CAPITAL GROUP® | AMERICAN FUNDS®

What is a cash balance plan?

A cash balance plan is a "hybrid" retirement plan that combines features of both defined benefit and defined contribution plans.

While a traditional defined benefit plan provides for a specific benefit at retirement, a cash balance plan provides the benefit at retirement as an account balance.

Plan sponsors contribute a flat-dollar amount or percentage of compensation ("pay credit") and credit a specific interest rate each plan year.

And while a cash balance plan may have higher administrative costs than a 401(k) plan, largely because its funding must be certified by an actuary each year, its tax benefits can offset this additional administrative cost.

It's important to note, however, that a cash balance plan may not be right for all companies. For example, a cash balance plan must be funded on an annual or more frequent basis. Employers should be confident the firm's cash flow and profitability will permit it to meet its funding requirement. Also, the responsibility of investing the plan assets for the participants rests with the employer. If investment returns do not keep up with funding requirements, additional and often unanticipated contributions will have to be made.

Generally, a local TPA can help with the plan design.

Add a cash balance plan to help increase tax savings and improve participant outcomes

While it's true that defined contribution plans continue to eclipse defined benefit plans by an ever-widening margin, at least one particularly bright spot can be found in the defined benefit realm: cash balance plans, which can offer the best of both defined contribution and defined benefit worlds.

And this bright spot could prove to be especially attractive for highly compensated business owners and their key employees. As a result, cash balance plans can provide new opportunities for third-party administrators (TPAs) and financial professionals to better serve clients and grow their retirement plan practices. Capital Group, home of American Funds, can help financial professionals realize those benefits.

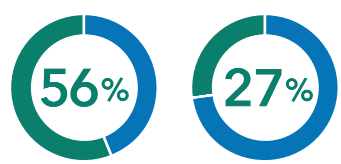
A growth market

The number of cash balance plans has grown:

2021 **24,624** plans → 2022 **25,901** plans

In 2022, cash balance plans accounted for:

56% of the 46,500+ **defined benefit plans**



27% of the more than $80.1 billion in **annual contributions** to defined benefit plans

While **95%** of cash balance **plans** are with employers who have **fewer than 100 employees …**

… **97%** of cash balance **plan assets** are from employers with **100 or more employees**

Sources: *Private Pension Plan Bulletin,* Abstract of 2022 Form 5500 Annual Reports, data extracted on July 8, 2024, U.S. Department of Labor; and 2021 abstract with data extracted on July 26, 2023.

Combine plan types to boost contribution limits

Employers can increase contribution limits by offering a combination of qualified retirement plans.

For example, if a cash balance plan is combined with a 401(k) profit-sharing plan, the annual contributions for a 60-year-old could total more than $406,000 in a single year and could provide the employer with tax savings of more than $182,000, as the highlighted row in the table below indicates.

Age	401(k) only		401(k) with profit-sharing		Cash balance	Total annual contributions	Potential employer tax savings*
60	**$31,000**	or	**$81,250**	**+**	**$325,000**	**$406,250**	**$182,812**
55	31,000	or	77,500	+	255,000	332,500	149,625
50	31,000	or	77,500	+	200,000	277,500	124,875
45	23,500	or	70,000	+	155,000	225,000	101,250
40	23,500	or	70,000	+	120,000	190,000	85,500
35	23,500	or	70,000	+	95,000	165,000	74,250

2025 contribution limits; estimated for cash balance plans. 401(k) limit includes annual catch-up contributions for participants ages 50 or older. Actual results may vary depending on the actual plan design, participant compensation, employee demographics and projected retirement age. Calculations courtesy of Shore Tompkins Actuarial Resources, LLC.

*Based on an assumed tax rate of 45%. Calculation uses "Total annual contributions" excluding 401(k)-only contributions.

Which organizations might benefit from a cash balance plan?

Cash balance plans may best suit organizations with a predictable cash flow and consistent profits. These could include, but aren't limited to:

- Professional groups, including lawyers, doctors, dentists, engineers, architects and accountants
- Family and closely held businesses
- Sole proprietors
- An organization that's already maximizing contribution limits in its current defined contribution plan

Benefits of a cash balance plan

For **employers**, a cash balance plan:

- Is easier for employees to understand, which means they may appreciate it more than a traditional defined benefit plan
- Permits them to contribute either a percentage of pay or a flat-dollar amount
- Can work well in combination with a defined contribution plan
- Makes it easier to boost benefits for owners and other key employees, and to control the cost of benefits for others
- Offers control over investment strategy
- May help eligible business owners take advantage of the qualified business income deduction (QBI) if taxable income is reduced below the phase-out limit.†

For **plan participants**, a cash balance plan:

- Is easier to understand than a traditional defined benefit plan
- Is more portable than a defined benefit plan. Upon separation from service, cash balance accounts can be distributed or rolled over to an IRA or another employer-sponsored plan
- Permits higher contribution limits for key employees and older participants
- Involves little or no investment risk, depending on the plan design

† To qualify for the QBI (up to 20%) in 2025 at least partially, taxable income must be less than $483,900 if married filing jointly and less than $241,950 for all other tax filing statuses.

Sample cash balance allocations

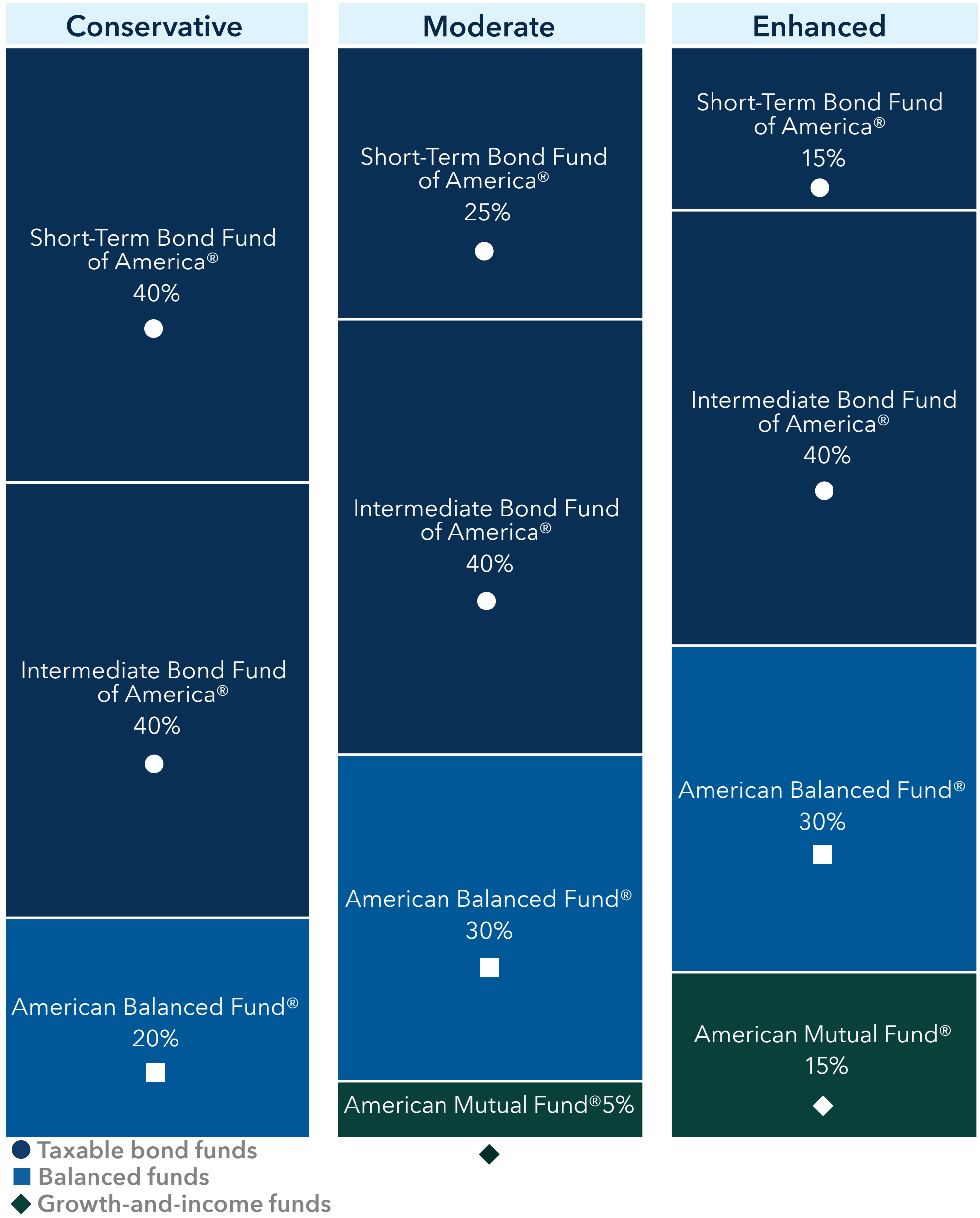
To help build a suitable cash balance investment portfolio, plan fiduciaries may find these sample cash balance allocations useful.

The sample allocations have different levels of risk, but preservation of capital is the primary objective of each sample. Preservation is especially important in a cash balance plan because the sponsor must make up the difference if the actual investment return lags the guaranteed interest-crediting rate.

In all three samples, American Balanced Fund serves as the core foundation, while Short-Term Bond Fund of America and Intermediate Bond Fund of America seek additional capital preservation. American Mutual Fund, only in the Moderate and Enhanced samples, offers more potential income and growth.

Although these samples aim to manage volatility, plan fiduciaries should review portfolio allocation quarterly or semi-annually to ensure the original allocations have not slipped due to market activity.

And even if you will not be serving as a plan fiduciary, you can add value to your relationships by making plan sponsors aware of these samples and helping them build the investment portfolio of their choice.



These portfolios consist of an allocation of funds for investors to consider and are not intended to be investment recommendations. Financial intermediaries may or may not recommend them to clients. The portfolios are hypothetical asset allocations designed for individuals with different time horizons and risk profiles. Allocations may not achieve investment objectives. Please talk to your financial professional for information on other investment alternatives that may be available. In making investment decisions, investors should consider their other assets, income and investments.

Allocations may not achieve portfolio objectives. There are risks and expenses associated with the funds. Investors and their financial professionals should periodically evaluate their investments to determine whether they continue to meet their needs. Diversification does not eliminate the risk of investing; losses are possible in a diversified portfolio. For more information about the risks associated with each fund, refer to the fund's prospectus. For more information about the funds, visit **capitalgroup.com.**

The return of principal for bond portfolios and for portfolios with significant underlying bond holdings is not guaranteed. Investments are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. The use of derivatives involves a variety of risks, which may be different from, or greater than, the risks associated with investing in traditional securities, such as stocks and bonds.

Cash balance plans offer four interest-crediting options

Plan assets in a cash balance plan are pooled and may be invested by an investment manager in one of three safe-harbor options or in an actual-rate-of-return option.

Safe harbor options:

- A 30-year Treasury bond rate, which has ranged from 0.99% to 5.11% over the past five years as of December 31, 2024.
- A fixed rate, which can be no higher than 6%.
- A rate that would credit the greater of a 30-year Treasury yield or a 5% fixed rate.

Actual-rate-of-return option: Sponsors can base the interest-crediting rate on the actual returns of a portfolio, provided it is well-diversified and designed to reduce volatility.

Sponsor obligations: With the safe-harbor options, sponsors are responsible for the difference if the underlying investments, net of expenses, return less than the stated interest-crediting rate.

On the other hand, if actual returns exceed the fixed rate a sponsor has selected, sponsors can apply the excess to reduce future (not increase current) employer contributions.

However, with the actual-rate-of-return option, sponsors must guarantee that each participant's payout can never be less than the *sum of the employer's contributions to the plan*. This is referred to as the "preservation of capital rule."

How we can help support your cash balance plans

- **Extensive plan investment knowledge**
  We have decades of experience as an investment manager for both defined benefit and defined contribution plans.
- **A distinctive investment approach**
  Our objective-based approach to investing makes it easier to help your clients and their participants create portfolios that reflect their goals.
- **An array of investments**
  Our funds – individually or in combination, such as in the sample allocations – could provide a sound foundation for a cash balance plan investment portfolio.
- **Experience working with TPAs**
  We can connect you with a TPA who will help your clients design the right cash balance plan for their needs. 98% of Capital Group retirement plans have a TPA (as of December 31, 2024).
- **Flexible compensation**
  Capital Group offers compensation flexibility to both TPAs and financial professionals through a variety of share classes, and TPAs can receive quarterly sub-TA payments.*

*Sub-TA for cash balance plans is available only when fund assets are held by Capital Group. Please check with your home office.

Let us help you get started

If you'd like to set up a cash balance plan with American Funds as investment options, check with your home office or **call us at (800) 421-9900, option 2.**

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

This content, developed by Capital Group, home of American Funds, should not be used as a primary basis for investment decisions and is not intended to serve as impartial investment or fiduciary advice.

Capital Client Group, Inc.

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