$29 Billion of payments over 50 years
$17 Billion of Liability (calculation of assets needed now to pay benefits)
(to calculate: need investment return and life expectancy)
WHAT HAS HAPPENED SINCE 2007?

- PEOPLE CONTINUE TO LIVE LONGER

- INTEREST RATES (INVESTMENT RETURN) USED FOR CALCULATING ASSETS NEEDED TO PAY PROMISED PENSION BENEFITS ARE LOWER

- IMPACT OF PENSION REGULATIONS SUCH AS PENSION PROTECTION ACT OF 2006
WHAT DOES THIS MEAN TO ALU

- INCREASES RISK OF HAVING TO CONTRIBUTE TO OUR PENSION PLAN FOR THE FIRST TIME & IN AN ACCELERATED MANNER

- A PENSION LIABILITY INCREASES ALU’S RISK IN NOT BEING ABLE TO BORROW ECONOMICALLY BECAUSE IT IS CONSIDERED TO BE A VOLATILE DEBT
WHAT IS THE PENSION INDUSTRY SOLUTION: PENSION DE-RISKING

DE-RISKING BENEFITS THE PLAN SPONSOR BY:

• REDUCING THE SIZE OF THE RISK WITHIN THE PLAN

• TRANSFERRING THE RISK TO ANOTHER PARTY

CAN RISK BE 100% ELIMINATED? FOR SPONSORS – YES; FOR RETIREES - NO
PENSION DE-RISKING ACTIONS THAT TRANSFER THE RISK

- Lump Sum Buyout Offers

- Sale of Pension Assets and Liabilities to Another Party Such as an Insurance Company (A Third Party Buyout)
**Lump Sums**

- ARE NOT NEW: HAVE BEEN MADE IN THE PAST TO TERMINATED VESTED

- WHAT IS NEW: MAKING AN OFFER TO RETIREES WHO ARE ALREADY RECEIVING ANNUITY PAYMENTS LIKE GM AND FORD HAVE

- IN ORDER TO MAKE THE OFFER TO IN-PAY RETIREES A FAVORABLE IRS PRIVATE LETTER RULING IS REQUIRED
**Lump Sums**

- **LUMP SUM IS A MATHEMATICAL CALCULATION REQUIRING ASSUMPTIONS**

- **AS DISCUSSED, PLAN LIABILITY IS THE AMOUNT OF ASSETS NEEDED TO PAY THE PROMISED BENEFITS FOR ALL PARTICIPANTS USING ASSUMPTIONS FOR INVESTMENT RETURN AND LIFE EXPECTANCY/MORTALITY RATE**

- **YOUR LUMP SUM OFFER INDIVIDUALIZES THAT PLAN LIABILITY. IT IS THE AMOUNT NEEDED TODAY TO BE ACTUARIALYALLY EQUIVALENT TO YOUR CURRENT ANNUITY’S REMAINING PAYMENTS BASED ON ASSUMPTIONS FOR INVESTMENT RETURN AND LIFE EXPECTANCIES.**
LUMP SUM: DOL & IRS REQUIREMENTS

- LUMP SUM OFFERING MUST BE AT LEAST EQUAL TO THAT CALCULATED WITH IRS PRESCRIBED INTEREST RATE AND MORTALITY RATE (LIFE EXPECTANCY)

- NO LUMP SUM CAN BE OFFERED UNLESS A LIFE OR JOINT LIFE ANNUITY IS ALSO OFFERED. PROVIDES US AN OPPORTUNITY TO SWITCH FROM A SINGLE LIFE ANNUITY TO A JOINT SURVIVOR: COMPENSATE FOR DEATH BENEFIT REMOVAL.

- IN THE PLRs, THE IRS HAS TAKEN NO POSITION ON THE ACCURACY OF THE LUMP SUM OFFER CALCULATION
LUMP SUM DECISION

- Retirees decision will consider qualitative and quantitative factors.

- This presentation only focuses on the quantitative: longevity & investment return.

- For simplicity, examples will be based on only a single life annuity.

- You can say no.
LUMP SUM QUANTITATIVE CONSIDERATIONS

LONGEVITY
PLAN RISK
TRANSFERRED
TO RETIREE

INVESTMENT
RETURN RISK
TRANSFERRED
TO RETIREE
WHAT IS LONGEVITY RISK?
IT IS INCREASED LIFE EXPECTANCY
LONGEVITY RISK AND PROBABILITY OF BEING ALIVE

How Long Will I Live After Retirement?
Probability a 65-year-old will be alive at given ages.

<table>
<thead>
<tr>
<th>Age</th>
<th>Probability</th>
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<tbody>
<tr>
<td>65</td>
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<tr>
<td>70</td>
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<td>55%</td>
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<tr>
<td>110</td>
<td>49%</td>
</tr>
<tr>
<td>115</td>
<td>37%</td>
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</tbody>
</table>
LONGEVITY RISK EXAMPLE

- In 2015, 200 people aged 65 with pension of $50,000, expected to live until 85, lump sum calculated to be $700,000 for $1 million of benefit payments. With new mortality tables in 2016/2017 lump sum would be $736,000.

- However, 120 people are still alive in 2035, they now have an average life expectancy of 90.

- 80 people are still alive in 2040 where $50,000 per year has not been available between 2036 and 2040, a cumulative $300,000 deficit per person.
LONGEVITY RISK EXAMPLE CONT’D

- LUMP SUM REQUIRED FOR THE 80 PEOPLE AT OLD MORTALITY RATE IS $800,000
- LUMP SUM AT NEW MORTALITY RATES IS $864,000
- TO COMPENSATE FOR LONGEVITY RISK, THE INVESTMENT RETURN NEEDS TO INCREASE ON THE LUMP SUM THE RETIREE RECEIVES.
- FOR THIS EXAMPLE, THE 4% INVESTMENT RETURN WOULD NEED TO INCREASE TO AROUND 6%
ANOTHER WAY TO LOOK AT THE LUMP SUM AMOUNT OFFERED

FOR A $700,000 LUMP SUM OFFER WHICH BUYOUTS YOUR $50,000 PENSION FOR 20 YEARS, THE OFFER IS OFFERING YOU THE FOLLOWING AMOUNTS PER YEAR:

- YEAR 5: $47,000
- YEAR 10: $34,000
- YEAR 15: $28,000
- YEAR 20: $23,000
LUMP SUM FINANCIAL WINNERS & LOSERS

<table>
<thead>
<tr>
<th>Longevity Risk: Die Earlier Than Life Expectancy</th>
<th>Longevity Risk: Live Longer Than Life Expectancy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment</strong></td>
<td><strong>Investment</strong></td>
</tr>
<tr>
<td>Return Risk: Higher Than Lump Sum Rate</td>
<td>Return Risk: Lower Than Lump Sum Rate</td>
</tr>
<tr>
<td>Financial Winner</td>
<td>Financial Loser</td>
</tr>
<tr>
<td><em>Not Sure</em></td>
<td><em>Not Sure</em></td>
</tr>
</tbody>
</table>

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**INVESTMENT**

**RETURN RISK:**

*Higher Than Lump Sum Rate*  

*Lower Than Lump Sum Rate*
THE SELLING OF A PENSION PLAN OR A PART

- THREE PARTIES EFFECTED: SPONSOR, BUYER, AND PARTICIPANT
- NORMALLY PRICED AT 110% OF PENSION OBLIGATION BOUGHT OUT (COMPENSATES BUYER FOR LONGEVITY RISK)
- BOTH GM AND VERIZON WERE BOUGHT OUT AT 110%
- BUYOUT IS THROUGH A GROUP ANNUITY OFFERED BY A THIRD PARTY (INSURANCE COMPANY, I.E PRUDENTIAL)
- PARTICIPANT RECEIVES LITTLE WARNING, NOT ALL PARTICIPANTS MAY BE TRANSFERRED, CANNOT SAY NO
- PARTICIPANT COULD BE EXPOSED TO SECONDARY RISK
PARTICIPANT BUYOUT PERSPECTIVE

• PARTICIPANT IS A MEMBER OF GROUP ANNUITY CONTRACT
• NO PBGC GUARANTY, VARIABLE GUARANTEES FROM STATES
  – OHIO = $300,000 (ANNUITY’S PRESENT VALUE)
  – ARIZONA = $250,000
  – INDIANA = $100,000
  – NEW JERSEY = $100,000
  – ALABAMA = $250,000

DOL REGULATION REPLACED BY FRAGMENTED STATE REGULATION

NO PLAN SPECIFIC DISCLOSURES (THE CURRENT ANNUAL FUNDING NOTICE)
WHAT ARE THE REGULATOR’S AND CONGRESS DOING?

- VERY LITTLE: BUT SUFFERING FROM A SPLIT PERSONALITY

- FOR EXAMPLE, VOTED TO ESTABLISH QUALIFIED LONGEVITY ANNUITIES WITHIN 401Ks, WHILE AT THE SAME TIME ALLOWING LUMP SUM OFFERS TO ELIMINATE OUR EXISTING PENSION ANNUITIES

- DOL & SEC & OBAMA BATTLING OVER FIDUCIARY VERSUS SUITABILITY STANDARDS
WHAT CAN YOU DO?

➢ BE PREPARED – HAVE A LIST OF QUESTIONS

➢ DO NOT JUST FOCUS ON INVESTMENT RETURNS

➢ CONSIDER USING THE FOLLOWING:

“I AM NOT A FIDUCIARY. THEREFORE, I AM NOT REQUIRED TO ACT IN YOUR BEST INTERESTS, AND AM ALLOWED TO RECOMMEND INVESTMENTS THAT MAY EARN HIGHER FEES FOR ME AND MY FIRM EVEN IF THOSE INVESTMENTS MAY NOT HAVE THE BEST COMBINATION OF FEES, RISKS, AND EXPECTED RETURN FOR YOU.”