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What Plan Sponsors & Their Advisers Need to Know About Strategic Plan Terminations

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Goals & Learning Objectives

Plan sponsors will learn:

1. When and how a strategic plan termination could meet your goals and improve participant outcomes.
2. How to assess pros, cons, costs and considerations versus potential benefits and savings.

Advisers will learn:

1. The roles and responsibilities of an adviser during the strategic plan termination process.
2. How to determine if a prospect is a good candidate and how to open the conversation.

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Agenda

1. Background
2. IRS Regulations & Concerns
3. Case Studies
4. How it Works
5. Conclusions & Suggestions

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Disclaimer

Reminder: This webcast provides general information only and is **not** a substitute for professional advice on the legality of a strategic plan termination for your plan. Please consult with your Kravitz consultant to review your specific case.

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Background: Understanding Strategic Plan Terminations

Understanding Strategic Plan Terminations

Definition

A strategic decision by a firm’s owners/partners to terminate their established, mature Cash Balance or defined benefit retirement plan, followed by distribution of assets and subsequent adoption of a new Cash Balance plan with a different design and/or a different Interest Crediting Rate (ICR).

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5 Reasons Why Companies Consider Strategic Plan Termination

1. **Partners want to transfer current Cash Balance plan assets to 401(k) profit sharing plan and/or IRAs** with the goal of broadening investment options and increasing investment returns.
2. **Retirement committee and/or plan adviser seeking to reduce potential investment risk** for guaranteeing an interest crediting rate (ICR) on large account balances.
3. **Replace a traditional defined benefit plan with a new Cash Balance plan** rather than make the DB to CB transition through a cumbersome, difficult plan conversion process.
4. **Desire to redesign plan** following significant growth of firm and/or a merger or acquisition, changes to partnership structure, and other demographic or design flaw factors.
5. **Retirement committee seeks to change the interest crediting rate (ICR)** to Actual Rate of Return (ARR) or to ARR with multiple investment options, with the goal of reducing risk and widening options for partners at different stages of retirement readiness.

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Immediate Advantages for Plan Sponsors

- ✓ Account balances/lump sum benefits distributed to participants can be taken in the form of annuity, cash or rollover.
- ✓ Firm is released from further interest liability and principal guarantees.
- ✓ 'Blank slate' for innovative and advanced plan design.
- ✓ Under the new plan, firm can conduct a new survey and establish new contribution amounts.
- ✓ In new plan, the firm can change plan provisions and interest crediting rate.
- ✓ Potential cost savings (varies by plan): lower employer contributions, no audit fees, lower administration fees.

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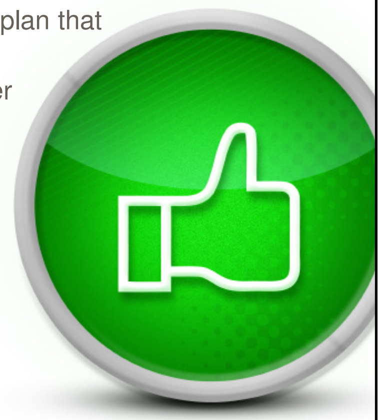
Opportunities for Plan Advisers

- ✓ Differentiate yourself in a competitive market by introducing an innovative option that very few plan sponsors know about.
- ✓ Replace a traditional defined benefit plan or an outdated Cash Balance plan with a new custom designed plan that meets client's business objectives.
- ✓ Opportunity to advise clients on IRA rollover investments, increase 401(k) plan assets under management, and other advisory opportunities.
- ✓ Provide better, more strategic investment advice on a new Cash Balance plan.
- ✓ Reduce overall risk by moving to Actual Rate of Return (ARR).



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Mythbusters!

Common myths about pension plans:

1. You can't replace a traditional defined benefit plan with Cash Balance plan.
2. You can't terminate a pension plan less than 5 or 10 years old.
3. You can't have two pension plans operating at the same time.
4. You can't have a traditional defined benefit plan and a Cash Balance plan in place at the same time.

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IRS Regulations and Concerns

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When is it acceptable to terminate a Cash Balance plan?

- ✓ The IRS has very specific rules and guidelines governing when a firm may terminate an existing qualified plan.
- ✓ If these are perceived to be violated, the IRS could disqualify the new plan and/or prohibit distributions from the old plan.
- ✓ Hence, understanding IRS language is important – we will take a closer look at 3 concepts:
  1. “Permanence”
  2. “Business necessity”
  3. “A few years”

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IRS language and guidelines

"A plan established and maintained by an employer…to provide systematically for the payment of definitely determinable benefits to his employees after retirement. … The term 'plan' implies **a permanent as distinguished from a temporary program.** …The abandonment of the plan **for any reason other than business necessity** within **a few years** after it has taken effect will be evidence that the plan from its inception was not a bona fide program for the exclusive benefit of employees in general."

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What it means in practice

- "A few years" is never defined in the regulations, but the IRS has stated they will not question a plan termination that occurs 10 or more years after initial adoption.
- For plans that have been in existence **less than 10 years**, the new plan adopted after termination should have enough meaningful differences from the old plan to make a case for '**business necessity.**'

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Examples of Business Necessity

- Change of ownership
- Acquisition or merger
- Significant reduction in company's ability to fund a plan

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Key Takeaway

- If the old plan has existed less than 10 years, the new plan **cannot look like a direct continuation of the old plan,** and thus an obvious attempt to access the assets from the old plan. This could result in disqualification and penalties.
- Examples of meaningful differences between old and new plan:
  - Different group of employees covered
  - Change to the interest crediting rate (ICR)
  - Change of ownership

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Case Studies

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Case Study 1: Large Medical Group

Kravitz took over administration of an existing 5-year old Cash Balance plan.

Challenges and concerns:

- ✓ All 200 employees were included, became expensive to manage
- ✓ Fixed-rate ICR of 5% became difficult to maintain in low interest rate era
- ✓ Some senior partners wanted access to assets

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Case Study 1: Large Medical Group

Solution:

- ✓ New plan design included just 50 participants, non-shareholder physicians carved out.
- ✓ New plan used Actual Rate of Return (ARR) instead of 5% fixed rate, reducing most funding issues and simplifying strategy.
- ✓ New plan design demonstrated meaningful differences from prior plan, thus passing IRS scrutiny and receiving a favorable determination letter (FDL).

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Case Study 1: Large Medical Group

Process:

- ✓ Kravitz dedicated plan termination consultant created a 16-month transition strategy.
- ✓ Effective communication with shareholders and staff to explain process and changes.
- ✓ All notification requirements were met in a timely manner.
- ✓ Kravitz Loans & Withdrawals team streamlined process of rollovers, coordinated with multiple 401(k) providers.

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Case Study 1: Medical Group

Results:

- ✓ Time-consuming and expensive audit process eliminated (plans with <100 participants have no audit requirement).
- ✓ Employer contribution costs significantly reduced.
- ✓ Cost of plan termination mitigated by lower administration costs, lower contribution amounts.
- ✓ Client enjoys reduced risk and minimal funding issues with Actual Rate of Return ICR.

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Case Study 2: Large Law Firm

Challenges and concerns:

- ✓ Existing 8-year old plan had to maintain 2 different ICRs due to changes made after the 2010 IRS regulations.
- ✓ Overly complex recordkeeping.
- ✓ Plan had $300M in assets, management wanted to reduce liability on the books, with burdensome fiduciary requirements such as quarterly reporting.
- ✓ Firm recently acquired another smaller law firm and wanted to integrate plan participants.

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Case Study 2: Large Law Firm

Solution:

- ✓ New plan design used Actual Rate of Return (ARR) only, no longer a need to maintain 2 ICRs.
- ✓ New plan integrated all participants of recently acquired firm.
- ✓ Excess assets were transferred to 401(k) plan per a plan resolution.
- ✓ New plan design demonstrated meaningful differences from prior plan, thus passing IRS scrutiny and receiving a favorable determination letter (FDL).

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Case Study 2: Large Law Firm

Process:

- ✓ Kravitz dedicated plan termination consultant created a 20-month transition strategy.
- ✓ Effective communication with shareholders and staff to explain process and changes.
- ✓ Provided assistance with QDROs for divorced participants, and locating missing participants with balances.
- ✓ Kravitz Loans & Withdrawals team streamlined process of rollovers, coordinated with 401(k) provider.

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Case Study 2: Law Firm

Results:

- ✓ Client very happy with simplified new plan and integration of acquired firm's plan participants.
- ✓ Relief from burdensome fiduciary requirements and not having to carry a $300M liability.
- ✓ Many partners/shareholders were able to increase contribution levels.
- ✓ With only 1 ICR in place, administrative costs were reduced and investment management was simplified.

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How it Works: Steps, Timelines & Process

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8 Steps to Strategic Plan Termination & Creating a New Plan

Step 1
Create PBGC Notice of Intent to Terminate and send to all participants as required, minimum of 60 days in advance of plan termination date.

Step 2
Board Action and a plan amendment required to terminate plan and must be signed before plan termination date.

Step 3
Review asset allocation strategy to hedge and reduce fluctuation of plan assets.

Step 4
Plan is submitted to IRS and PBGC for approval. It can take the IRS from 12 to 24 months to issue a determination letter.

**Due to approval delays, it is possible to distribute sooner.*

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8 Steps to Strategic Plan Termination & Creating a New Plan

Step 5
Once approval is received from both agencies, plan assets typically are distributed to participants (taxable, or "rolled over" to IRA or 401(k)/profit sharing plan)*

Step 6
New survey for level of benefits to be provided by company in new plan.

Step 7
New plan design and investment strategy reviewed and approved by committee.

Step 8
New plan adoption and submission to IRS for favorable determination letter.

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Ideal Timing

What is the best timing for plan termination?

We recommend terminating as of the last day of the current plan year, with the new plan starting on the first day of the next plan year.

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Ideal Timing

Due to the length of time it takes to receive an IRS determination letter, you may need to wait 12 -24 months to distribute assets. ***However, waiting for the letter is <u>not</u> always necessary.***

Typically, the new plan is started while the terminated plan continues to exist.

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Plan Year Deadlines

PBGC Covered Plan Waiting for IRS Letter	2018	PBGC Covered Plan NOT waiting for IRS Letter
Distribute PBGC Notice of Intent to Terminate	11/01/2018	Distribute PBGC Notice of Intent to Terminate
Sign Board Resolution terminating the plan	12/31/2018	Sign Board Resolution terminating the plan
	2019	
Complete 2018 PY compliance testing	3/31/2019	Complete 2018 PY compliance testing
Distribute PBGC Notice of Plan Benefits (no election form included)	4/15/2019	Distribute PBGC Notice of Plan Benefits (includes election form)
Mail IRS & PBGC submissions	4/30/2019	Mail IRS & PBGC submissions
	6/15/2019	Collect signed election forms
	6/30/2019	Fund any required or desired contributions
	7/01/2019	Checks are mailed
	9/30/2019	Prepare PBGC Form 501 & final PBGC premium filing once all distributions are confirmed
	10/31/2019	Provide trust account statement confirming $0 balance
	12/31/2019	Complete final Form 5500 filing

PBGC Covered Plan waiting for IRS Letter	2020	PBGC Covered Plan NOT waiting for IRS Letter
Receive IRS Favorable Determination Letter	4/30/2020	
Prepare and distribute election form packages	5/31/2020	
Collect signed election forms	6/30/2020	
Fund any required or desired contributions	6/30/2020	
Checks are mailed	7/15/2020	
Prepare PBGC Form 501 & final PBGC premium filing once all distributions are confirmed	9/30/2020	
Provide trust account statement confirming $0 balance	10/31/2020	
Complete final Form 5500 filing	12/31/2020	

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Potential Challenges and Considerations

- ✓ Cost of purchasing annuities (if requested). Current low interest rate environment makes it expensive to purchase annuities.
- ✓ Due to the cost involved in strategic plan termination, this option works best for midsize to large plans.
- ✓ If plan is covered by PBGC (Pension Benefit Guarantee Corporation), additional filing requirements and rules apply.
- ✓ Costs vary by plan, but can include IRS and PBGC filings, preparing all notices, amendments and benefit calculations, and cost of implementing a new plan.
- ✓ Administrative cost to maintain two plans during overlap period.

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Potential Challenges and Considerations

- ✓ If plan is underfunded, need to fully fund plan before assets are distributed. If plan is overfunded, can use overfunding to pay fees or allocate on a nondiscriminatory basis to all plan participants.
- ✓ Need to collect election forms from all participants including terminated participants.
- ✓ If you wait to distribute assets until IRS approval received, plan assets could not be distributed for up to 18 months.
- ✓ If plan has poor performance, company has to deposit extra tax-deductible contributions to fully fund plan.

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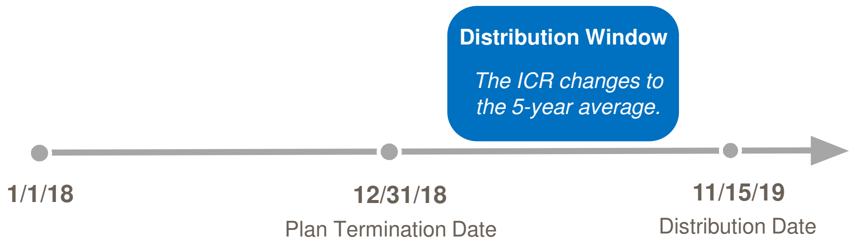
Potential Challenges and Considerations

Note: a different interest rate (ICR) guarantee will be in place during the "distribution window," the period of time *after* the plan termination date but *before* the assets are distributed to plan participants.



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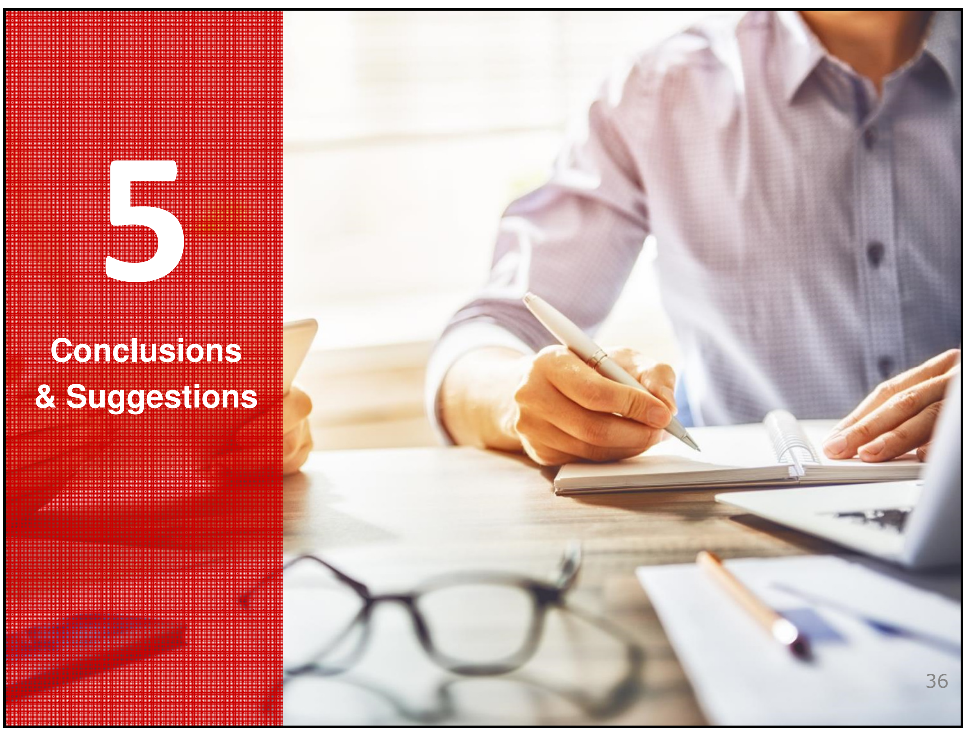

Conclusions

- ✓ For the right client, like our case study firms, strategic plan termination is a game changer!
- ✓ If handled effectively and strategically, you can reduce costs, lower risk, improve participant outcomes, and increase client satisfaction.
- ✓ In all cases, proceed with caution and work with a skilled, experienced TPA partner who has deep knowledge of IRS rules and processes.

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3 Tips for Plan Sponsors

1. Work in partnership with your TPA and plan adviser to assess pros/cons of strategic plan termination based on your plan challenges and goals.
2. Survey partners/shareholders on plan satisfaction.
3. Consistent, timely participant communication is key to a successful process. Create timelines and seek input on the process.

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4 Key Takeaways for Advisers:

1. Most plan sponsors don't know that strategic plan termination is an option. You can use it as a helpful door-opener.
2. Start the conversation by asking questions about client satisfaction with current plan design and investment strategy.
3. Be cautious about promising results. Get help from a trusted TPA partner to review options, costs and timelines so client has a realistic picture.
4. Adding strategic plan termination to your kit of marketing tools will differentiate you from other plan advisers.

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Next Steps to Explore Strategic Plan Termination as an Option:

1. Current Kravitz clients: meet with your Kravitz Consultant to review goals, benefits and potential challenges.
2. Plan sponsors not currently working with Kravitz: reach out to us for a free phone consultation to review options.
3. Advisers: connect with your regional Kravitz Sales Consultant to discuss prospects.

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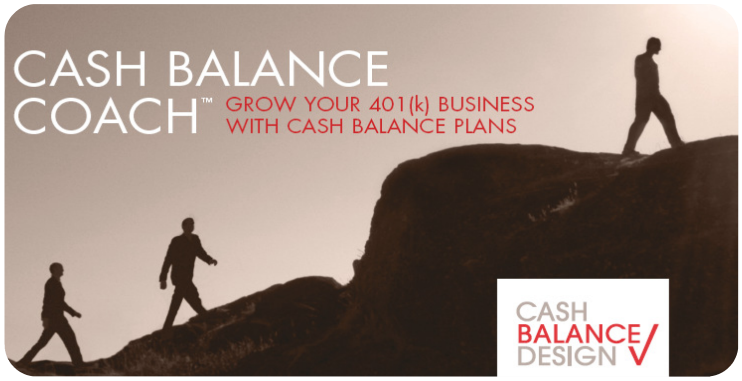
Cash Balance Coach™ Training Program



CashBalanceCoach.com: 1,700 alumni and growing!

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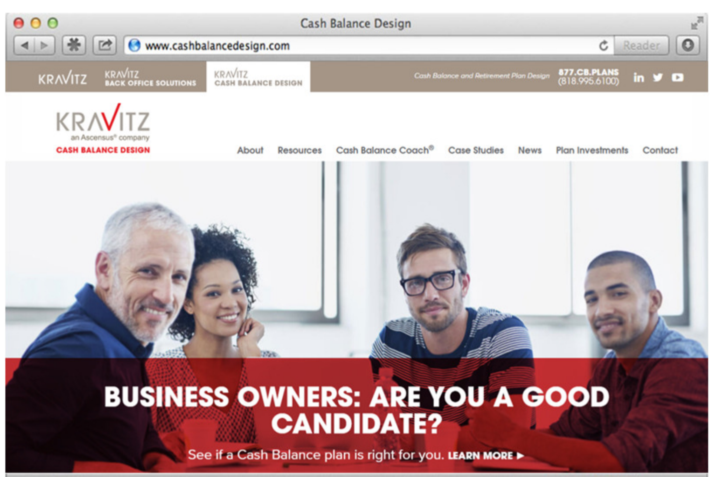
Online Resources: CashBalanceDesign.com 877 CB-Plans



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