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Subject: legal advice regarding cash balance plans

Subject: Eligibility of certain cash balance plans for the § 411(b)(1)(H) safe harbor rules regarding lump sum-based benefit formulas and indexed benefits

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

BACKGROUND

Some defined benefit plans have statutory hybrid benefit formulas (as defined in § 1.411(a)(13)-1(d)(4)) and must comply with the requirements applicable to statutory hybrid plans, including the vesting requirements of § 411(a)(13)(B) and § 1.411(a)(13)-1(c), the plan conversion amendment requirements (if applicable) of § 411(b)(5)(B)(ii) and § 1.411(b)(5)-1(c), and the capital preservation rule of § 411(b)(5)(B)(i)(II) and § 1.411(b)(5)-1(d)(2). Some of these plans, commonly called cash balance plans, contain a benefit formula in which a participant's accumulated benefit is expressed as the current balance of a hypothetical account maintained for the participant, with a participant's accrued benefit equal to the single life annuity payable at normal retirement age (or the current age, if later) that is the actuarial equivalent of the participant's current hypothetical account balance plus projected future interest credits to that date. Many cash balance plans provide that a single-sum distribution of a participant's benefit is equal to the participant's hypothetical account balance. However, some cash balance plans provide that a single-sum distribution of a participant's benefit is not equal to the participant's hypothetical account balance and instead is determined as the present value of the participant's accrued benefit using the actuarial assumptions specified in § 417(e)(3).

ISSUE

May cash balance plans with a single-sum distribution that is determined as the present value of the participant's accrued benefit using the actuarial assumptions specified in § 417(e)(3) use the safe harbor rules of § 411(b)(5)(A) (which apply to lump sum-based benefit formulas) or § 411(b)(5)(E) (which apply to indexed benefits) to satisfy the age discrimination requirements of § 411(b)(1)(H)?

CONCLUSION

As of the effective date of the 2014 revisions to § 1.411(b)(5)-1 (which generally apply for plan years beginning on or after January 1, 2017), cash balance plans with a single-sum distribution that is determined as the present value of the participant's accrued benefit using the actuarial assumptions specified in § 417(e)(3) are not eligible for the safe harbor rule for plans with lump sum-based benefit formulas under § 411(b)(5)(A) and § 1.411(b)(5)-1(b)(1) (which applies to many cash balance plans using the safe harbor formula measure described in § 1.411(b)(5)-1(b)(1)(i)(B)). However, these plans are generally eligible for the safe harbor rule for plans with indexed benefits under § 411(b)(5)(E) and § 1.411(b)(5)-1(b)(2).

LAW AND ANALYSIS

Section 411(b)(1)(H) generally provides that a defined benefit plan is not qualified if an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.

Under § 1.411(b)(5)-1(b)(1)(i), a plan is not treated as failing to meet the requirements of § 411(b)(1)(H)(i) with respect to an individual who is or could be a participant if, as of any date, the accumulated benefit of the individual would not be less than the accumulated benefit of any similarly situated, younger individual who is or could be a participant. Thus, this test involves a comparison of the accumulated benefit of an individual who is or could be a participant in the plan with the accumulated benefit of each similarly situated, younger individual who is or could be a participant in the plan. This rule applies only if the benefit under the plan is based on one of three safe-harbor formula measures, which are set forth in § 1.411(b)(5)-1(b)(1)(i)(A) through (C). The safe harbor formula measure set forth in § 1.411(b)(5)-1(b)(1)(i)(B) is the current balance of the hypothetical account maintained for the participant if the accumulated benefit under the plan is the current balance of a hypothetical account. Pursuant to § 1.411(b)(5)-1(b)(1)(ii)(F), for plan years that begin on or after January 1, 2017,^[1] a benefit measure is a safe-harbor formula measure described in § 1.411(b)(5)-1(b)(1)(i)(B) only if the formula under which the balance of a hypothetical account is determined is a lump sum-based benefit formula.

A benefit formula does not constitute a lump sum-based benefit formula, according to § 1.411(a)(13)-1(d)(3), unless a distribution of the benefits under that formula in the form of a single-sum payment equals the accumulated benefit (except to the extent the single-sum payment is greater to satisfy the requirements of § 411(d)(6)). Some plans with cash balance benefit formulas provide that the single-sum distribution is determined as the present value of the participant's accrued benefit determined using the actuarial assumptions specified in § 417(e)(3). These plans are not plans with a lump sum-based benefit formula because the amount of the single-sum distribution is not equal to the hypothetical account balance. See § 1.411(a)(13)-1(d)(3). Therefore, they are not eligible for the safe harbor under § 1.411(b)(5)-1(b)(1).

^[1] This rule was added in T.D. 9693, 79 Fed. Reg. 56442 (September 19, 2014). Under § 1.411(b)(5)-1(f)(2)(i)(B)(3), the effective date of this rule for collectively bargained plans is the later of (i) January 1, 2017; and (2) the earlier of January 1, 2019; and the date on which the collective bargaining agreement terminates.

Under § 1.411(b)(5)-1(b)(2)(i), a plan is not treated as failing to meet § 411(b)(1)(H) solely because a benefit formula (other than a lump sum-based benefit formula) “provides for the periodic adjustment of the participant’s accrued benefit under the plan by means of the application of a recognized index or methodology. An indexing rate that does not exceed a market rate of return is deemed to be a recognized index or methodology.” This safe harbor for indexed benefit plans is not available “unless the aggregate adjustments made to a participant’s accrued benefit under the plan (determined as a percentage of the unadjusted accrued benefit) in a period would not be less than the aggregate adjustments for any similarly situated, younger participant. This test requires a comparison, for each period, of the aggregate adjustments for each individual who is or could be a participant in the plan for the period with the aggregate adjustments of each other similarly situated, younger individual who is or could be a participant in the plan for that period.” See § 1.411(b)(5)-1(b)(2)(ii).

Under a cash balance plan, a participant’s accrued benefit at any relevant time is equal to the single life annuity payable at normal retirement age (or the current age, if later) that is the actuarial equivalent of the participant’s current hypothetical account balance plus projected future interest credits to that date. If the plan’s interest crediting rate does not exceed a market rate of return, then the plan’s interest crediting rate is deemed to be a recognized index or methodology for purposes of applying the rules for indexed benefits under § 411(b)(5)(E) and § 1.411(b)(5)-1(b)(2). If the interest crediting rate under a cash balance plan is the same for participants of all ages, then the periodic adjustments that are applied to the hypothetical account balance for an interest crediting period do not provide an aggregate adjustment to the accrued benefit for that period for any participant that would be less than the aggregate adjustment for that period for any similarly situated younger participant. Therefore, a cash balance plan under which the single-sum distribution is determined as the present value of the participant’s accrued benefit using the actuarial assumptions specified in § 417(e)(3) (so that the safe harbor under § 1.411(b)(5)-1(b)(1) does not apply to the plan) may be tested for compliance with the requirements of § 411(b)(1)(H) disregarding future interest credits pursuant to the rules for indexed benefits under § 411(b)(5)(E) and § 1.411(b)(5)-1(b)(2).

Footnote 1: This rule was added in T.D. 9693, 79 Fed. Reg. 56442 (September 19, 2014). Under § 1.411(b)(5)-1(f)(2)(i)(B)(3), the effective date of this rule for collectively bargained plans is the later of (i) January 1, 2017; and (2) the earlier of January 1, 2019; and the date on which the collective bargaining agreement terminates.