Improving the Image of Traditional Defined Benefit Pensions

by Dennis R. Ackley

Traditional defined benefit (DB) pension plans may be the least understood benefit offered by employers – but by no means are they the least expensive. Through innovative communication techniques, you can increase employees' understanding and perceived value of your DB plan. It has been said that DB plans no longer make sense in a "free-agent" labor market where employees roam from organization to organization. The "money now" aspects of 401(k) and cash balance plans are said to better reflect the interests of today's employees.

However, CEOs are becoming increasingly interested in the relationships between a company's satisfied customers, happy investors, and loyal employees. Today, loyalty is not simply another word for long service. It now defines an employee/employer relationship built on mutual trust and a passion for mutual success. How long that relationship continues is a measure of loyalty. Creating and maintaining a workplace environment where loyalty is valued and can flourish is a difficult and complicated task. Yet employee loyalty may differentiate high-performing organizations.

> ***Innovative communication can dramatically improve the impact of traditional DB plans by:***
> - ***Boosting employees' perception of the value – usually by hundreds of thousands of dollars, and***
> - ***Demonstrating how DB plans reward employee loyalty.***

As more CEOs become convinced that employee loyalty helps drive business success, they will be asking human resource executives, "What are we doing to reward loyalty?" Traditional DB plans can be part of the answer.

With the expected shift in workforce demographics, many employers will need to retain qualified, seasoned employees. And as older employees begin to realize they need more money to retire, they'll increasingly value DB plans. Plus, there is growing concern about the inevitable end of the bull market, especially in light of many 401(k) participants' lack of investment sophistication.

For these and other reasons that may support a business's strategy, traditional DB plans still have their place.

But DB plans are saddled with a boring image and communication problems stemming from the era of more paternalistic employers. Back then, communication efforts were little more than an unattractive booklet containing a lightly edited version of the plan document text and a complex benefit formula. Neither employers nor employees much cared that the information was nearly incomprehensible. As computers became prevalent, companies began providing employees with personalized statements of their accrued and projected benefits. This overall approach has not changed in decades.

Now more than ever, there is a need to explain the real value of DB plans clearly – not just for baby boomers, but also for younger workers. They need to understand the sizable reward they can earn by spending their careers with an organization that offers a traditional DB plan.

By more vividly communicating the value of DB plans, employers can gain a competitive advantage in recruiting and retaining top-notch talent to help drive business results. And isn't that a key reason an organization spends money on benefits?

What's in It for Me?

"Your projected age-65 defined benefit pension plan benefit is $1,554.42 a month payable for your life only."

This is the kind of notice millions of employees receive once a year regarding their DB plan. They have the same "ho-hum" response you just had.

Instead, put some snap into the message to highlight the plan's real value. Show the big numbers. Be clear. Be straightforward. Use the power of personalized statements and web sites to show a "career reward value" like this:

> "By continuing your Acme Inc. career to age 65 – assuming your pay and the plan remain unchanged – your estimated Career Reward Plan annual benefit will be $18,650, payable monthly for as long as you live. If you receive those payments from age 65 to 90, the Plan will have paid you $466,250 – insured up to the limits by the Pension Benefit Guaranty Corp., a U.S. government agency."

Nearly a half a million bucks will get their attention. It is easy to understand and personally meaningful. And the projection uses no funky "future dollars" and no "pseudo lump sums" that may not even be available (or may even go down as interest rates used in the calculations go up).

Income You Can't Outlive

The "career reward value" highlights the most overlooked value of a DB plan – its lifelong payments. Also overlooked is the fact that the payments – up to set limits – are guaranteed by the U.S. government through the PBGC. Plan sponsors have to pay the premiums for this insurance; they may as well get some credit for it. It's a guarantee that defined contribution plans lack.

Lumps sums in 401(k) plans are attractive. But at the end of working careers, a lump sum will seem much smaller when retirees realize it must last for as long as they live.

A soon-to-retire 65-year-old looking forward to living to age 85 (240 months) needs to know a $100,000 lump sum is worth around $416 a month ($100,000÷240) – assuming investment returns equal inflation, about what a bank savings account would earn. Even earning two percentage points above inflation would generate only another $88 a month. And for this retiree, at age 85, the money would be gone.

DB plans, on the other hand, provide income that people cannot outlive. Emphasizing the inexhaustible stream of payments – the "career reward value" – will strike a positive chord with employees.

Inflation will be a problem regardless of what kind of payouts retirees receive. For DB plans, the monthly amount will not likely change unless it has a rare cost-of-living or similar provision.

Avoid Bad Starts

Organizations make a terrible first impression when they show relatively new employees – those with a year or two of service – their DB Plan accrued benefit. It is a puny amount. Rather than "Wow!," most short-service employees snicker, "Is that all?"

Why highlight something the DB Plan is intentionally designed not to do – reward short-service employees. (You don't send out personalized statements to short-service employees each year telling them they won't receive a ten-year service award.) Just as bad, why tell employees about a benefit they'd get if they quit? Don't you want them to stay?

Under the Employee Retirement Income Security Act (ERISA), only employees who make written requests must be told their accrued benefits. How many employees who are looking forward to a long career care about how much they would get if they quit today?

If you have been showing employees their accrued benefits, it may be best to phase it out. Next year put the accrued information near the bottom of the statement and reword it so it no longer says "accrued" ("If your Acme career had ended on Dec. 31 of last year, you would be entitled to $XXXX a year – paid monthly – for as long as you live.").

If your organization is not doing so already, soon you will likely provide personalized DB plan information via some type of employee self-service system. Then employees can use their current service and pay – or projected future amounts – to estimate their benefits. This can eliminate the practice of showing a separate accrued benefit calculation.

For much the same reason, do not show a monthly amount for the projected income. No one expects to be retired for only one month. Show a "career reward value" – the amount to be paid annually for as long as the pensioner lives (but mention that the actual benefit is paid monthly).

Plain Talk Please – and No "Retirement"

DB plan communication is the last bastion of employee benefits gobbledygook. It's time to use plain language. One way to do that is to have the HR department assemble a team consisting of a benefits communication expert, an "agreeable" legal counselor, a DB plan specialist, and a member of the HR communication function. Tell the team to make the DB plan description as understandable as the 401(k) plan. Then test the team's work product to see if the goal was met.

"Retirement" is a concept that is becoming less useful and a word to avoid. Many employees say they never intend to retire in the traditional sense. Also, "retirement" does not attract the attention of young employees you may be trying to recruit.

Moreover, "retirement" in the DB plan name does not define what the plan does – reward loyalty. Find a new name that does – like "Career Reward Plan." And in your new description of the plan, state, "when your full-time career ends" instead of "retire."

Making Loyalty Count

Employees want to be proud of their employer and proud of the work they do. They also want to hear their employer say it is proud of them – and prove it.

Loyalty matters in traditional DB plans. For every year employees invest with the organization – up to the plan's limits – the DB plan rewards them.

A personalized DB plan statement or web site can highlight the "loyalty value" of one or a few years. This also sends a subtle message about how much the employee will lose by going to another employer. Here's how:

> "Your loyalty to Acme Inc. during 1998 added a projected $20,400 to the amount your Career Reward Plan will pay if your lifetime benefits start at age 65 and you receive these benefits until age 90. By continuing with the company for another five years, you will add an estimated $102,030 to those lifetime benefits during that period. These figures assume your pay and the plan remain unchanged. This is in addition to the contribution Acme makes to your 401(k) plan and any stock options you receive."

Recruiting Punch

Too often in recruiting materials and applicant interviews, employers just say "...and we offer a company-paid pension plan."

That will not get the attention of talented candidates the organization is trying to impress.

How about something like this in recruiting brochures or on your company's web site:

> "At Acme Inc., we know loyal employees are high performers who make our customers say "Wow!" That's why Acme has a special Career Reward Plan. It provides you a lifetime income when your career at Acme ends. Suppose you were "fast forwarded" right now to the end of a 25-year career with Acme. Using the value of money today and an average pay of $45,000, at age 65 your annual payout for as long as you live would be $16,875. During the 25 years from age 65 to 90, you would receive $421,875 – that's the plan's "career reward value." These figures assume that your pay and the plan remain unchanged. Naturally, as your pay goes up, so does the payout amount."

Would new recruits find this attractive when combined with the description of the 401(k) plan, stock options, and other benefits and perquisites of the new job?

A Package Deal

Most personalized statements separate DB and 401(K) plans. This sends the wrong message if the company wants both plans to be viewed as important elements in employees' future income.

One way to increase appreciation of the DB plan is to explain it as a "value" they can count on even if the stock market dives – a lifelong income with a PBGC guarantee. Here's how the DB plan's "guaranteed future income value" could be show on an employee's personalized statement:

"You should consider the value of your Career Reward Plan benefit in deciding how to invest your 401(k) account. Acme Inc. insures your Career Reward Plan benefit – up to the legal limits – through the PBGC, a U.S. government agency. As of January 1, 1999, your projected "career reward value" is $466,850 – it's also your "Guaranteed Future Income Value" from the plan. This value increased from $445,850 on January 1, 1998. The 1999 amount is based on your current pay. As your pay increases, so will your projected benefit from the plan."

Selecting the Right Rewards

Traditional DB plans are not right for every employer.

Like each element in the arsenal of human resource programs, what DB plans do (the "walk") must support what the company says it values (the "talk").

For some employers, traditional DB plans provide a great way to demonstrate how employee loyalty is rewarded. While 401(k) plans say, in effect, "Thanks for your last pay period," and cash balance and profit sharing plans say, "Thanks for last year," DB plans say, "Thanks for your career."

Which message should your employees hear?

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Dennis Ackley

For 20 years Dennis Ackley has been an advocate for clarity and accountability in retirement education – helping workers gain the knowledge to achieve the financial future they want. His award-winning communication programs on retirement, investing, and health care have reached three million employees at hundreds of employers. For more articles and more information, visit ***www.DennisAckley.com***.