CASE STUDY

De-risking a Pension Plan via Terminated Vested Lump Sum Program

"Our Hospital's transition from a traditional DB Plan to a matching 401(k) Plan went very smoothly. The guidance and expertise provided by Cowden Associates, Inc. were critical factors behind our success."

- Hospital, President/CEO

Issue

A large not-for-profit healthcare organization was looking to freeze its defined benefit pension program as pension costs were increasing. The plan also had a large and growing number of terminated vested participants, and the HR department was having a harder and harder time keeping track of these participants. Annual funding notices were being returned as undeliverable and follow-up steps to locate these participants entailed the use of locator services, which added to the expense of the plan. In addition, PBGC premiums were increasing year over year. With interest rates changing annually, the pension liability on the hospital's financial statements had become very volatile.

Solution

As part of Cowden's full-service retirement and actuarial services, we helped the hospital to understand that a plan freeze is the first step in ultimately terminating the plan. To incrementally defease the plan over time (since the plan was too underfunded to immediately terminate), a plan was presented to management to offer a lump sum payment to the terminated vested participants in lieu of them receiving a monthly benefit many years down the road. This would accomplish the following:

- Reduce overall plan liabilities
    - o Lower plan financial risk exposure; lowers volatility on balance sheet
- Reduce PBGC premiums
- Reduce ongoing administrative costs and plan administration
- While annual cash contributions would increase slightly, the ASC 715 pension liability could be $500,000 less after the program. This was important for loan covenant purposes.

A timeline was also presented to make sure the program was completed by the end of the hospital's fiscal year. In conjunction with input from the hospital, Cowden prepared the communication materials to allow the participants to make an informed decision on whether to accept the program.

Result

As a result of the program, 80% of the terminated vested participants responded to the offer. 75% accepted the offer, 3% actually began their monthly benefits and 2% declined the offer. 20% were never heard from.

The financial impact of the program showed that the ASC 715 pension liability improved by $400,000 at the end of the fiscal year. Annual cash contributions increased by $50,000, but this was partially offset by annual PBGC savings of $10,000 (which would have continued to increase in future years). In addition, HR administration services for this group was greatly diminished. Overall, the hospital was very pleased with the outcome of this program.

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Cowden Associates, Inc.
Four Gateway Center ♦ 444 Liberty Avenue ♦ Suite 605 ♦ Pittsburgh, PA 15222
412.208.0482 ♦ 1.888.889.9432 ♦ www.cowdenassociates.com

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