

Defined Benefit Plans: Getting Money in Gets All the Attention. Getting It Out Deserves Just as Much.

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For any firm or business owner serious about maximizing tax-deferred retirement accumulation, a defined benefit or cash balance plan deserves a serious look. The contribution capacity is significant, the deductions are immediate, and assets grow tax-deferred at a level no other qualified plan can match. These are exceptional tools, used by small businesses and large professional service organizations alike for very good reason.

The conversation around these plans tends to be heavily front-loaded. Plan design, contribution maximization, compliance testing, and annual administration. That is where the focus lives, and frankly, that is often where the sale is made.

What often gets glossed over is the other side: ensuring that what comes out is just as carefully managed. The funded status, the investment strategy, the rules governing how and when benefits can actually be paid — these determine whether the plan ultimately delivers on what it was designed to do. In many plans, they can end up treated as someone else's problem.

DC vs. DB: Similar Names, Fundamentally Different Obligations

The 401(k) has become synonymous with retirement savings, and for many business owners and professionals, it becomes the frame of reference through which all retirement plan decisions get filtered. When a defined benefit or cash balance plan gets added to the picture, the instinct is sometimes to manage it the same way. Pick an allocation, monitor performance, and rebalance periodically. The name is different but the assumption may be the same: it's a retirement account, and retirement accounts get invested for growth.

That assumption can be costly.

A defined contribution plan caps what goes in. The employer contributes, the employee invests, and the account balance at retirement is the benefit. Investment risk belongs to the employee and there is no fixed obligation the portfolio has to meet.

A defined benefit plan caps what comes out. The employer guarantees a specific, legally defined benefit and carries all of the investment risk. If the portfolio underperforms, the employer makes up the difference. If it

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outperforms, the excess cannot simply be returned. The investment strategy isn't just about growth. It is about funding a defined obligation to specific people on a specific timeline.

The portfolio doesn't just need to perform. It needs to perform in relation to a liability that is growing and changing throughout the life of the plan. Managing that gap is not a year-end task. It is the ongoing job.

The Plans Being Established Today Have a More Defined Finish Line and a Shorter Horizon

Pension Benefit Guaranty Corporation (PBGC)-insured DB plans peaked at over 114,000 in 1985.¹ Roughly 22,200 single-employer plans remain active today.² Large corporate pensions have largely been frozen or transferred, with pension risk transfer activity reaching approximately \$48–\$52 billion in 2022 — a record high.³ Meanwhile, smaller plans have surged. Cash balance plans grew from approximately 17% of all DB plans in 2010 to over 57% by 2022, with plans under 100 participants increasing by 287% over that period.⁴

Two groups are largely driving this growth. Small business owners using these plans as concentrated tax deferral vehicles, and professional service organizations — law firms, medical groups, accounting practices — layering them on top of existing DC plans to create additional accumulation strategies for partners and key personnel who have exhausted what other plan structures can offer.

The objective in both cases: contribute, accumulate tax-deferred, and distribute as a lump sum, typically within five to fifteen years. These are not programs designed to pay retiree benefits for decades.

That shift in objective, from sustaining ongoing benefit payments over decades to accumulating, distributing, and terminating within a defined window, is what raises the stakes on liability management. In the old pension model, excess assets supported a rolling, indefinite obligation with no finish line to overshoot. And while underfunding was never ideal, a plan with decades of future contributions and investment returns ahead had time and some runway to close the gap. In the plans being established today, the objective is different, the horizon is shorter, and there is less runway and limited flexibility to course correct. The liability has to be managed toward a clean and specific end point, and it is moving the entire time.

¹ Pension Benefit Guaranty Corporation, Trends in Defined Benefit Pension Plans, pbgc.gov. The combined number of PBGC-insured single-employer and multiemployer DB plans peaked at 114,400 in 1985.

² Congressional Research Service, Pension Benefit Guaranty Corporation (PBGC): A Primer, IF12951 (updated 2025). In FY2025, the PBGC single-employer program covered 22,200 plans.

³ LIMRA Group Annuity Risk Transfer Sales Survey, as reported by S&P Global Market Intelligence (March 2023) and Aon U.S. Risk Transfer Report (March 2023). The 2022 PRT market totaled approximately \$48.3 billion (LIMRA) to \$51.8 billion (Aon) in single-premium transactions, both representing all-time highs.

⁴ Congressional Research Service, Data on Private Sector Defined Benefit Plans, 2010–2022, IF13065 (July 2025). Analysis based on Department of Labor Form 5500 data. The number of small cash balance plans (fewer than 100 participants) increased by 287.2% between 2010 and 2022; by 2022, cash balance plans outnumbered traditional DB plans.

Because of How These Plans Are Now Operating, These Rules Demand More Attention Than Ever

These plans are now largely lump-sum driven, and there is a set of rules governing whether participants can actually receive their benefit in that form. Many participants don't know these rules exist. Many investment strategies aren't being managed with them in view. Given the shorter horizons, the defined end points, and the finite benefit obligations involved, that gap in awareness carries real consequences.

This is where liability-driven investing becomes relevant. Unlike a traditional investment approach focused on growth and risk-adjusted returns, liability-driven investing manages the portfolio in relation to the plan's specific obligations — who is owed what, when they need it, and under what conditions they can receive it. For a DC plan, the account is the benefit and growth is the objective. For a DB plan, the portfolio exists to meet a defined, calculable obligation. Those are different jobs, and managing them the same way is where plans quietly get into trouble.

Who is leaving, when, and can the plan pay them

Throughout the life of a DB plan, the liability is not static. Benefits are accruing, participants are aging toward distribution events, interest rates are moving, and funding obligations are shifting in response. An investment strategy that isn't malleable, actively managed and calibrated to that moving target at every stage isn't managing the plan. It is managing a portfolio that happens to sit inside one.

DB plan assets are pooled. A partner retiring at 65, a physician departing on severance, and a key employee requesting an in-service distribution at 59½ all draw from the same pool with different timelines and triggers. The portfolio has to be managed against that full cash flow picture, not just a single termination date.

The plan's Adjusted Funding Target Attainment Percentage, or AFTAP, is a measurement of the plan's funded status per requirements of the Employee Retirement Income Security Act of 1974 (ERISA). It determines whether participants can access their benefit at all. When the AFTAP falls below 80%, lump sum distributions become restricted and benefit-increasing amendments are prohibited. Below 60%, lump sums are likely prohibited entirely and future benefit accruals must freeze.

For the top 25 highest-paid highly compensated employees, there is an additional layer. Under Treasury Regulation §1.401(a)(4)-5, lump sum cannot be distributed to any of them unless the plan is at least 110% funded after that distribution. A plan at 105% funded when a senior partner requests their benefit means that partner may need to wait, receive a partial lump sum or an annuity instead. That outcome is a direct consequence of a funded status that wasn't actively managed against a known distribution event.

Interest rate sensitivity

Traditional DB plans carry a dynamic that most cash balance plans do not. Because the benefit is expressed as the present value of future annuity payments, that value (i.e., liability) moves with interest rates. When rates fall, that liability rises and funded status can deteriorate without any change in portfolio performance. Conversely when rates rise, a plan that may have been slightly underfunded may now be significantly overfunded. Managing the portfolio and being malleable to these changes is what defines whether the plan has a smooth exit strategy.

Underfunding can create contribution and balance sheet pressure that may compound at the worst possible time

ERISA requires the plan to fund both the current year's benefit accrual and any existing shortfall, and that funding is mandatory regardless of where the business is financially. When funded status falls, the required contribution covers both, often substantially more than anticipated. A market downturn doesn't reduce the plan's obligations, it increases what must be contributed at exactly the time the business may be least positioned to absorb it.

For businesses that borrow, an underfunded DB plan is also reported as a liability on the company's balance sheet under ASC 715. That pension liability is visible to lenders and can affect debt covenants and borrowing capacity in ways sponsors may not have considered when the plan was established.

Overfunding at termination

The primary purpose of most plans established today is current income tax deferral. But the maximum benefit one can receive is capped under IRC Section 415. When plan assets grow, through contributions, investment gains, or both, beyond what is needed to fund that maximum benefit, the plan is overfunded. At termination, that surplus cannot simply be returned.

If solutions aren't identified while there is still time to act, the cost can be severe. Excess assets returned to the employer face a 50% federal excise tax, reducible only under specific conditions such as directing the surplus to a replacement DC plan or toward retiree health benefits. Combined with ordinary income tax, the effective cost can reach 70 to 90 cents on the dollar. The deductions built over years of contributions can be largely recaptured on the way out, not because the plan failed, but because the gap between what it held and what it was obligated to pay wasn't being managed while there was still time to address it.

Conclusion

Investment performance and liability management are never guaranteed and not every risk can be eliminated. But the risks described here share a common origin: a plan that received careful attention at the front end and insufficient attention to liability management throughout its life.

The actuary and the investment advisor each play essential roles. When those two conversations happen in isolation, without a shared view of distribution obligations, funding thresholds, and the plan's intended end point, the gaps between them are where these outcomes can take hold. Managing what comes out of a defined benefit plan requires the same ongoing discipline that went into building it. In many plans, that is the piece that can go missing.