Cash Balance Plans (Pre-PPA 2006)

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A. Purpose

This internal guidance document is intended to provide PBGC staff with guidance on how to process cash balance plans that terminated before the rules governing Statutory Hybrid Plans became effective under the Pension Protection Act of 2006 ("PPA 2006")

The second edition clarifies that this Internal Guidance Document generally applies only to pre-PPA 2006 cash balance plans and makes editorial and formatting changes. Because this Internal Guidance Document's provisions on de minimis lump sums may apply to some post-PPA 2006 cash balance plans, this edition updates those provisions to reflect Section 304 of the SECURE 2.0 Act of 2022, Division T of the Consolidated Appropriations Act, 2023, which increased the threshold for mandatory distributions from pension plans from $5,000.00 to $7,000.00.

B. Scope

This Internal Guidance Document states the special rules that PBGC will apply to certain cash balance plans (see below) with respect to:

- valuing benefits for purposes of employer liability, section 4044 asset allocation, and section 4022(c) determinations,
- determining the annuity that the participant will receive, and
- determining whether the participant is eligible for a de minimis lump-sum payment and, if so, the amount of that payment.

This Internal Guidance Document generally deals only with cash balance plans NOT subject to the Statutory Hybrid Plan rules of PPA 2006 (see below with respect to certain Statutory Hybrid Plans which had not converted from the whipsaw method described in Section F of this Internal Guidance Document). This means that this Internal Guidance Document applies generally only to a cash balance plan that (see below with respect to collectively bargained plans terminating before the beginning of the 2010 plan year):

- did NOT terminate during or after the plan year beginning on or after 1/1/2008 and
- was NOT created as a Statutory Hybrid Plan on or after 6/29/2005 and
- was NOT converted to a Statutory Hybrid Plan on or after 6/29/2005.

For cash balance plans and other lump-sum based hybrid plans, such as Pension Equity Plans, which are subject to the Statutory Hybrid Plan rules of PPA 2006, see Internal Guidance Document Statutory Hybrid Plans .

Hybrid plans that are not subject to PPA 2006, such as pre-PPA 2006 Pension Equity Plans, should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

This Internal Guidance Document applies to pre-PPA 2006 cash balance plans that terminate in a distress or involuntary termination, regardless of whether DOPT or trusteeship precedes the Internal Guidance Document's issuance. Although this Internal Guidance Document is principally directed at plans trusteed by PBGC, PBGC will also apply this Internal Guidance Document to non-trusteed plans as appropriate. Any questions on the applicability of this Internal Guidance Document to non-trusteed plans should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

As discussed above, this Internal Guidance Document also has continuing applicability to Statutory Hybrid Plans where the plan had not converted from the whipsaw method. See section F below and section I.2 of Internal Guidance Document Statutory Hybrid Plans.

NOTE: If the cash balance plan was a collectively bargained plan that terminated after 1/1/2008 but before the beginning of the 2010 plan year, contact PSDGuidance@pbgc.gov to determine whether Internal Guidance Document Cash Balance Plans (Pre-PPA 2006) or Internal Guidance Document Statutory Hybrid Plans applies.

C. Background

C.1. Description of Ongoing Cash Balance Plans

A cash balance plan is a defined benefit pension plan. However, unlike most defined benefit plans that describe the participant's benefit in terms of the participant's annuity at normal retirement age, a cash balance plan generally will define the participant's benefit by reference to the amount of a hypothetical account balance. A typical cash balance plan provides that each year the plan will credit a participant's hypothetical account balance with a pay credit (i.e., a percentage of the participant's pay for the year) and an interest credit (i.e., the hypothetical earnings on the account balance). The plan must specify both the pay credit and the interest credit. The cash balance plan also must specify the conversion factor that the plan will use to determine the annuity from the account balance. (The annuity conversion factor can be a single number, can be shown in a table, or can be derived from specified interest and mortality assumptions.)

Participants in ongoing cash balance plans who separate from employment generally have the right to receive their benefits in annuity form, although they typically choose (with spousal consent) to receive their benefits in lump sum form. In most cases, the plan defines the lump sum amount as no less than the hypothetical account balance. While cash balance plans generally are designed to pay only the hypothetical account balance, they may have to pay more in some cases in order to avoid an impermissible forfeiture under Code section 417(e) and ERISA section 205.

Under Code section 417(e) and ERISA section 205, the amount of a lump-sum may not be less than the present value of the participant's normal retirement annuity, using either plan factors or the applicable interest rate and mortality table of Code section 417(e), whichever produces the greater value. To determine this present value in a cash balance plan, the plan must project the hypothetical account balance using the interest credit up to the participant's normal retirement date, convert that amount to an annuity, and then discount the annuity back to the calculation date using the applicable interest and mortality table of Code section 417(e) (or plan factors if the plan factors would provide a greater present value.) However, when PBGC calculates the DOPT present value of de minimis lump-sums in a trusteed plan, it substitutes the PBGC lump-sum assumptions for the plan/Code section 417(e) assumptions to determine the amount of the lump-sum. In either case, because the interest credit may be greater than the discount interest rate, the present value of the annuity may be greater than the hypothetical account balance.

Many plans, however, simply pay a lump-sum in an amount equal to the hypothetical account balance. The IRS has said that doing so complies with the Code and ERISA (i.e., nonforfeitability is not violated) if the interest credit meets certain requirements. The IRS set forth the permissible values for the interest credit in Notice 96-8 (1996-1 C.B. 359), summarized in the table in section D.2.b below. Plans that satisfy Notice 96-8 may pay a lump-sum equal to the hypothetical account balance, regardless of whether a greater amount would otherwise be required under Code section 417(e) and ERISA section 205.

C. 2. PBGC's Issues for Trusteed Cash Balance Plans

When a cash balance plan terminates in a distress or involuntary termination, PBGC must perform its plan valuation and make its benefit determinations as it does for a traditional defined benefit plan. PBGC uses the plan's interest credit and annuity conversion factors to make benefit determinations. If the plan's interest credit and annuity conversion factors are fixed or if the plan provides a method for converting variable factors to fixed rates ("fixing" the variable factors), the plan presents fewer special valuation or payment issues. However, PBGC faces unique issues when it must perform a plan valuation or calculate a de minimis lump-sum as of DOPT for a plan that lacks a fixed index or a method for fixing a variable index.

D. Benefit Valuations

D.1. General

This paragraph 1 deals with how to perform the valuation as of DOPT. See paragraphs E. and F. for explanations of how to calculate benefits that will be paid to participants. Note that there may be a difference between the valuation liability for a participant and the amount PBGC will pay to the participant as a lump-sum.

In order to value a participant's benefit, PBGC must calculate the value, as of DOPT, of the participant's annuity commencing at expected retirement age (XRA). To determine the participant's annuity, PBGC must project the participant's hypothetical account balance using the plan's interest credit from DOPT to the participant's XRA, then convert that projected balance to an annuity using the plan's annuity conversion factors. PBGC must then determine the value of the annuity. To do this, PBGC must discount the annuity to DOPT using PBGC's interest and mortality assumptions under the valuation regulation (for annuities or lump-sums, as appropriate).

The XRA is calculated by reference to a plan's earliest retirement age. Many cash balance plans allow elective lump-sums (and hence must provide immediate annuities) at any age. A participant's earliest "retirement age" is not simply his or her current age merely because the participant can receive an immediate annuity. Rather, PBGC will determine the earliest retirement age in a cash balance plan as in any other plan.

In valuing benefits for cash balance plans, PBGC will follow its general valuation rules for trusteed plans, supplemented by the following guidance.

D.2. Projecting the Account Balance

D.2.a. Fixed Interest Credit

If the plan document specifies a fixed interest credit, PBGC will use that rate to credit the participant's hypothetical account balance. PBGC will follow plan procedures as to the frequency of interest crediting and the conversion of annual rates into rates for crediting more frequently than annually.

D.2.b. Variable Interest Credit Based on a 96-8 Index.

The following chart shows Standard Indices and their Associated Margins as set forth in IRS Notice 96-8:

	Notice 96-8 Standard Index	**Associated Margin**
The discount rate on:	3-month Treasury Bills	175 basis points
	6-month Treasury Bills or 12- month Treasury Bills	150 basis points
The yield on:	1-year Treasury Constant Maturities	100 basis points
	2-year Treasury Constant Maturities	50 basis points
	3-year Treasury Constant Maturities	50 basis points
	5-year Treasury Constant Maturities	25 basis points
	7-year Treasury Constant Maturities	25 basis points
	10-year Treasury Constant Maturities	0 basis points
	Any longer period Treasury Constant Maturities	0 basis points
	Annual rate of change of the Consumer Price Index	3 percentage points

If the plan document specifies a variable interest credit that is based on an index that is specified in IRS Notice 96-8 (see above) — either with no plan margin or with a plan margin that is constant (regardless of whether it is outside the Associated Margin specified in IRS Notice 96-8) — PBGC will fix the variable interest credit as follows:

Start with the average of the annual yields for 30-year Treasury constant maturities for the month specified in the plan and —

i. decrease it by the "Associated Margin" (for variations from 30-year Treasury constant maturities) for the variable index the plan uses, as set forth in IRS Notice 96-8 (see above), and

ii. increase or decrease it by any plan margin (e.g., in a plan that defines the interest credit as the yield on 1-year Treasury constant maturities + 50 basis points, the plan margin would be "+ 50 basis points").

PBGC will follow plan procedures as to the frequency of interest crediting and the conversion of annual rates into rates for crediting more frequently than annually.

The average of the annual yields on 30-year Treasury constant maturities is published monthly in Federal Reserve release G.13 and is available online.

Example

Assume that a calendar year plan credits interest annually on December 31 and specifies the interest credit for a given calendar year as "the yield on 1 year Treasury constant maturities for the July preceding the beginning of the year, plus 50 basis points." If DOPT is September 2, 2000, and the average of the annual yields for 30-year Treasury constant maturities for July 1999 is 5.98%, PBGC will use an interest credit of 5.48%, calculated as follows:

5.98%	July 1999 average for 30-year Treasury constant maturities
- 1.00%	Associated Margin for 1-year Treasury constant maturities (IRS Notice 96-8)
+ 0.50%	plan margin (50 basis points)
5.48%	PBGC interest credit

D.2.c. Variable Interest Credit Not Based on a 96-8 Index

If the plan contains a variable interest credit that is not based on a Standard Index included in Notice 96-8, or that is based on such an index with a plan margin that is variable, the plan should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

D.2.d. No Interest Credit Specified

If the plan does not specify an interest credit and there is no guidance provided by plan practice, PBGC will credit each participant's hypothetical account balance with interest from DOPT to XRA using the average of the annual yields for 30-year Treasury constant maturities for the calendar month prior to the month of plan termination.

D.3. Converting Projected Account Balance to Monthly Annuity Benefit

PBGC will follow plan procedures (supplemented by the following guidance) to convert an account balance to a monthly annuity. If plan procedures involve use of interest or mortality assumptions that are variable, PBGC will determine an annuity conversion factor based on the interest and mortality assumptions outlined below. If plan procedures call for converting an account balance to a monthly annuity using a variable element not discussed below, the case should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

D.3.a. Interest Rate for Annuity Conversion

PBGC will apply rules similar to those specified above in D.2. (for fixing or imputing the value of the interest credit) in situations in which the annuity conversion factor is dependent on an interest rate.

D.3.b. Mortality Table for Annuity Conversion

D.3.b.1. Fixed Mortality Table

If the plan document specifies a fixed mortality table, PBGC will convert each participant's hypothetical account balance using the fixed table.

D.3.b.2. Variable Mortality Table

If the plan specifies a variable mortality table, PBGC will convert each participant's hypothetical account balance using the table that would apply to an annuity starting on DOPT. If the specified mortality table includes a projection scale, the plan should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

D.3.b.3. No Mortality Table Specified

If the plan does not specify either a fixed or variable mortality table and there is no guidance provided by plan practice, PBGC will convert each participant's hypothetical account balance using the Code section 417(e) mortality table that would apply to an annuity starting on DOPT.

E. Annuity Payments

E.1. In General

PBGC will follow plan provisions, to the extent those provisions exist, in determining the annuity PBGC will pay. PBGC will credit actual interest under a fixed or variable index until the participant's annuity starting date and will convert the hypothetical account balance at that point using the plan's annuity conversion factors.

E.2. Crediting Interest to the Account Balance

E.2.a. Fixed or Variable Interest Credit Specified

PBGC will credit each participant's hypothetical account balance with interest using the actual interest credit specified in the plan. PBGC will follow plan procedures as to the frequency of interest crediting and the conversion of annual rates into rates for crediting more frequently than annually.

E.2.b. No Interest Credit Specified

If the plan does not specify the interest credit and there is no guidance provided by plan practice, PBGC will credit each participant's hypothetical account balance with interest once a year on the last day of the plan year. The interest credit will be the average of the annual yields on 30-year Treasury constant maturities for the third calendar month preceding the month containing the first day of the plan year.

For example, assume a plan year begins on March 15. Interest for the year March 15, 2001, through March 14, 2002, would be credited on March 14, 2002, using the average of the annual yields on 30-year Treasury constant maturities for December 2000 (the third calendar month preceding March 15, 2001).

PBGC will credit a fractional year's interest from the beginning of a plan year to a participant's benefit commencement date. For example, assume a participant in the plan from the preceding example will retire with benefits commencing on June 1, 2001. His or her account as of March 15, 2001, would be credited with interest for the period March 15 through June 1, 2001.

E.2.c. Index No Longer Exists (or Exists Only in a Substantially Modified Form)

If the plan uses a variable index for either the interest credit or annuity conversion factor and the index does not exist for part or all of the relevant period (or no longer exists in the same form), the case should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

E.3. Converting the Accumulated Account Balance to a Monthly Annuity Benefit

PBGC will convert each participant's account balance to an annuity using the interest and mortality conversion rates specified in the plan document. If the plan does not specify conversion rates and there is no guidance provided by plan practice, PBGC will convert each participant's account balance using the average of the annual yields on 30-year Treasury constant maturities for the third calendar month prior to the beginning of the plan year in which the participant's annuity starting date occurs and the Code section 417(e) mortality rates applicable to the participant's annuity starting date.

E.4. Annuity Payment Date

PBGC will begin to pay participants their annuity benefits no earlier than the time when they would have been able to commence payments consistent with PBGC's rules for other plans. In the case of a plan that converts to a cash balance plan, if a participant would have been eligible for an early retirement benefit under the old plan provisions, then that early retirement date applies for purposes of the entire benefit. If it is not clear when benefits can commence, the plan should be referred to PSDGuidance@pbgc.gov for consultation with OGC.

F. De Minimis Lump-Sum Payments

F.1. In General

The following guidance supplements PBGC's regulation dealing with payment of de minimis benefits (i.e., $5,000.00 or less if DOPT is on or before December 31, 2023, or $7,000.00 or less if DOPT is on or after January 1, 2024). Note that the amount of the benefit paid will not affect the valuation of benefits.

F.2. To Determine Whether the Benefit Is De Minimis

PBGC will calculate both:

Step (1): the present value at DOPT (determined using PBGC's lump-sum valuation factors) of the participant's monthly termination benefit commencing at XRA and
Step (2): the hypothetical account balance at DOPT to the extent payable under Title IV of ERISA.

If either step (1) or step (2) is $5,000.00 or less if DOPT is on or before December 31, 2023, or $7,000.00 or less if DOPT is on or after January 1, 2024, PBGC may pay a lump-sum, subject to section F.3.

A participant's termination benefit is the guaranteed benefit, plus any additional benefits to which plan assets are allocated, plus any 4022(c) benefit.

F.3. Spousal Consent

If the hypothetical account balance at DOPT to the extent payable under Title IV of ERISA (i.e., step (2) of section F.2) is $5,000.00 or less if DOPT is on or before December 31, 2023, or $7,000.00 or less if DOPT is on or after January 1, 2024, but the present value at DOPT (determined using PBGC's lump-sum valuation factors) of the participant's monthly termination benefit commencing at XRA (i.e., step (1) of section F.2) exceeds $5,000.00 if DOPT is on or before December 31, 2023 or $7,000.00 if DOPT is on or after January 1, 2024, PBGC will require spousal consent before paying the benefit as a lump-sum.

If PBGC pays an estimated lump-sum based on a hypothetical account balance (i.e., an estimate of step (2) of section F.2) of $5,000.00 or less if DOPT is on or before December 31, 2023, or $7,000.00 or less if DOPT is on or after January 1, 2024, but anticipates that the present value (using PBGC factors) of the monthly termination benefit (i.e., an estimate of step (1) of section F.2) might exceed $5,000.00 if DOPT is on or before December 31, 2023, or $7,000.00 if DOPT is on or after January 1, 2024, PBGC will require spousal consent for payment of the estimated lump-sum.

F.4. To Determine the Amount of the De Minimis Lump-Sum Benefit Payable

If, under section F.2, the participant is eligible for a lump-sum payment and the participant does not elect an annuity, PBGC will (subject to the spousal consent rules in section F.3) pay the greater of

(1) the present value at DOPT (determined using PBGC's lump-sum valuation factors) of the participant's monthly termination benefit commencing at XRA (i.e., step (1) of section F.2) or section F.2.

(2) the hypothetical account balance at DOPT to the extent payable under Title IV of ERISA (i.e., step (2) of section F.2), whether or not such amount exceeds $5,000.00 if DOPT is on or before December 31, 2023, or $7,000.00 if DOPT is on or after January 1, 2024.

F.5. Scope of Paragraph F

The rules in this paragraph F. apply to two types of cash balance plans — those that have always used a cash balance formula and those that have replaced a traditional formula with respect to all service with a cash balance formula for all service. This includes plans that set up an opening cash balance account when the plan is amended and provide the greater of the cash balance benefit or a grandfathered benefit based on the traditional formula.

Other plans freeze the traditional formula with respect to service up to a certain date (the "A" formula) and use a cash balance formula (starting with a zero account balance) for service after that date (the "B" formula). Any plan with such an "A + B" formula should be referred to PSDGuidance@pbgc.gov for consultation with CPRD and OGC.