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# **Funding Issues and Opportunities for Winding Down or Terminating Your DB Plan**

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*42<sup>nd</sup> Annual Retirement and Benefits Seminar*

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# Today's Agenda – April 26, 2013

- Issues Facing Plan Sponsors – *Volatile Funding/Increased Risk*
- De-Risk Pension Liabilities – *Eliminate, Minimize, or Manage*
- Pension Risk Management – *Liability Driven Investing (“LDI”)*
- Frozen Pension Plans – *Actions You Should Take Now*

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**Issues Facing Plan Sponsors Today**  
*Volatile Funding/Increased Risk*

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# Funding and Financial Accounting (DB Plans)

- Pension Protection Act of 2006
  - New minimum funding requirements
  - Accelerates contribution requirements for “at risk” plans
  - Limits benefit increases and accruals for “underfunded” plans
  - Changes interest rate calculation for lump sum distributions
  
- FASB 158
  - The over funded / underfunded status of a DB plan must be recorded as an asset / liability on the company’s balance sheet
  - The funded status of a DB plan must be measured as of a company’s reporting date

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# Increased Volatility/Risks

- Great Recession (2007 to 2009)
  - Plummeted plan assets
  - Decreased “funding ratio” of plans
  - Increase plan funding requirements
  
- Declining Interest Rates (past decade)
  - Increase plan liabilities
  - Increase plan funding requirements
  
- Risks (impact assets and liability decisions)
  - Interest Rates – Future unknown
  - Inflation
  - Increasing Mortality

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**De-Risk Pension Liabilities**  
*Eliminate, Minimize, or Manage*

# De-risking Strategies/Options

- Eliminate
  - Freeze benefit accruals
  - “Buy Out” liabilities via annuity
  - “Cash Out” liabilities via lump sum offering (terminated and/or retirees)
  - 2012 Examples: Ford, GM, and Verizon
- Minimize
  - Reduce future benefit accruals
    - Ratchet down current “final pay” benefits
    - Convert to “cash balance” plan design
  - “Buy In” retiree liabilities via annuity
- Manage
  - Target “endgame”
  - Align Risk and Returns

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**Pension Risk Management**  
*Liability Driven Investing (“LDI”)*



# LDI Framework

- Step 1: Initial Analysis
  - Conduct ALM Study – Stochastic projections of assets, liabilities, plan metrics
  - Compute current “hedge ratio”
  - Evaluate plan sponsor “risk tolerances”
  - Establish “endgame”
- Step 2: Develop Strategic Plan
  - Determine “risk budget”
  - Develop “glidepath” – balance between return-seeking assets and liability-hedging assets
  - Establish “trigger points” – decisions for de-risking/re-risking
- Step 3: Evaluate Investment Options/Benchmarks
  - Liability-Hedging Assets – Longer duration bonds, overlays, pooled investment, SMAs, other
  - Benchmarks – customize, third party LDI indices

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## LDI “Framework” (cont.)

- Step 4: Implement LDI Investment Strategy
  - Change asset allocation to “starting point” of glidepath
  - Timing considerations
- Step 5: On-going Monitoring/Reporting
  - Shifting assets per “trigger” points in glidepath
  - Monitor “risk budget” frequently e.g. daily, weekly, monthly
  - Periodic stochastic forecasting – asset and liabilities
  - Detailed reporting capability

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**Frozen Pension Plans**  
*Actions You Should Take Now*

# Frozen Plans – Actions to Take Now

- Procure “Preliminary” Terminal Annuity Bids
  - Thorough review of plan/prepare RFP/Issue to Annuity Carriers
  - Identify any past data issues/benefit computation errors
  - Correct operational errors
  - Periodically obtain “market value” of liabilities
- Evaluate Cost of Maintaining Plan vs. Termination
  - Fees – Actuarial, Administration, Audit, Trustee, Investment Management
  - Senior management absorption of time
  - Funding requirements to terminate and accounting treatment
- Draft Action Items (understand process and timing)
  - Plan design considerations BEFORE you terminate
  - IRS/PBGC Filings – Deadlines and Timeframes
  - Participant Notices/Elections
  - Annuity Procurement
  - Internal and External Resources

# Questions?

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