below*

Retirement Plan Contribution Limits for 2020

Age	401 (k) with Profit Sharing	Cash Balance	Total	Tax Savings*
70	$63,500	$336,000	$399,500	**$147,815**
65	$63,500	$271,000	$334,500	**$123,765**
60	$63,500	$261,000	$324,500	**$120,065**
55	$63,500	$203,000	$266,500	**$98,605**
50	$63,500	$158,000	$221,500	**$81,955**
45	$57,000	$123,000	$180,000	**$66,600**
40	$57,000	$96,000	$153,000	**$56,610**
35	$57,000	$75,000	$132,000	**$48,840**

*Assumes a 37% tax bracket.

shows the annual maximum Cash Balance Plan contributions—based on age—for 2020. Cash balance contributions reduce the owner's taxable income dollar for dollar and also grow tax-deferred.

Q. How does a Cash Balance Plan work?

With a Cash Balance Plan, each participant's benefit grows annually in two ways: a contribution credit and an interest crediting rate. Participant benefits are guaranteed by the employer who solely bears the investment risk.

The contribution credit is the amount that the employer contributes annually on behalf of the owners and the participants. The contribution is deposited the following year prior to business taxes being filed. This amount can either be a flat dollar value or a percentage of income; for example, $1,000 annually per participant or 2% of a participant's annual compensation. This contribution can be different for employees and owners so long as the plan passes compliance testing. The annual funding formula is specific for each company and is dependent on employee demographics and employer goals. A cash balance illustration can model funding formula options for your specific business to help you evaluate whether this is a good strategy.

The interest crediting rate (ICR) is the rate at which the plan guarantees interest on accumulated contributions. This rate is typically tied to an index, such as the 30-year treasury yield.

An actuary calculates the required employer contribution each year based on market growth of plan assets, plan census data and the interest crediting rate. The actuary also makes sure that the plan passes annual compliance testing. These tests make sure contributions made to highly compensated employees bear a reasonable relationship to contributions made to non-highly compensated employees.

Assets within a Cash Balance Plan are pooled and come only from the employer. Investments are directed by the plan trustee, not individual participants. Typically, investments within the plan seek returns that are consistent with the interest crediting rate to minimize risk for the employer.

Cash Balance Plans are generally used in conjunction with a 401(k) Profit Sharing Plan in order to maximize benefits to the owner and pass compliance testing. Contributing to a 401(k) Profit Sharing Plan provides some funding flexibility to the employer. This can also help mitigate the employer's investment risk because assets in the 401(k) Profit Sharing Plan are not subject to the employer-guaranteed interest crediting rate.

Who is eligible for a Cash Balance Plan?

A Cash Balance Plan can be designed to provide different levels of benefit to different employees, as long as annual non-discrimination requirements are satisfied. For example, in some cases a plan could provide $100,000 per year to owners and 2% of compensation to other eligible employees. At the minimum, a Cash Balance Plan must cover the lesser 40% of employees or 50 employees.

Q. Are there risks associated with a Cash Balance Plan?

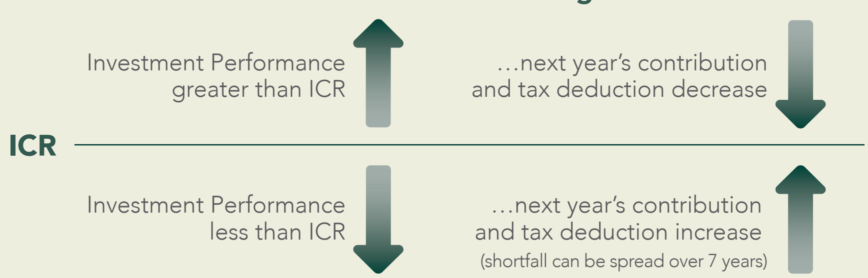
Yes. At Fisher Investments, we are committed to providing unbiased and balanced information on every aspect of a Cash Balance Plan—the best way to help you make the right decision for your business. While the benefits of a Cash Balance Plan can seem attractive to business owners, there are also significant risks that should be considered. They include:

Value Fluctuation. Investment risk is borne solely by the employer. The employer guarantees that the assets within the plan will grow by the stated interest crediting rate (ICR), regardless of actual market performance. For example, if the beginning of year (BOY) balance is $100,000 and the interest crediting rate is 4%, the end of the year (EOY) balance should be $104,000. If, due to market performance, the EOY balance is only $50,000, the employer is responsible to fully fund the $54,000 shortfall in addition to the planned contribution credit. If the contribution credit is $100,000, the employer's contribution requirement is $154,000. The shortfall funding requirement can be amortized over seven years to help smooth out market volatility.

Conversely, if, due to market performance, the EOY balance is $124,000, the employer's contribution requirement would decrease by $20,000. Instead of contributing $100,000, the employer must contribute $20,000 less, or $80,000, which decreases the employer's tax deduction for that year.

Because market volatility affects the predictability of annual ongoing contributions, assets within a Cash Balance Plan typically seek returns consistent with ICR.

Risks of Over/Under Performing the ICR



The following simplified case studies illustrate the concept of value fluctuation risk.

Scenario #1
Investment Performance Exceeds Interest Crediting Rate

Beginning of Year (BOY) Balance: **$100,000**

Annual Contribution Credit:.................. **$100,000**

Interest Crediting Rate: **4%**

Market Performance: **20%**

End of Year (EOY) Balance: **$120,000**

Net Result for Employer:
To fully fund the account, the employer must contribute to bring the value up to $204,000. Because of market performance, the employer contribution for this year is reduced from $100,000 to $84,000, which reduces the employer's tax deduction by $16,000.

Scenario #2
Investment Performance is Less than the Interest Crediting Rate

Beginning of Year (BOY) Balance: **$100,000**

Annual Contribution: **$100,000**

Interest Crediting Rate: **4%**

Market Performance: .... **-20%**

End of Year (EOY) Balance: **$80,000**

Net Result for Employer:
To fully fund the account, the employer must contribute to bring the value up to $204,000. Because of market performance, the employer contribution for this year is increased from $100,000 to $124,000. The additional $24,000 contribution can be amortized over seven years.

The plan actuary will calculate the employer's required contribution threshold every year.

How do we establish a Cash Balance Plan for our business?

Fisher Investments will walk you through the following process *(top of next page)* in order to establish a Cash Balance Plan for your business.

Inflexible Funding. Contribution credits are required annually and cannot be modified from year to year. Before adopting a Cash Balance Plan, the employer should be sure that it can commit to the ongoing annual funding requirements. If a business is unable to sustain cash flow sufficient to fund the plan over the long term, a Cash Balance Plan is not a good option.

Administrative Expense. Because a Cash Balance Plan requires ongoing actuarial work, it is typically more costly to administer than a 401(k) Profit Sharing Plan.

Q. Is a Cash Balance Plan set in stone?

Generally, yes. A Cash Balance Plan should only be established if the employer intends for it to be "permanent." The employer could possibly reduce the amount of future contributions to the Cash Balance Plan as long as certain conditions are met. This can be done by either amending the plan document or "freezing" the benefit accruals. A Cash Balance Plan can also be terminated in some circumstances, but it is a lengthy process and can be costly to the employer.

Administrative Complexity. Generally speaking, a Cash Balance Plan is more complex than a 401(k) Profit Sharing Plan. Because it is a more sophisticated benefit, it requires ongoing administrative effort, additional decision-making and associated costs.

Q. Where does the money for a Cash Balance Plan come from?

All assets within a Cash Balance Plan come from company coffers. Generally, a minimal amount is contributed on behalf of employees, while the majority of the assets are contributed for the principals. Typically, principals will use the Cash Balance contribution to reduce their taxable income. For example, a 50-year-old doctor who earns $500,000/year might choose to reduce his salary to $350,000 and take $150,000 as an annual Cash Balance Plan contribution. Because money in the Cash Balance Plan is tax-deferred, this directly reduces the doctor's tax burden.

This can get tricky when there are multiple principals involved. Each principal will need to decide how much he or she wants to put toward the Cash Balance Plan and will need to adjust his or her compensation accordingly. Some businesses have a practice manager who can facilitate individual meetings with each principal to determine how much each would like to contribute.

The process to establish a Cash Balance Plan:

1. Feasibility Study	Fill out the Fisher Investments census template and we will provide you an illustration. The illustration will show funding options and how much you could save in taxes each year through implementing a Cash Balance Plan.
2. Service Agreement	After evaluating the illustration, if you decide to move forward with a Cash Balance Plan, you will sign the Fisher Investments Fiduciary Retirement Agreement and the actuary's Service Agreement.
3. Plan Documents	The actuary will create Cash Balance Plan documents. The plan will be tailored to fit your firm's unique goals and also complement your existing 401(k) plan (if applicable).
4. Plan Installation	Your Fisher Investments Retirement Counselor will lead you through the plan installation process to ensure a smooth, seamless transition.
5. Plan Kick Off	Your Fisher Investments Retirement Counselor can travel onsite to explain the plan features to your eligible employees and answer any questions.
6. Ongoing Service	Your Fisher Investments Retirement Counselor will provide check-in calls, annual plan reviews and investment education for your plan participants.

Q. What are the roles and responsibilities associated with a Cash Balance Plan?

Fisher Investments partners with an independent actuary to help your business evaluate your financial needs, goals and circumstances. Each role in your Cash Balance Plan is described in the chart *below*:

Role	Responsibility
Employer	• As the plan fiduciary, it is the employer's responsibility to select and monitor service providers • Provide and fund the plan • Allocate assets among plan investment options
Fisher Investments 401(k) Solutions	• As an ERISA 3(38) Investment Manager, Fisher will select, monitor and update the investment options available in the plan • Support the employer in selecting and monitoring service providers • Facilitate communication between plan sponsor and service provider
Plan Actuary and Recordkeeper	• Create plan documents • Annual actuarial calculations • Annual compliance testing • Prepare IRS Form 5500

Q. Who is the ideal candidate for a Cash Balance Plan?

A Cash Balance Plan may be a good fit for your business if some of the following are true:

- You or your business partners want to significantly increase your rate of retirement savings
- Your business consistently produces steady revenue
- You or your business partners have personal annual income greater than $275,000 and are seeking an annual tax deduction of $55,000 or more
- Your company has fewer than 15 employees per one owner
- You and your business partners are generally older than your employees
- You already fund an employer contribution of 5% or more of employee compensation or are interested in doing so. This could include a Profit Sharing Plan or Safe Harbor 401(k).

For more information about Cash Balance Plans, please call us at **866-607-5156** or visit **www.fisher401k.com**

Glossary

Cash Balance Plan: A type of defined benefit plan that acts similarly to a defined contribution plan because the benefit amount is based on annual ongoing employer contributions.

Contribution Credit: The annual amount that an employer must contribute to a Cash Balance Plan on behalf of the participants. This can be a dollar value or a percentage of the participant's income.

Defined Benefit Plan: This type of plan, also known as a traditional pension plan, promises the participant a specified monthly benefit at retirement. The employer is responsible for determining how the plan's assets are invested and bears all risk if the plan's assets are insufficient to cover the promised benefit. Often, the benefit is based on factors such as salary, age and the number of years of employment.

Defined Contribution Plan: In a defined contribution plan, the employee and/or the employer contribute to the employee's individual account under the plan. The employee often decides how his or her account is invested and bears all investment risk. The amount in the account at distribution includes the contributions and investment gains or losses, minus any investment and administrative fees. The 401(k) plan is a popular type of a defined contribution plan.

Interest Crediting Rate (ICR): The annual rate at which the sponsor of a Cash Balance Plan guarantees interest on the accumulated contributions credits. This rate is typically tied to an index such as the 30-year treasury rate.

Fisher Investments 401(k) Solutions

For many successful professional practices with steady revenue, Fisher Investments 401(k) Solutions is a logical choice. Specializing in Employer Sponsored Retirement Plans with less than $20 million in assets, we provide extensive client consultation and education, 3(38) investment manager fiduciary services, and a fair and transparent fee structure. To learn more about how Fisher Investments 401(k) Solutions can benefit your retirement strategy, call us at 866-607-5156.

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5525 NW Fisher Creek Drive, Camas WA 98607

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