The Pension Fund

Analysis and Recommendations

Erlanger Health System Board of Trustees
Board Meeting
September 24, 2020

Retirement Plans

Erlanger Retirement Program

Erlanger 403b, 401(a) & 457(b)
Defined Contribution Plans
(Non-ERISA)

Erlanger Non-for-Profit 403(b), 401(a)
Defined Contribution Plans
(ERISA – WCH/Murphy)

Pension Plan

Defined Contribution Plans open to all eligible employees with 1,000 hours of service annually.

Old plan includes only employees hired on or before June 30, 2009

Current Retirement Plans Offered to Associates

- Defined *Contribution* Plans – Covers all employees age 25 and above with one year of service with at least 1,000 hours of service per year and vested after 3 years
- The Defined *Contribution* Plans are working as planned -
  - Four plans covering 6,925 individuals with total assets of $241 million
  - Currently, Erlanger contributes 3% of salary and wages plus an additional matching contribution of 50% of the employee match up to 2% for a potential total of 5% contribution.
  - EHS contributions for FY 2019 and 2020 – 12,835,740 and 10,498,276[1]
  - Dollars are portable – that is the employee can move them to a new employer or to a Rollover IRA when they leave
- **These plans are not impacted by any of the issues surrounding the Defined Benefit Plan.**
- **The Board is commitment to maintaining competitive contribution levels to these plans.**

[1] *Reflects the suspension of funding during the pandemic*

The Pension Fund:
A Timeline for Perspective

An "old" style retirement plan started in 1964 and assumed with the creation of Authority in 1977, provides a monthly annuity at retirement based on a formula in the plan that includes age, years of service and compensation.

1996: Effective with retirements on or after July 1, 1996 the plan offers the participants an option of receiving a lump sum or the monthly benefit.

2009: The plan was no longer open to employees hired on or after July 1, 2009 and defined contribution plans were established as alternative.

2014: The benefit accrual was frozen at the years of service on June 30, 2014. Participants in the plan began participation in the defined benefit plan. Also any participant with 10 years of service and whose years of service and age totaled 75 or more received an additional 2.5% contribution for five years. At the time, the estimated cost of the 2.5% contribution was $800,000.

NOTE: *Governmental plans are not subject to ERISA; Subject to other limitations and governmental requirements*

Defined Benefit or Pension Fund

- Approx. 1,300 *active participants* in the Fund impacted *by* the Board's decision.
- Approx. 1,403 *vested terminated participants* in the Fund impacted by the Board's decision.
- There are approximately 228 *retirees* whose benefits will not change because of the Board's decisions.
- Annual contributions + investment income must ultimately equal the value of benefits paid to participants plus plan expenses
- The anticipated demand on the Pension Fund to help ensure future benefits are paid to participants means the funding must increase because of:
    - Acceleration of benefit payments
    - Lower than expected investment returns
- The Pension Fund is not governed by ERISA. It is compliant with all federal and state laws and was recently reviewed by the Tennessee Department of the Treasury on September 19, 2019.

The Pension Fund *Strengthening Strategy*

After significant analysis and consultation with our hospital management, actuary, investment advisors, and legal team over the last six months, we are prepared to recommend a *strategy* to the Board of Trustees ("Board") to help *strengthen* the Chattanooga-Hamilton County Hospital Authority Pension Retirement Plan and Trust (the "Pension Fund" or "Fund") to a healthier and more sustainable financial condition.

The Pension Fund
Guiding Principles

1. (403(b), 401(a), 457(b)) will not change-Board committed to funding
2. Continuing a decades-long process
3. What is best for <u>all</u> participants
4. Within the scope of the Board's fiduciary responsibility
5. Reasonable and necessary
6. Other options considered and rejected-including terminating the Fund
7. Intended to protect every current participant in the Fund
8. Impact individuals hired on or before June 30, 2009
9. Do not impact participants who choose monthly annuity payments

The Pension Fund: *Analysis*

Without timely adjustments in the administration of the Pension Fund and the temporary suspension of lump sum pay outs, the future of the Pension Fund as it exists now will be uncertain.

- On June 30, 2020: Currently approx. 36% funded or $83.5 million underfunded
- On June 30, 2020: Current balance is approx. $46.7 million
- Contributed above required amounts for FY 2020 by $2.1 million; budgeted contributions for FY 2021 will be higher than FY 2020 by $1,675,000

Recent Funding Has Exceeded the Minimum Requirement

- Erlanger has been making higher than required contributions to avoid a crisis in the fund and support higher demand for benefit payments. Below are comparisons of actual contributions and benefit payments:

	Actual Contributions	Benefit Payments	Net Contribution
2018-19	7.4 Million	10 Million	(2.6 Million)
2019-20	9.8 million	10.4 Million	(0.6 Million)
2020-21	11.4 million	21.0 Million	(9.6 Million)
Total	28.6 million	41.43 Million	(12.8 Million)

Current Plan: Benefit Payments in 2021 – 2024
(Estimates only)

- Benefits will exceed the funding, even at higher levels, creating issues of liquidity and limited investment options in the future

	2021	2022	2023	2024
Contributions	11,450,000	11,090,000	11,090,000	11,090,000
Benefit payments	21,010,000	20,110,000	17,790,000	15,940,000
Shortfall - drawn on investments	-9,610,000	-9,020,000	-6,700,000	-4,850,000
Invested balance at year end	38,770,000	31,110,000	25,380,000	21,190,000

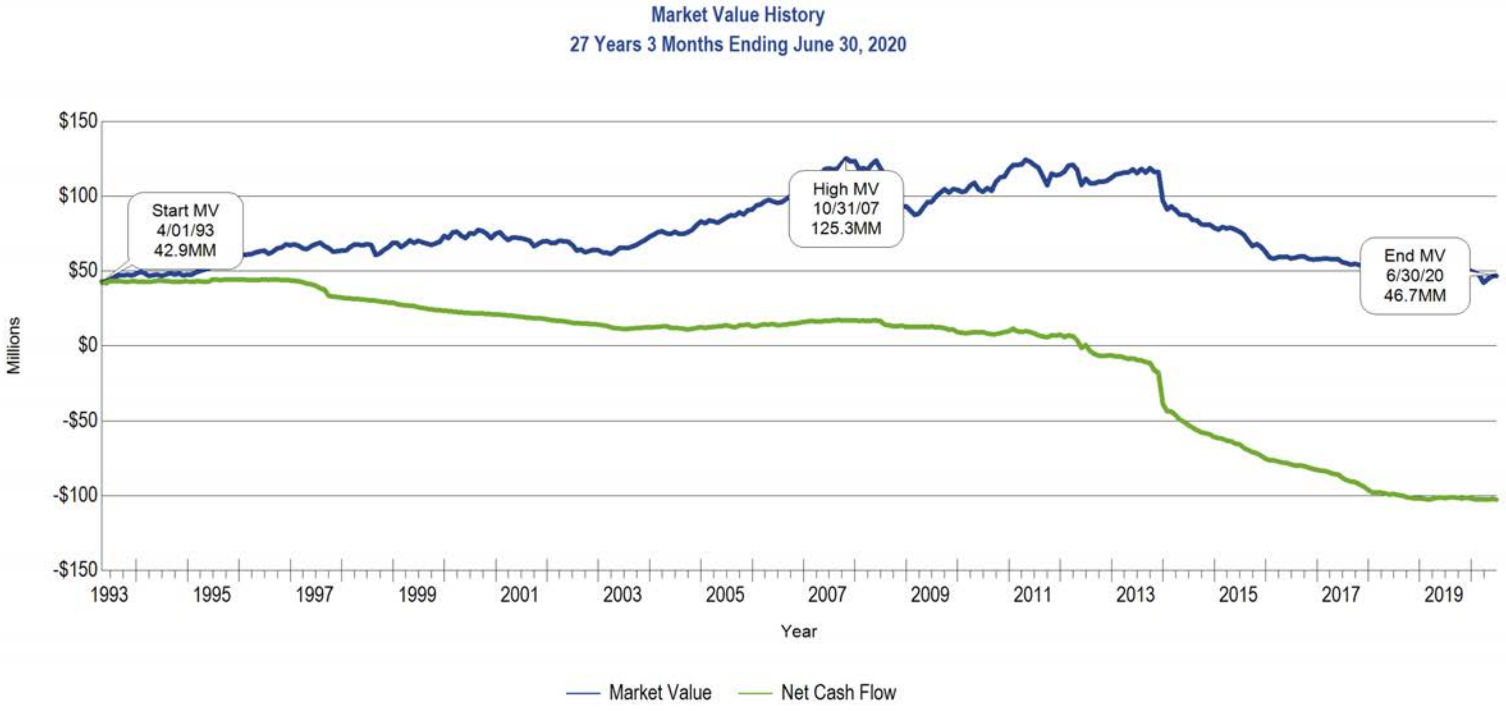
Payments in the 1st Quarter of 2021

	July	August	Sept (thru 9/21)	Fiscal YTD (thru 9/21)
Expected Withdrawals during period				
- Estimated Annuity Payments	(159,544)	(161,540)	(172,295)	(493,379)
- Estimated Lump Sum Payments	(2,399,914)	(2,816,386)	(4,670,914)	(9,887,214)
- Estimated Expense	(29,117)	(62,566)	(23,491)	(115,174)
Total Expected Withdrawals	(2,588,575)	(3,040,492)	(4,866,700)	(10,495,767)

The Lump Sum Payments of $9.9 million at 1% are estimated to be $2.0 million higher than they would have been on June 30, 2019 at 3.25%.

Fund Value v. Net Outflows

- Since 1993, the net of contributions less benefit payments is a negative $145 million while investment change has been $149 million.



The Pension Fund *Analysis*

- The Pension Fund cannot expect to invest its way out of this current situation due to the realities of the investment markets.
- The single most significant factor in the financial health of the Fund is the difference between the expected investment return and the actuarially equivalent interest rate used to determine the optional lump sum form of benefit. The Fund, as structured, does not permit a change in the actuarially equivalent interest rate. It is this difference, and the resulting drain on Fund assets that has prompted the change.

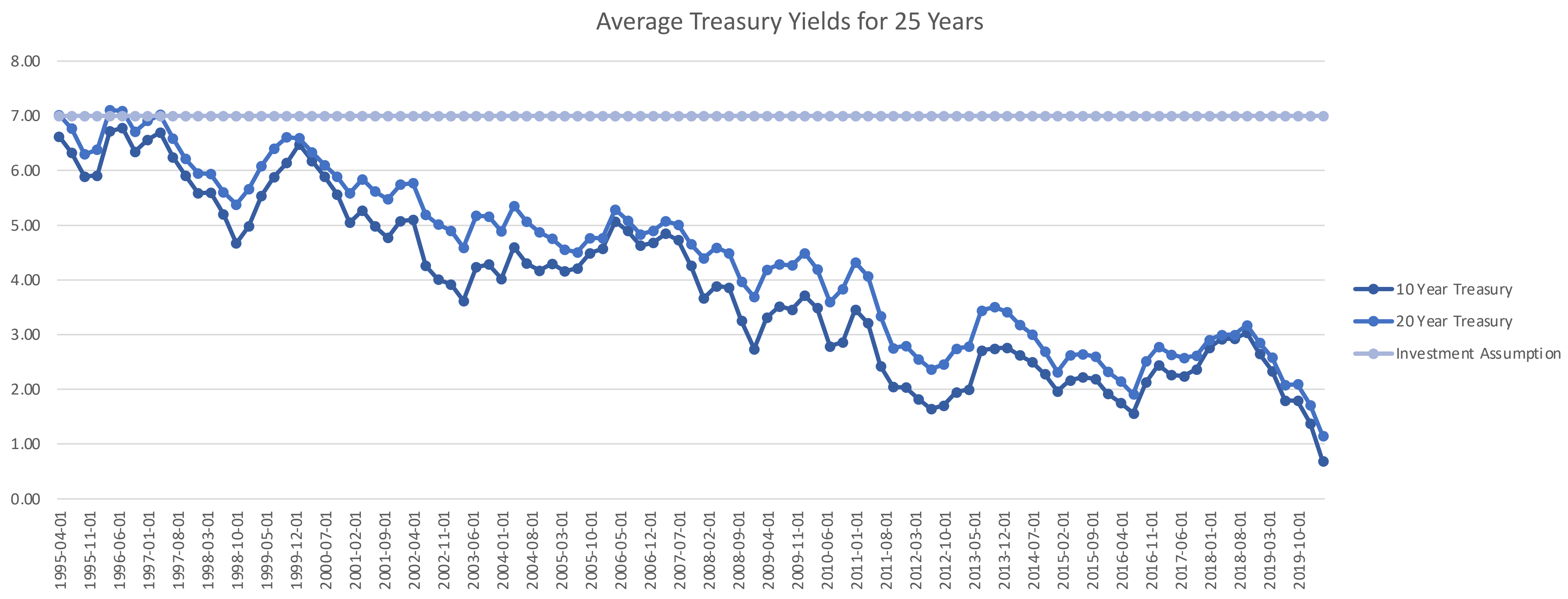
The Pension Fund

Analysis

(continued)

- The option in the Pension Fund to take lump sum payments is based on assumptions set out in the Plan that cannot be changed. In other words, the Pension Fund establishes the interest rate and mortality tables used to calculate the optional lump sum payment amounts. The market-based interest rate using the 15-year treasury used to calculate optional lump sums has been declining, along with other interest rates, for years and currently the interest rate used to calculate optional lump sums (15-year treasury note) is 1%. The very low interest rate coupled with low returns in the investment markets, have been major factors in the accelerated decline of the funding of the Pension Fund.

Average Treasury Yields for Last 25 Years



Lump Sum Assumptions

Fiscal Year Ended[1]	7/1/2018	7/1/2019	Recent Models
2020	3.50%	3.00%	1.25%
2021	4.00%	3.25%	1.75%
2022	4.50%	3.50%	2.25%
2023	4.50%	3.75%	2.75%
2024	4.50%	4.00%	3.25%
2025	4.50%	4.25%	3.75%
2026	4.50%	4.25%	4.25%
2027+	4.50%	4.50%	4.50%

1 The Years are shown based on Year end. These correspond to years in the actuarial reports based on Years beginning Actuarial report is 2019, the corresponding FY is 2020

Interest Rates in the Immediate Future

Fed sees rates near zero at least until 2023

BILL O'LEARY/THE WASHINGTON POST VIA AP

Federal Reserve Board Chairman Jerome Powell speaks in June during a hearing on Capitol Hill in Washington.

BY CHRISTOPHER RUGABER
THE ASSOCIATED PRESS

The Federal Reserve expects to keep its benchmark interest rate pegged near zero at least through 2023 as it strives to accelerate economic growth and drive down the unemployment rate.

The central bank also said Wednesday that it will seek to push inflation above 2% annually. The Fed left its benchmark short-term rate unchanged at nearly zero, where it has been since the pandemic intensified in March.

The Fed's benchmark interest rate influences borrowing costs for homebuyers, credit card users and businesses. Fed policymakers hope an extended period of low interest rates will encourage more borrowing and spending, though their new policy also carries risks of inflating stock or causing other financial market bubbles.

The Fed's moves are occurring against the backdrop of an improving yet still weak economy, with hiring slowing and the unemployment rate at 8.4%. The central bank did note some improvement in the economy, however, forecasting that GDP would fall by 3.7% compared to a June forecast of a 6.5% drop. On employment, the Fed projected an unemployment rate at the end of the year of 7.6% instead of the 9.3% it projected in June.

At a virtual conference with reporters following the statement, Powell said the economic outlook still remains highly uncertain and depends heavily on the ability of the U.S. to get control of the pandemic.

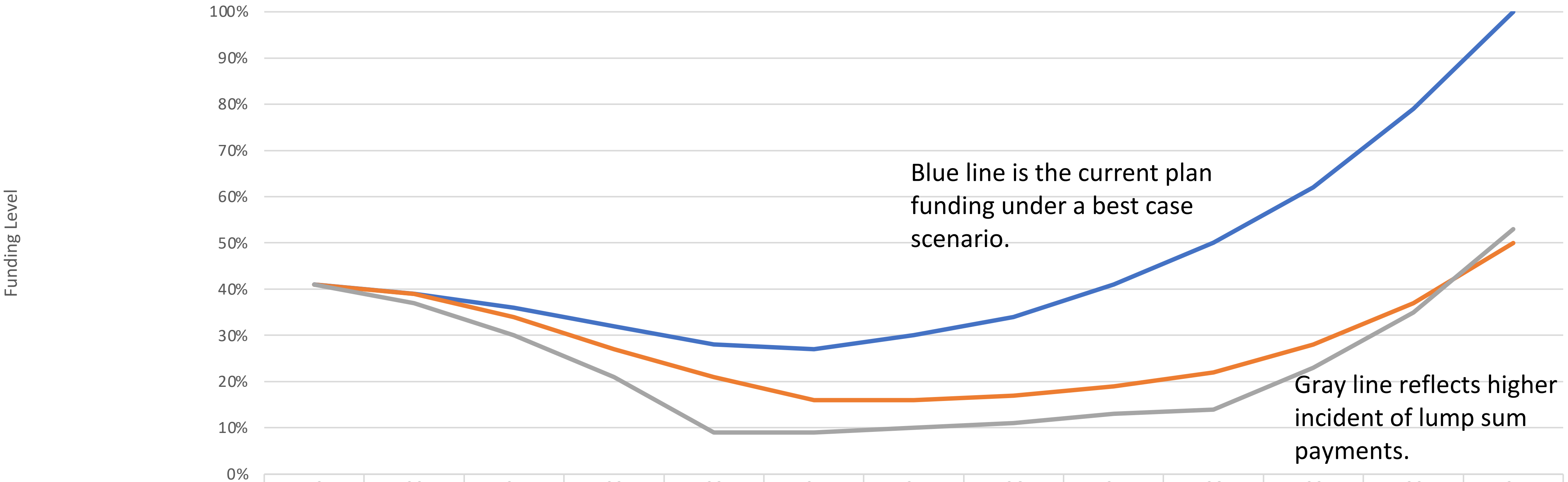
"A full economic recovery is unlikely until people are confident that it is safe to re-engage in a wide variety of activities," Powell said.

The Fed's statement formalized a change in its policy toward inflation. Fed Chairman Jerome Powell first said last month that the Fed would seek inflation above 2% over time, rather than just keeping it as a static goal.

See RATES › C4

Doing Nothing

Funding Level Unchanged



	19	20	21	22	23	24	25	26	27	28	29	30	31
Current	41%	39%	36%	32%	28%	27%	30%	34%	41%	50%	62%	79%	100%
Making only ADC payments	41%	39%	34%	27%	21%	16%	16%	17%	19%	22%	28%	37%	50%
Lump Sum At 100%	41%	37%	30%	21%	9%	9%	10%	11%	13%	14%	23%	35%	53%

Key Factors Impacting Funding Levels
Do Nothing

- Limited opportunity for investment, based liquidity needs
- Return of Invested Assets and a sudden drop in markets
- Accelerated election of lump sum
- Interest Rates impacting the lump sum discount rate

The Pension Plan
Strengthening Strategy

The *recommended strategy* to continue to strengthen the funded status of the Pension Fund has three primary components.

1. **An administrative component:** The Fund has allowed participants who continue to work past age 65 to receive an actuarially adjusted increase upon retirement. Eliminating this practice and otherwise bringing Fund administration into compliance with the Fund document **will reduce the unfunded liability by approximately $8.6 million**.
   - In the future, *a participant must weigh the benefits of continuing to work beyond age 65*, receiving salary and benefits, including the defined contribution benefits offered by Erlanger, *or retiring at age 65*.
   - The proposed discontinuation would allow any employee who is already over 65 to retain their individual accrual through September 24, 2020.

The Pension Plan
Strengthening Strategy

(continued)

2. Calculation of Lump Sum: Currently the Plan provides for calculation based on age 65 but administrative process allows for greater of Early Retirement at age 55 or age 65. No dollar impact currently identified. However, we should follow Plan document.

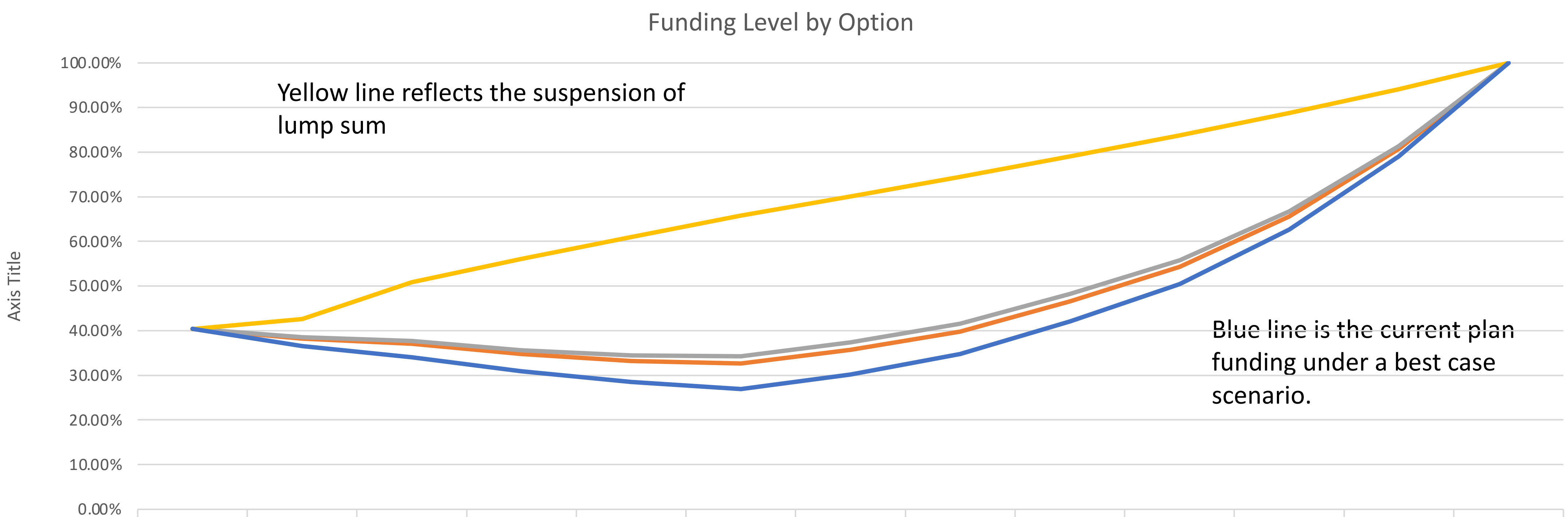
3. Identify Lost Participants: Currently, there are some participants that Erlanger has lost contact with. Human Resources and Prudential Benefit Administration are to make a more concerted effort to locate all participants. There is the potential for savings if a participant is determined to be lost. If the participant is later found, the liability to that participant would have to be restored. Every effort will be to find all participants. Accordingly, no savings have been included.

The Pension Plan
Strengthening Strategy

(continued)

- **A practical component:** This component of the strategy will align the Pension Fund with most similarly situated defined benefit plans by changing the death benefit payable to the beneficiary of an active participant to 50% of the participant's accrued benefit. This change is consistent with the current benefit payable to the beneficiary of a retiree receiving monthly payments. This component will reduce the unfunded liability by approximately $1.1 million.
- **A temporary component:** This component of the strategy will suspend the optional lump sum payment form and other periodic optional forms of benefit until the funded status of the Pension Fund reaches 80%. This change does not affect the monthly payment option, the form of benefit.

Funding Levels - With Recommended Changes



	19	20	21	22	23	24	25	26	27	28	29	30	31
Type 1	40.36%	38.26%	37.10%	34.75%	33.16%	32.64%	35.66%	39.82%	46.62%	54.29%	65.58%	80.72%	100.00%
Type 1 & 2	40.36%	38.48%	37.68%	35.65%	34.42%	34.25%	37.34%	41.53%	48.23%	55.75%	66.72%	81.37%	100.00%
Type 3	40.36%	42.57%	50.87%	56.10%	61.02%	65.76%	70.11%	74.50%	79.03%	83.74%	88.74%	94.13%	100.00%
Current	40.36%	36.56%	34.02%	30.88%	28.46%	26.91%	30.18%	34.71%	42.06%	50.42%	62.65%	79.08%	100.00%

Key Factors in the Future Levels
With Proposed Changes

- Annual Funding
- Number of individual electing monthly annuity payments
- Interest Rates impacting the lump sum discount rate
- Return on invested assets

The strengthening strategy will help improve the Pension Fund to a healthier and more sustainable condition.

It is fiscally responsible, legally sound, and immediately necessary to help improve the funded status of the Fund to a level that will cause the Fund to be sustainable for participants and their beneficiaries.

The Pension Plan
Administrative Actions

1. Implement changes to be consistent with the plan documents.
2. Proceed with funding the FY 2021 contributions from hospital cash first.
3. Establish more transparent procedures for the fund's cash flow.
4. Realign investments and asset allocations based on Boards final action.

The Pension Plan
Next Steps

1. Answer your questions
2. Review the proposed amendments and resolutions