CLIENT CASE STUDY

PLAN TERMINATON

Russell Investments

$450M CORPORATE PENSION PLAN PURSUES COST-EFFECTIVE RISK TRANSFER AND PARTIAL PLAN TERMINATION STRATEGY

The organization

A wood products company with a frozen corporate pension plan with an estimated $450 million liability supporting over 4,000 employees and retirees. The plan is overseen by the retirement committee of the company, including executive leadership from the strategy, finance and human resource teams. The plan has been in existence since 1964.

The challenge

The last decade has been tough for pension plan sponsors. Many had hoped market returns would improve their funded status while limiting their cash contributions to the plan. While equity market returns were strong, the interest rate used to value liabilities continued to fall, causing pension liabilities to grow at an average annual rate of 7% to 8% throughout the decade. Russell Investments had the good fortune to work with a plan sponsor that navigated the decade well through a combination of equity market returns, effective interest rate risk management and funding decisions. The plan sponsor hedged out some of the interest rate risk through its Liability Driven Investing (LDI) program and made regular contributions to improve its accounting funded status to above 90%. This led the plan sponsor to analyze the steps that could be taken to reduce the burden of the plan on the organization. Importantly, the plan sponsor wanted to consider both the financial burden (e.g., incremental cash contributions) and administrative (e.g., actuarial work and HR / finance staff time) costs of risk transfer options.

The solution

Russell investments began the process of assessing risk transfer costs. We started with a review of the plan liability profile and the plan design to get a sense for how the liability structure would likely impact the range of costs to terminate the plan. In our analysis (see Exhibit 1), we found that to reach full funding, it would require a cash contribution of $46 million. In addition, to reach a funded status level where full plan termination became viable, additional cash contributions of $20 million to $70 million would be required. While the organization did have some cash on hand to contribute, the plan sponsor determined it did not have enough cash on hand to fund up and completely terminate the plan.

Goal

Review risk transfer options that were effective and efficient both in terms of financial costs as well as the administrative burden.

Exhibit 1: Overview of plan termination pricing[1]

POPULATION	PREMIUM VS. ACCOUNTING		ESTIMATED ACCOUNTING LIABILITY ($M)	TERMINATION COST	
	LUMP SUM	ANNUITY PURCHASE		LOW ESTIMATE	HIGH ESTIMATE
Active	-5% to +5%	+15% to +30%	$149	161	187
Terminated Vested	-5% to +5%	+10% to +25%	41	43	50
Retired	N/A	+0% to +15%	264	269	290
		Total	**454**	**473**	**527**
Estimated premium (%) over accounting liabilities				+4%	+16%
Year-end assets			408	408	408
Contributions needed to fully fund the shortfall			**46**	**65**	**119**

With full plan termination off the table, Russell Investments then analyzed plan provisions to see how the organization's benefit structures might make it attractive to purchase annuities for a sub-set of its plan population. We found that their retiree benefit forms were straightforward, and their employee population had demographic attributes that might make them inexpensive to annuitize. At this point, the plan sponsor reached out to an insurer to solicit a bid on their retiree population to confirm the cost of this potential strategy. The plan sponsor found it would be able to purchase $277 million in annuities for retirees, which would remove over 40% of the plan's liability at a small premium. This was an attractive tradeoff to the plan sponsor, and it wanted to consider moving ahead with an annuity purchase for all current plan retirees. However, before moving forward, we worked with the plan sponsor to evaluate the post-risk transfer funded status impact.

The plan sponsor's objective was to maintain the plan's funded status at a level of 90% or greater following the retiree population annuitization. Russell Investments was able to demonstrate that if the plan sponsor contributed approximately $20 million to the plan, it would achieve this result while dramatically reducing the magnitude and volatility impact of the pension plan on the overall organization.

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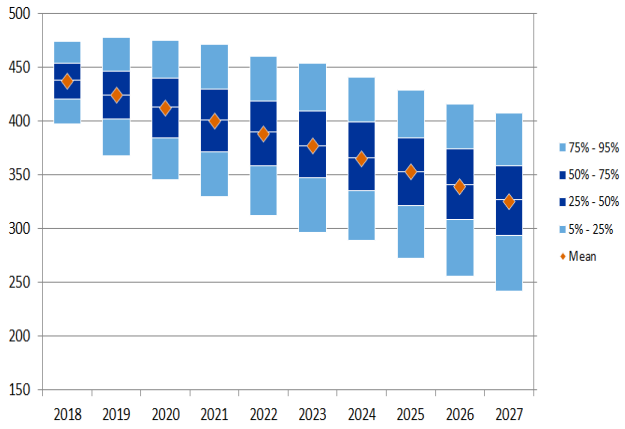
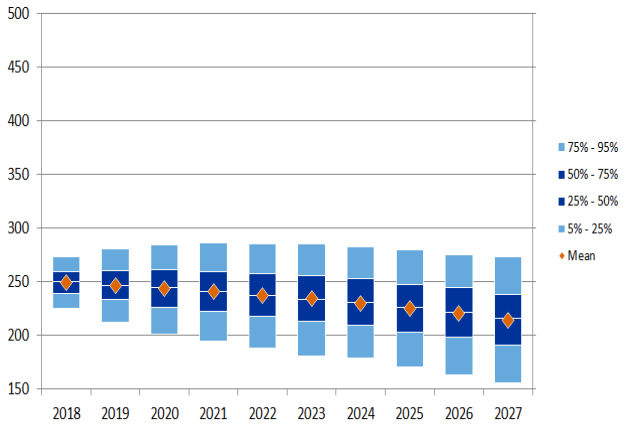
Exhibit 2: Evolution of plan liability[2]

Current plan liability

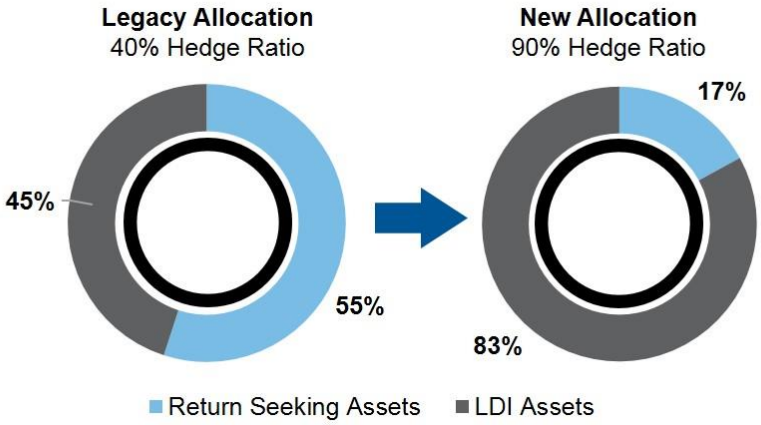


Post-annuitization liability



Once we completed the funding analysis, we began evaluating the investment strategy for the remaining portion of the portfolio. With plan funded status over 90% we modified the plan's existing LDI strategy and put in place an updated asset allocation that increased the liability driven bond allocation and hedge ratio. Return seeking assets (equities and alternatives) were reduced from 55% to 17%, while the LDI allocation was increased from 45% to 83%. In addition, the duration of the plan's liability, after the removal of the plan's retiree population, increased by over four years. To increase the hedge ratio, we employed Treasury STRIPs to increase the plan's hedge ratio from 40% to over 90%. This revised LDI strategy allowed the plan to effectively hibernate by focusing the bulk of the remaining portfolio on hedging liabilities while waiting for the non-retired population to move into retirement when the additional cost of purchasing annuities is expected to become significantly lower.

Exhibit 3: Evolution of plan's asset allocation[3]



Results

The partial plan termination and revised investment strategy allowed the plan sponsor to:

- Remove over 40% of the plan's liabilities in a cost-effective manner with limited impact to the company's financials.
- Implement a revised LDI strategy for the hibernated plan that focused the bulk of the remaining portfolio on hedging liabilities. This strategy allowed the plan sponsor to wait to purchase additional annuities until the non-retired population moves into retirement. This approach allowed the plan sponsor to efficiently manage the overall cost of plan termination.
- Maintain a funded status in excess of 90%.
- Decrease the financial and administrative burden of the plan on the organization.

Since the partial plan risk transfer, Russell Investments continues to assist the plan sponsor in the ongoing modeling of the liability and LDI strategy to ensure that the plan's asset allocation is limiting the firm's exposure to funded status volatility. In addition, as the portion of the new retiree population grows over time, Russell Investments continues to work with the plan sponsor to assess the financial impacts of purchasing annuities and transferring portions of the plan's liability to an insurer in a cost-effective manner.

QUESTIONS?

Call Russell Investments at **855-771-2966**
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[1] Source: Russell Investments. Ranges shown are intended to be indicative of the ranges that may be offered to an average pension plan population. Actual results will depend on actual plan provisions and demographics and may be higher or lower than the amounts shown here. Assets and estimated liabilities are as of December 31, 2016 and based on cash flows provided by the plan actuary. An insurance company or annuity pricing consultant should be contacted for actual pricing.
[2] Source: Russell Investments. Exhibit 2 is calculated using the study input and assumptions outlined in this report. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.
[3] Source: Russell Investments

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