IT'S WHAT'S INSIDE THAT COUNTS.

PLAN SPONSOR OF THE YEAR 2012

Defined Benefit

Hickory Springs Manufacturing Co.

For Hickory Springs Manufacturing Co., running a pension plan in challenging times comes down to how well it matches assets and liabilities.

The furniture and bedding maker's defined benefit plan had been more than 100% funded before the equity market's 2008 slide, but saw a "huge decline" in asset returns at that point, Chief Financial Officer Stephen Ellis says. It was not the plan's only recent grappling with market volatility. "Having gone through these issues twice in the past nine years, we realized that we had to do some things differently," he says.

Its investment strategy centers on sharpening the focus on matching assets and liabilities. That led the Hickory, North Carolina-based company to become the first U.S. defined benefit plan sponsor to do a pension buy-in transaction, a $75 million pension-risk transfer with Prudential Retirement, announced in May 2011 and covering the plan's retirees. Additionally, the company has a liability-driven investing (LDI) plan in the works for handling the plan assets related to active employees.

The 97%-funded plan, which closed to new entrants in January 2009, has 4,759 participants and $150 million in assets. As for closing to new entrants, Ellis says, "We were trying to figure out what is valuable to young employees and new employees, and we determined that

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Stephen W. Ellis, Chief Financial Officer, Hickory Springs Manufacturing nobody understood or valued the defined benefit plan." Hickory Springs also has two 401(k) plans with a total of approximately 1,600 participants and $50 million in assets.

Ellis first heard about the Prudential buy-in product at an LDI conference in 2009. "It made a ton of sense to me," he says. "It was better than a traditional LDI program, because it is a guaranteed deal. That does not exist anywhere else." The company studied the idea carefully for a year and a half, with the help of consultant BCG Terminal Funding Co., and decided in April 2011 to go ahead.

Buying a Buy-in

Hickory Springs remains the pension plan's fiduciary, "and is still ultimately the obligor," says Glenn O'Brien, a Prudential managing director. He explains the basic idea: "A buy-in is an allocation to move a certain set of assets into a 'buy-in asset class' with a guarantee of an outcome; it guarantees cash flows equal to the amount of money that Hickory Springs owes its pensioners," he says. Think of it like this, he suggests: Hickory Springs is still the primary insurer of all the pension benefits, but it effectively re-insured the part of its plan covering people who already retired; and, as people retire, Hickory Springs can add them to the buy-in deal.

Hickory Springs no longer has the $75 million of assets covered by the agreement. "Prudential holds that $75 million in a separate account, so that gives us added security that if something goes wrong with Prudential, that money is protected," Ellis says. Hickory Springs has no control over how that money gets invested by Prudential. "Each month, we submit to them a current list of retirees, and we highlight any deaths or other changes," he says. "They send us a check for the amount of the benefits, and we pay retirees at the beginning of the month."

The buy-in's main advantage "certainly is the 100% match between assets and liabilities," Ellis says. "Also, with this product, we are able to maintain the relationships we have with retirees. We issue the check each month, and we still talk to retirees. We think that is important."

Although pension buy-ins have been done in the United Kingdom, being a U.S. pioneer did concern Hickory Springs officials somewhat, Ellis acknowledges. "That was discussed multiple times in our pension committee meetings," he says. "It was a perceived risk. We certainly questioned, if this is such a good deal, why hasn't anyone else done it?"

Cost could explain part of the answer. Ellis declines to discuss the buy-in's cost but says that, in evaluating the fee, Hickory Springs considered the spread between the present value of the liabilities and the Prudential fee, as well as the fact that the deal would save the company ongoing money in areas such as investment-management fees. "For us, the discount was greater than the spread between what the liabilities were and what Prudential was charging," he says.

Prudential's price "is a fairly nominal amount over the plan's 'economic liability,'" referring to not just the value of actual retiree liabilities, but associated costs such as Pension Benefit Guaranty Corp. (PBGC) premiums and investment-management fees, O'Brien says. The price "is somewhere between zero and 4%" above the actual liabilities, he says, declining to be more specific.

Looking More Closely at LDI

With the retiree portion of its pension liabilities taken care of, Hickory Springs has turned its attention to how to best match its assets and liabilities that cover current employees. "It immediately changed how we would consider the rest of the assets, and the timeline in terms of what we need to match. So that caused us to look more seriously at LDI," Ellis says. "We think it is the best way to manage these long-term liabilities."

As of September 30, 2011, the plan had 18.4% of its pension portfolio in U.S. equities; 15% in alternative investments, including hedge funds and commodities; 1.1% in foreign equities; and 62% in fixed income, with about 85% of the fixed-income holding being the Prudential buy-in contract. The remainder is in cash.

No final decisions on an LDI shift had been made at press time, but plan officials were refining the strategy with the help of consultant CAPTRUST Financial Advisors. The plan may put 50% of the remaining assets beyond the buy-in contract in LDI-driven fixed-income investments such as corporate bonds, with the other 50% remaining in equities and other asset classes. That potential shift would take the overall portfolio from 62% in fixed income to 78%, says Valerie Reid, Hickory Springs' finance director.

Very low interest rates make this a challenging time to shift into LDI, Reid agrees. "Still, we believe that our liabilities need to drive our decisions," she says.

Ellis knows the challenges. "The biggest risk probably is that an LDI strategy does not guarantee a match to the liabilities, and you can still have volatility," he says, "and, depending on the length of your liability stream, you may not be able to find the bonds to match your liabilities."

However, he thinks the tradeoffs work for Hickory Springs. "It is taking some return off the table, but greatly reducing the volatility of the liability," Ellis says. "That makes a lot of sense for the company."
—*Judy Ward*