Case study

Implementing a streamlined end-to-end plan termination strategy

Client Profile

A client of the Principal Financial Group®, this not-for-profit organization is an independent healthcare provider located in the Midwest. The organization had over 600 participants in a hard-frozen defined benefit (DB) plan.

The challenge

- **A frozen DB plan with no termination strategy in place:**
  - With no termination strategy in place 13 years after freezing their DB plan, participants' benefits were potentially at risk and the organization was left with the continued cost and risks associated with DB plans.
  - Because of the static asset allocation that was in place, the asset allocation didn't change as interest rates increased or decreased, nor as the assets neared fully funded status.
- **Market volatility reduced funded status:**
  - As a result of not having a termination strategy in place, the organization had a drop from nearly 100 percent funded to only 72 percent in funded status during a volatile economic market.
- **Limited expertise also drove the need for a plan termination strategy:**
  - One of the organization's board members had a great deal of DB plan expertise, but would soon be leaving the position.

Principal® solutions

Working together, the organization's financial professional and Principal® designed a "road map" to terminate the plan. One significant change they recommended was switching from a static asset allocation to Dynamic Asset Allocation (DAA), which adjusts the asset allocation to a more conservative mix as the plan's funded status improves, interest rates increase, or both. It also helps to fully fund the plan and prevent significant losses in funded status, which the organization had previously experienced. Other recommendations included:

- Implementing a quarterly funded status tracking report to help the organization and their financial professional evaluate when to make changes to the plan's asset allocation. This also helped the organization keep track of how close the plan was to termination.

Switching to DAA closed the funding gap by $1.5 million — even with a shortened plan termination timeframe.

- Relying on Principal's expertise and experience of consulting on an average of 30 plan terminations a year to develop an accelerated termination timeline.[1] Identification of steps that could be shortened or omitted were recommended based on the client's preparedness and comfort level with the risk of those changes.
- Purchasing an annuity for retirees to take advantage of the favorable interest rate environment prior to terminating the plan, removing this portion of the liability from the plan. This would remove the risk that the liability for this group of individuals would increase if interest rates decreased at the time of the plan's final risk transfer.

The results

Working in collaboration with their financial professional, Principal was able to help identify and execute a streamlined plan termination strategy, allowing the organization to:

Prevent further deterioration of their funded status. Switching to DAA helped increase the organization's funded status to nearly 80 percent. This closed the funding gap by $1.5 million, providing savings to the organization and reducing the final contribution they would need to make at termination.

Shorten the final termination process. The average final plan termination process takes 12-24 months. Consultation from Principal helped the organization develop an accelerated termination timeline. Because of this consultation, the organization was able to complete the termination in just six months (from notice to final distribution) and prior to the board member's departure.

Settle the liabilities for the plan's retirees prior to termination. Taking advantage of the favorable interest rate environment, the organization purchased an annuity to settle the liabilities for the plan's retirees prior to termination. If the organization had waited to purchase the annuity until the final risk transfer, their liabilities for the retirees could have increased by approximately $62,000 since interest rates had decreased.

[1] As of 12/31/16