SUMMIT
Benefit & Actuarial Services, Inc.

What is a Cash Balance Plan? A Cash Balance plan is a "hybrid" plan in that is fundamentally a Defined Benefit plan but expresses benefits in the form of an account balance (like a Defined Contribution plan) rather than an annuity benefit at retirement. It has the following features:

- Like a Defined Benefit plan the investment risk lies with the employer.
- The maximum benefit that can be paid follows rules similar to the Defined Benefit plans
- The plan document specifies the annual credit (often called the "pay credit") and the annual interest credit to the participant's account. For example, a plan might say that the annual credit for Shareholders is $100,000 and the interest credit is 5% per annum.
- Plan participants receive easily understandable statements showing the value of their account.

Who Bears the Investment Risk? In a Cash Balance plan the investment risk lies with the employer. There cannot be any participant investment choice – all assets are pooled and trustee-directed.

Cash Balance Plans offer the following advantages over traditional Defined Benefit Plans:

- Career average benefit pattern – avoids the heavy weighting of benefits to final years of work.
- Employees have a much better understanding of their benefits
- Lump sum payments are not subject to IRC §417(e) rates
- Direct tracking of contributions made to benefits that are ultimately distributed
- Age-neutral contributions for employees

What Interest Crediting Rate can be used for the accounts?

- A fixed rate of up to 6% - we recommend a lower fixed rate (e.g. 4%) in today's low interest rate environment to avoid the possibility of investment losses that need to be made up,
- A Treasury yield rate (e.g. 30 year Treasury bond)

1. The Trust's actual rate of return with a 5% cap. Under this option, investment risk is passed to the participants and generally avoids any losses to be made up, eliminates any stranded costs when a shareholder leaves, and provides stable testing results. However this method introduces a lot of complexity and should only be used in situations with multiple shareholders. It does not increase the benefits that can be paid by the plan.

The Trust's investment strategy should be coordinated with the plan's crediting rate to avoid losses.

Cash Balance Plan must be designed and operate in a way that follows all the rules for Defined Benefit plans:

- A schedule of credits that all shareholders can live with must be created (for example, an equal credit for everyone, or a percentage of salary, or an amount from a table based on age are safe approaches). Allowing each shareholder to "choose" a different credit amount may fall afoul of the requirements.

- A shareholder can be named out of the document, and the plan can be amended at a later time to allow the person in at the specified credit.

- The plan can only be amended *prospectively* and *infrequently*!

- Once someone has worked 1,000 hours, they have earned a credit for that year, and the contribution must be made. So if you leave during a year and you have worked 1,000 hours, there will be a required contribution on your behalf!

How Long Should the Cash Balance Plan be Maintained?

- The IRS has a permanency requirement. Although there is not an objective standard, five years appears to be a sufficient time to satisfy the permanency requirement.

- Within these five years the Cash Balance plan can be amended to adjust the annual credits, but such an amendment must be done early in a year before the annual credits are accrued.

- In the event of a significant business event (e.g., sale of the business, severe financial downturn, loss of primary contract, etc), the plan could be terminated.

- At the time the plan is terminated, a favorable determination letter should be sought from the IRS to ensure that the permanency requirement is satisfied.

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What Happens When a Highly Compensated Employee ("HCE") Terminates Employment or Retires?

- Upon termination of employment, an eligible participant has the option to receive a lump sum distribution or an immediate/ deferred annuity

- The annuity is the default option and, if chosen, the plan would purchase an annuity for the benefit of the plan participant

- If a lump sum distribution is chosen, the participant's spouse (if any) must consent to the distribution in writing

- Lump sums may be directly rolled over into an IRA

- Due to IRS restrictions an HCE may not be able to receive their lump sum distribution immediately in some circumstances: if the remaining plan assets were not to exceed 110% of the remaining plan liability after the distribution. This would generally happen if the value of plan assets is down due to a decline in the market. In this case the HCE would have three options:
    - Leave the money in the plan, where the cash balance account balance will continue to be credited with interest at the plan's crediting rate until such time as the 110% threshold can be met.
    - Start taking a monthly benefit from the plan
    - Roll the lump-sum distribution to an IRA with the requirement that the IRA trustee sign a collateral agreement agreeing to repay monies to the plan, if the plan should terminate with insufficient assets.