

IRS Issues Final Rules For Cash Balance and Pension Equity Plans

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On September 19, 2014, the IRS published final regulations that affect defined benefit plans that use a lump sum-based benefit formula, including cash balance plans and pension equity plans. These plans are defined benefit plans with defined contribution features that generally express a participant's accrued benefit as the balance of a hypothetical account (a cash balance formula) or as an accumulated percentage of the participant's final average compensation (a pension equity plan or PEP formula).

The final regulations affirm large portions of previously proposed rules and make several technical adjustments to the rules governing these types of plans. Some of the more noteworthy changes include:

- The expansion of permissible PEP formulas to include a benefit formula that is expressed as a percentage of the participant's *highest* average compensation with a permitted lookback period for determining highest average compensation, such as the highest 5 out of the last 10 years.
- With respect to the requirement that interest crediting rates not exceed a market rate of return, the list of permissible interest rates has been expanded to include rates of return based on a subset of plan assets, an increase in the permitted maximum fixed rate from 5% to 6%, an increase in the maximum floor from 4% to 5% for government bond-based rates and the use of segmented rates.
- Protection against cutback rules for changes to the lookback month and stability periods used for interest credits. This protection is subject to a one-year "greater of" rule under which the larger of the two interest credits must be provided.

Due to significant concerns expressed in comments to the proposed regulations, the IRS continues to postpone action on the possibility of allowing interest-crediting rates tied to hypothetical investment options selected by participants.

The final regulations apply to plan years that begin on or after January 1, 2016. Plans that use interest-crediting rates that are impermissible under the final regulations must be amended prior to the first day of the first plan year that begins on or after January 1, 2016. The IRS has concurrently issued proposed regulations dealing with the anti-cutback implications in the event that the new permitted interest crediting rates are more restrictive than existing noncompliant interest crediting rates. Provided that specified requirements are met, the proposed rules would allow

a plan to provide future interest credits on previously accrued benefits using rates that are more restrictive than existing noncompliant rates.

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