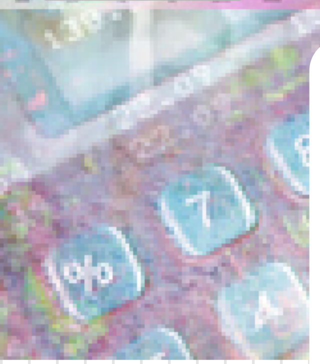
QAS Case Study #4 - Misstatement of Liability



Concept: The Unique Nature of Complex Pricing and the Requirement for Strategic Planning

A corporation hired a consulting firm to estimate the present value of accrued liability for their "over-funded" defined benefit plan. Based upon an estimated liability of approximately $45,000,000, the plan sponsor decided to terminate the plan, and because it was restructuring, the recovery of surplus was an important strategy. The corporation, a publicly traded company, had already declared an "extraordinary earnings gain" reflecting the expected recovery of surplus.

After several months of delays, the most competitive annuity cost the plan sponsor could attain was $68,000,000 - a difference of $23,000,000! The price itself was not the worst news; the value of trust assets had declined from $71,000,000 to $65,000,000.

The corporation retained QAS to evaluate potential alternatives. Sensing that there was little that could be done, the employer decided to "freeze" its plan instead of terminate. Three months later QAS perceived unrest in the bond market and suggested that the company consider an annuity purchase. A decision to proceed was made at a special board of directors meeting.

Interest rates were extremely volatile, but many carriers made positive comments about the availability of favorable pricing. Negotiations yielded substantial concessions: reserve strain was exceeding expectations because of heavy early retirement incentives; interest rates were leveling off; the additional reserve strain of the heavy deferred life content was becoming too costly; and, the benefit provisions precluded several carriers from quoting.

Annuity costs ranged from $64,000,000 to $77,000,000. After confirming the method of benefit calculations and correcting several erroneous assumptions on the part of the carriers, a closing date was scheduled. It appeared that one of 3 carriers would be able to provide aggressive pricing. However, bad news resurfaced: a $2,000,000 loss was realized in liquidating the bond portfolio. After crunching more numbers, "cash" now stood at $59,500,000.

The early rounds of heavy, final negotiations produced a "best cost" of $62,700,000. A quick calculation by the consulting actuary indicated that the employer could make a maximum tax deductible contribution of $900,000. This boosted available cash to $60,400,000. Pulling out all the stops, QAS negotiated a $2,300,000 final reduction on a "business deal" basis and close the transaction for $60,400,000.

Time Frame:	6 Weeks
High Bid:	$77,100,000
Best Initial Offer:	$64,300,000
Final Acceptance:	$60,400,000
Consultant Offer:	$68,000,000
Savings Over Consultant:	$7,960,000 / 11.7%