CASE STUDY: Using the AFS Optimizer to Improve Nonqualified Plan Funding Efficiency

BACKGROUND

- A large publicly-traded company sponsors a non-qualified deferred compensation plan with a liability in excess of $100 million; informally funded with life insurance. The funding vehicle was designed and implemented in 2004, and reflected the expectation of a high level of plan participation and compensation deferrals.
- As a result of the financial down-turn, the actual deferrals and premium contributions were much less than originally expected.

PROBLEMS / ISSUES

- Excess capacity (too much death benefit in relation to deferrals/premiums) in the Corporate Owned Life Insurance (COLI) leading to poor performance.
- Inappropriate / unresponsive asset management by the existing COLI broker.
- Extreme reluctance on the part of Human Resources to modify the terms of the plan, or to disturb the participant experience in any way.

ANALYSIS

- Modification versus replacement of the existing block of COLI:
  - Another group of COLI consultants recommended that the existing block of COLI (a registered variable life product) be replaced with Private Placement contracts. They projected significant savings with respect to insurance loads and expenses, and a potential improvement in asset performance.
  - However, as noted above, Human Resources did not want to bother the participants with the consent to be insured process that would be required with the replacement of the existing block.
  - As an alternative, EBS analyzed in detail the potential benefits of modifying the existing block of COLI. Using the proprietary AFS “Optimizer Process”, we were able to first project benefit payments and the growth of the plan liability under a range of assumptions about levels of participation, compensation deferrals, and rates of earnings. We then were able to run thousands of iterations of the analysis of various COLI and non-COLI financing combinations and adjustments to the COLI contracts which we could overlay onto the benefit payment projections to determine the optimal structure of the funding vehicle.

SOLUTION / RESULT

- The existing block of COLI funding was “right-sized” yielding a projected $23 million in P&L improvement over the next 10 years (see graph below)
- The client avoided the significant transaction costs associated with the replacement of the existing block of COLI and,
- No modification of the plan, and no disturbance of the participants was required.