Lump Sum Payments for Terminated Vested Participants

2012 Retirement Webinar Series

March 8, 2012
Lump Sum Payments for Terminated Vested Participants

Today’s Participants

- Joe McDonald
  Aon Hewitt

- Byron Beebe
  Aon Hewitt

- Joy Ferguson
  Aon Hewitt

- Alan Bradford
  Baptist Health System

Agenda:

- Hot Topics in Pension Risk Management
- Considerations for Lump Sum Cash Out
- The Baptist Health System Story
Hot Topics in Pension Risk Management
Five Key Trends for 2012

1. Employer confidence plummets, but still want to help employees achieve success

2. Improving results through tools like advisory services and income solutions

3. Review of funds and fees in defined contribution plans

4. Focus on managing risk in defined benefit pension plans

5. Reduced retiree medical subsidies and new efforts toward cost management

Survey:
2012 Hot Topics in Retirement

About the survey
Views of 501 employers representing more than 12 million employees
<table>
<thead>
<tr>
<th>Type of Risk</th>
<th>Priority</th>
<th>Confidence</th>
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<tbody>
<tr>
<td>Investment</td>
<td>1</td>
<td>7</td>
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<tr>
<td>Interest Rate</td>
<td>2</td>
<td>3</td>
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<td>Compliance</td>
<td>3</td>
<td>9</td>
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<tr>
<td>Fiduciary</td>
<td>4</td>
<td>8</td>
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<tr>
<td>Diversification</td>
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<td>6</td>
</tr>
<tr>
<td>Litigation</td>
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<td>5</td>
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<tr>
<td>Plan Design</td>
<td>7</td>
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<tr>
<td>Demographic</td>
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<td>2</td>
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<tr>
<td>Longevity</td>
<td>9</td>
<td>1</td>
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</tbody>
</table>

**Perspectives on Risk—Confidence and Priority**

1. High Priority
2. Low Priority
3. High Confidence
4. Low Confidence
Lifecycle of a Pension Plan

Liabilities
- Open
- Closed
- Frozen

Assets
- Equity-Focus
- Glidepath
- Fully Funded

Termination
Managing Liabilities—Trends

Prevalence of Defined Benefit Plans

**1995**
- Open: 80%
- No Plan: 20%

**2011**
- Open: 31%
- Closed: 20%
- Frozen: 16%
- No Plan: 33%

*Source: Aon Hewitt review of Fortune 500 data*
## Defined Benefit Plan Activity
### Among Fortune 500 Organizations

<table>
<thead>
<tr>
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<tr>
<td>Close</td>
<td>8</td>
<td>6</td>
<td>8</td>
<td>12</td>
<td>7</td>
<td>7</td>
<td>7</td>
<td>5</td>
<td>0</td>
<td>1</td>
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<tr>
<td>Freeze</td>
<td>28</td>
<td>6</td>
<td>7</td>
<td>15</td>
<td>12</td>
<td>7</td>
<td>19</td>
<td>6</td>
<td>5</td>
<td>2</td>
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<tr>
<td>Terminate</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Organizations With Defined Benefit Plans</td>
<td>294</td>
<td>320</td>
<td>315</td>
<td>303</td>
<td>309</td>
<td>314</td>
<td>302</td>
<td>317</td>
<td>323</td>
<td>325</td>
</tr>
<tr>
<td>Total Organizations With Ongoing Defined Benefit Plans</td>
<td>333</td>
<td>333</td>
<td>332</td>
<td>330</td>
<td>330</td>
<td>328</td>
<td>328</td>
<td>328</td>
<td>328</td>
<td>328</td>
</tr>
</tbody>
</table>

<sup>1</sup> Through February 29, 2012. Based on publicly available information.

<sup>2</sup> Companies are counted in the year of their most recent change. For example, a company that closed in 2004 and froze in 2009 would be counted under 2009 only.
### Expected Changes to Defined Benefit Plans in 2012

<table>
<thead>
<tr>
<th>Change to Other Plan Design</th>
<th>Very Likely</th>
<th>Somewhat Likely</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change to other plan design</td>
<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Plan Design Change</th>
<th>Very Likely</th>
<th>Somewhat Likely</th>
</tr>
</thead>
<tbody>
<tr>
<td>Close participation</td>
<td>10%</td>
<td>8%</td>
</tr>
<tr>
<td>Freeze the plan</td>
<td>5%</td>
<td>12%</td>
</tr>
<tr>
<td>Reduce benefits</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>If offering traditional change to hybrid</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Extend participation to new hires</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>Terminate the plan</td>
<td>1%</td>
<td>3%</td>
</tr>
</tbody>
</table>

80% of plan sponsors with open plans were not expecting to make changes.
Managing Assets—Trends

Likely Plan Sponsor Actions in 2012

- **Conduct Asset-Liability Study**: 54%
- **Adjust asset allocation**: 58%
- **Align with liability characteristics**: 49%
- **Contribute more than IRS minimum**: 42%
- **Change to Mark-to-Market Accounting**: 11%

**Note**: Percentages shown include sponsors answering very likely or somewhat likely.

Additional options:
- **Equity-Focus**
- **Glidepath**
- **Fully Funded**
Settlement Strategies—Trends

Likely Plan Sponsor Actions for 2012

- Offer LS to TVs: 35%
- Add or liberalize lump-sum option: 19%
- Purchase annuities for retirees: 6%
- Transfer plan to another party: 6%

Note: Percentages shown include sponsors answering very likely or somewhat likely.
Considerations for a Lump Sum Cash Out
The Opportunity to Offer Lump Sum Cash Outs

The Pension Protection Act

- Changed the basis for minimum lump sum payments from pension plans
- New basis is fully phased in for 2012

**Opportunity:** Offer single sum payments to terminated vested employees without generating actuarial losses to the plan
Why Consider a Lump Sum?

- Offers participants choice and access to benefits earlier
- Limits future risk exposure
- Reduces PBGC premiums
- Reduces ongoing administrative costs
- Settles obligations at value close to actuarial liability
- Reduced administration in future plan termination
# Decision Points

<table>
<thead>
<tr>
<th>Program Design</th>
<th>Financial Implications</th>
<th>Administrative Concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Eligibility</td>
<td>- Settlement accounting triggers</td>
<td></td>
</tr>
<tr>
<td>- Window or permanent</td>
<td>- Review interest rate environment</td>
<td></td>
</tr>
<tr>
<td>- Maximum lump sum or benefit amount threshold</td>
<td>- Determine plan asset liquidity needs and sources of funds</td>
<td></td>
</tr>
<tr>
<td>- Nondiscrimination Test</td>
<td>- Monitor funding levels (e.g., 80% threshold)</td>
<td></td>
</tr>
<tr>
<td>- Concerns (fiduciary, legal, employee relations) related to those not offered the lump sum</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Accuracy of the data</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Ability to find inactive participants</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Review any restrictions on making pension plan amendment</td>
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</tbody>
</table>
Taking the Plunge

Need a project plan to address all aspects of the project

Financial Analysis
Investment Strategy
Design & Compliance
Communication Strategy
Administration
The Baptist Health System Story
About Us…

- One of the largest health care systems in Alabama
  - Four hospitals
  - 4,300 employees
  - Over 1,000 licensed beds
- Not-for-profit, 501(c) corporation
- Founded in Birmingham in 1922 by a group of Baptist congregations
Where We Started…

- Froze defined benefit pension plan on December 31, 2005
- As a non-electing “Church” plan, not subject to the same rules as ERISA plans
- Pension plan was underfunded primarily due to asset and interest rate experience over recent years
- Predominantly an inactive population:

![Pie chart showing the status of pension plan participants: 2,226 active, 2,668 inactive deferred, and 1,673 in pay status. 40% of total is inactive.](image)
## What We Wanted to Do…

<table>
<thead>
<tr>
<th>For Baptist</th>
<th>For the Participant</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Initiate a 10-year glidepath toward plan termination</td>
<td>▪ For the former employees with deferred benefits</td>
</tr>
<tr>
<td>▪ Reduce financial risk exposure of plan</td>
<td>– Create option not currently available</td>
</tr>
<tr>
<td>– Remove plan obligations at a lower “price” than currently recorded on</td>
<td>– Gain access to pension benefits earlier than anticipated</td>
</tr>
<tr>
<td>books due to interest rate difference</td>
<td>– Give control of retirement funds</td>
</tr>
<tr>
<td>– Decrease plan’s sensitivity to market interest rate changes</td>
<td></td>
</tr>
<tr>
<td>– Reduce plan deficit which decreases future pension expense and future</td>
<td></td>
</tr>
<tr>
<td>funding requirements</td>
<td></td>
</tr>
<tr>
<td>▪ Reduce plan’s administration costs</td>
<td></td>
</tr>
<tr>
<td>– Decrease number of participants with future pension benefits</td>
<td></td>
</tr>
</tbody>
</table>

**SOLUTION:** Offer a lump sum payment to inactive participants
About the Lump Sum Window…

**Limited timeframe:** 45-day election period *(10/1/2011–11/15/2011)*

**Lump sum:** Offered at 7.5% interest due to Church plan status

**Eligible participants:** Select group:
- Terminated vested participants
- Lump sum values up to $35,000
- About 50% of terminated vested population

<table>
<thead>
<tr>
<th>Eligible</th>
<th>Not Eligible</th>
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<tbody>
<tr>
<td>1,328</td>
<td>1,340</td>
</tr>
</tbody>
</table>

**About the Eligible Population**

- **Average age:** 52
- **Average accrued benefit:** $375/mo.
- **Average lump sum:** $16,500
Getting Ready…

9 month process…

Data
- Locate participants
- Confirm addresses
- Early mailing requesting key information (address, email, phone number, date of birth)
- Validate census data for benefit calculations

Start address search and data validation early!

Calculations
- Calculate benefits
- Finalize eligible group

Calculations much simpler if accrued benefits for terminated vested population finalized

Communications
- Develop strategy
- Draft communications
- Focus group testing
- Final approvals (board & legal)
- Call center set-up
  - Processes
  - Q&A development

Ongoing throughout process…
A Thoughtful Outreach to Participants…

<table>
<thead>
<tr>
<th>Earlier</th>
<th>Mid-September</th>
<th>Late-September</th>
<th>Mid-October</th>
<th>Late-October</th>
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</thead>
</table>
| **Focus Groups**  
(test messages) | **Announcement**  
(flyer, sent to eligible participants) | **Election Package**  
(cover letter, guide) | **Reminder 1**  
(flyer) | **Reminder 2**  
(postcard) |
| **Call Center Training**  
(expected questions) | | **Modeling Tool** | | |

And… email / phone call reminders in late-October through early-November
Got Participants to Pay Attention…

- **78%** of located participants **made active election** (even if choosing annuity)
- **53%** of located participants **elected a lump-sum payment**

- **~1,450** number of in-bound **calls to the call center**
And the Results Showed!

- **$10.6** million paid out in **lump sums**
- **$18.5** million released in **obligations**\(^1\)
- **$7.9** million decrease in **funded deficit** \(^2\)

\(^1\) Obligations measured at 5% (market rate at 12/31/2011)

\(^2\) Savings due to lump sum interest rate of 7.5%, allowed due to Baptist’s Church plan status
Lessons Learned…

<table>
<thead>
<tr>
<th>Preparation is key</th>
<th>Data, data, data…</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Create detailed project plans for each phase</td>
<td>- Finalize benefits for all terminated vesteds <em>(even if not ready for a lump sum window now)</em></td>
</tr>
<tr>
<td>- Invest time up-front on all aspects (communications, legal, financial, administrative)</td>
<td>- Locate participants</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Communication strategy matters</th>
<th>Effective partnership is critical</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Consider a comprehensive strategy to optimize results</td>
<td>- Engage trusted partners (internal and/or external, as appropriate)</td>
</tr>
</tbody>
</table>
Summary
## 2012 Retirement Webinar Series

<table>
<thead>
<tr>
<th>Date</th>
<th>Topic</th>
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<tbody>
<tr>
<td>March 8</td>
<td>Lump Sum Cash Outs</td>
</tr>
<tr>
<td>March 22</td>
<td>Mark-to-Market Accounting</td>
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<tr>
<td>April 19</td>
<td>Total Rewards Optimization and Delivery</td>
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<tr>
<td>May 3</td>
<td>Diversity: Disparity in Savings and Driving Solutions</td>
</tr>
<tr>
<td>May 24</td>
<td>Retirement Income Adequacy</td>
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</table>
Your Questions
Thank you.

For additional information, please contact:

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Joe.McDonald@AonHewitt.com