

Money Today or a Pension Far Away? — Communicating Cash-Balance Plans

by Dennis R. Ackley

Account-based pension plans – including the best known of the group, the cash-balance plans – are a heck of a lot easier to explain to employees than traditional pension plans. That’s one reason organizations are introducing them. Too many employers have been unsuccessful in getting employees to understand the value of traditional pension plans.

But a “nuts and bolts” explanation of the provisions is not the key to a successful introduction of the new plan.

For an account-based plan, the toughest and most important communication challenges are explaining:

- Why the new approach is being introduced, and
- What it is intended to do and not do.

Account-based plans are not simply a replacement of the existing plans. They are a new approach to helping employees understand and accumulate their financial resources

What Are These Plans?

Account-based plans are defined benefit pension plans (ensuring a specific payout amount) that look like defined contribution plans (pledging a specific input amount – such as 401(k) and profit-sharing plans). Because account-based plans are qualified under the Internal Revenue Code, they are subject to the same requirements for eligibility, funding, and vesting as other defined benefit plans – plus they must pay termination insurance premiums to the Pension Benefit Guaranty Corporation (PBGC).

Account-based plans have some of the popular features of defined contribution plans, including an

account for each participant. This shows the current value of the employer-paid benefit. The amount credited to the account is usually a percentage of the employee’s annual pay, such as 4% or 5% – or a flat dollar amount. Some plans determine credits based on age or length of service. The interest credited is a stated rate or tied to an index such as U.S. Treasury bills.

But unlike most 401(k) plans, employees cannot make investment decisions, borrow or withdraw from the account, or in most cases, make contributions.

Two Key Communication Elements

As in every benefits communication campaign, there are a host of important considerations and actions. But to make it clear to employees why an account-based plan is being introduced – and to explain what it will do and not do – two essential elements are needed.

“Account-based plans are not simply a replacement of the existing plans. They are a new approach to helping employees understand and accumulate their financial resources.”

#1 – Name the New Plan Something Other Than the “Retirement Plan”

For employees who have them, traditional defined benefit plans are “retirement plans.” These plans pay out sizable life-long benefits when long-service employees retire. Using that definition, most ***account-based plans are not retirement plans.*** They are “when your service ends” plans – whether to retire or start a new job or vocation – much like a savings plan.

If the new account-based plan is called a “retirement plan,” employees will naturally want to

see retirement comparisons between the old and new plans – projected retirement-age benefits. That is not the strength of an account-based plan (unless the new account-based plan assures future benefit accruals will be no less than under the old plan).

Rather than “retirement,” perhaps better names would be: The XYZ Company’s Future Income Fund...An Account for Your Future – a name that reflects what the plan provides. (Not “cash balance” – it does not describe the intent of the plan.) Perhaps the name and theme should promote the plan much like a fixed-income investment that assures employees a stable future account.

To make good use of an account-based plan in recruiting new employee prospects, don’t hide its key features by using “retirement” in the name of the plan. Too many young candidates will simply ignore it.

#2 – Communicate in a Way That Demonstrates Your People Strategy

In communicating a new account-based plan, be sure to use a “do what you say” approach. This starts by taking a look at what the new plan is designed to do as well as your organization’s intended people strategy. Both should be vividly reflected in the communication campaign.

For example, if one of your organization’s key goals is to use the new account-based plan to help attract the best talent, then as part of the initial communication, prepare a recruiting pitch about the new plan and post it on your internal and external web sites. And be sure existing employees know about it.

Also, tell employees how the plan supports fairness and rewards each year worked. Under often-used account-based plan provisions, all employees who invest the same number of years with the company will be rewarded with an account that reflects the same portion of their pay during that time – plus interest.

If one of your stated goals is to make the plan’s benefits more straightforward and easier to understand, maybe it’s not best to send the “benefit brigade” to communicate the plan. If the new account-based plan is simple – and it supports the people strategy – use some senior managers as key

communicators. And make sure the communication looks simple and is easy to understand.

Simple to Communicate?

Account-based plans may be simpler to explain than the traditional ones, but introducing them isn’t always a slam dunk.

In September 1997, *The Wall Street Journal* reported that a major firm had introduced a new cash-balance pension plan, telling employees it was a “big improvement” over the plan it replaced. According to the report, the communication to employees stated that the organization modified its pension plan “...to better meet the retirement needs of our people by helping them achieve financial security at retirement and to provide an incentive for younger people to stay with the firm for a longer period of time.”

Soon after the January 1, 1997 introduction, a number of employees began to question the value of the new plan. According to the article, some employees age 40 to 50 were seeing retirement payouts cut by nearly 70% – and they were “furious about the new plan.” In all, this was not the positive employee relations event the company had intended.

Who Are You Calling a Loser?

Organizations that make the switch to account-based plans from traditional pension plans face a difficult communication task with employees who likely would have received a larger benefit had the change not been made. Human resource staff members put in long hours studying the winners and losers in the plan-design process. (See “How Difficult Can It Be?” sidebar) Unless the organization is willing to allow employees to take whichever plan would provide the most – and drive up plan costs in the short-term – some employees are bound to end up on the short end. There’s another word for these losers – it’s “employees.” So be sure not to assign them the “loser” title publicly. Also, pay special attention to how this group is treated – it should be done as a textbook case of communicating “bad news.”

Here's a brief summary for your "bad news" communication checklist:

- Explain why the action is being taken.
 - Describe the news in a clear and straightforward manner – for this group, a comparison of the projected benefits under the new account-based plan and the old plan will probably be necessary.
 - Explain how the decision is fair to as many groups as possible – even if it is seen as unfair by this group.
 - Involve a high-status messenger in delivering the message.
 - Deliver the message in a timely manner.
 - Identify who made the decision and what process was used.
 - Describe the effort that went into the decision.
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- Outline some of the alternatives that were considered.
 - Show that the organization cares about employees (this will be tough).

Communication Solutions to Communication Problems

Improved communication is often mentioned as one reason for converting to an account-based pension from a traditional pension.

If that is the **only** reason, then maybe it's time to reinvent the communication.

Rather than killing off the traditional pension plan – provided it supports the organization's business and people strategy – find a communication solution.

There's an easy way to improve employees' understanding and appreciation of a traditional pension plan. Organizations should revamp the personalized pension communication to focus on the "lifetime retirement value" of a traditional pension plan. Here's an example ...

"By continuing your XYZ Company career to age 65 – assuming your pay and the Plan remain unchanged – your estimated Retirement Plan benefit would be \$18,650 each year for as long as you live. If you are retired for 25 years (age 65 to 90), the Plan will have paid you \$466,250."

Using this straightforward and accurate approach, even a modest pension plan can gain respect among employees.

Some communication techniques that are used for traditional pension plans have devalued the employees' perception of the plans. Here's how.

Most personal pension plan communication shows employees a projected monthly pension benefit – and little else about the plan. The only people who will get a pension for one month are those who die after receiving one payment. For most employees, the stream of monthly payments will go on for hundreds of months. Showing employees the total for a lengthy stream of payments shows the real value of the pension plan.

Another communication mistake is to automatically provide employees with the "accrued benefit." Talk about your bad first impressions. For newly hired employees, it is a minuscule benefit amount. The traditional pension plan is not designed to provide a sizable benefit to short-service employees. Why show off the plan's weakness unnecessarily?

The accrued benefit is the "here's what you'll get if you quit now benefit." Why highlight that? (Do you highlight the COBRA benefits for your health care plans?) The traditional pension plan rewards long service. So focus on the projected benefits at retirement age. If employees want to leave the organization before that age, they have the right to be informed of their accrued benefit. But don't show the "quit now" amount to employees the organization hopes will remain loyal.

Why Retirement Plans Are a Mystery

According to the 1998 Scudder Kemper Baby Boom Generation Poll, about two-thirds of the more than 75 million baby boomers have no idea how much their upcoming retirement will cost. For the other one-third, it is not clear how accurate a figure they have. None of this should be a surprise because less than one-half of the American workforce has ever tried to figure out how much money they will need to retire. That's according to the 1998 Retirement Confidence Survey.

Apparently, most American workers are clueless about the financial aspects of retirement. And they certainly need to become more savvy. That's because their retirement will likely cost more than any other purchase they make. Most people believe

a house will be their most expensive purchase. Yet, the price of a house will typically equal between two and four years of their pay. How much will 25 years without their pay cost? That's the price of retirement for someone retiring at age 60 and living to age 85. Fortunately, they'll have Social Security, pension income, personal savings, part-time jobs, and other sources of funds to help cover the cost of their retirement.

Sexy Lump Sums

Given this massive naiveté, it's little surprise that 88% of employees who had a choice took lump-sum payouts at the end of their employment rather than a lifetime of payments – called an annuity. Even 65% of employees over age 60 took the lump sum. So did 81% of the people with payouts valued at \$40,000 or more. These figures come from a 1998 Watson Wyatt study.

This helps explain why account-based plans with lump sums easily gain initial positive reaction from employees.

If employees don't know how much they will need for retirement, a single sum will probably seem more valuable than a string of payments.

Test it yourself. Ask a few employees, "At age 65, would you rather have \$100,000 or \$1,200 a month for life?" You'll likely find far more takers for the lump sum.

By the way, the actuaries say that \$1,200 a month is about 50% more valuable than the \$100,000 lump sum.

Part of the reason lump sums are popular is that employees don't stop to consider that half the men who reach age 65 will live past age 80. That's 180 months. Most women will live longer. And people with exceptional gene pools and good health could expect to live past 90. That's over 300 months.

The Dark Side

The attractiveness of the lump sum may be in part because of the remarkable stock market performance in recent years. Many people have come to expect they can earn sky-high investment performance on that seemingly huge payout. Yet, research shows that most people in their retirement years become quite conservative – focused heavily on the safety of all the money they'll ever have.

So at age 65, a retiree who plans on looking forward to living to 85 (240 months) should consider a \$100,000 lump sum divided into 240 payments. In this case, that has a value of around \$416 each month from the lump sum – assuming inflation and investment performance are the same. That may be a reasonable assumption for retirees who use bank savings accounts or government guaranteed investments for their life's savings. If inflation outpaces investment performance, the monthly value will be less. If the retiree's investment of the \$100,000 earns 2% above inflation – a 5% return in a 3% inflation environment – the retiree will get \$88 more each month. Yet, if the retiree lives beyond age 85, the monthly payment goes to \$0.

If the retiree chooses a monthly annuity – a lifetime of monthly payments – the \$100,000 lump sum would have been converted to about \$820 every month for life. Not a good deal if the retiree dies after only a few months. Inflation is still a problem. And retirees should consider the future stability of the insurance company that issues the annuity. However, if the lifetime payments are made by the defined benefit plan, a significant portion or all of the payments would be backed by the Pension Benefit Guaranty Corporation.

These are a few of the issues about the choice between a lump sum and an annuity that need to be carefully explained to employees as they plan their retirement.

Do What You Say

The account-based plans are not necessarily better or worse than the traditional plans. But they are different in the way they credit benefits – most often evenly to all employees regardless of when they leave the organization. Traditional plans credit benefits more heavily toward employees with longer service.

Naturally, employees who expect to have a short stint with the organization will appreciate the account-based plans. Employees who look forward to a long career with the company will find the traditional plans more attractive.

The key question is, what types of employees does management want to attract and reward? In some industries, the account-based plans are well suited – and traditional plans would not support the organization's business and people strategy. In

other businesses, traditional plans demonstrate the importance of long-service and long-term employee loyalty.

As in all key decisions about human resources, the adoption of any benefit plan should be linked to the business strategy. Here's the test. What does your organization say are its values and what does it do to prove it?

The move to account-based plans reflects a change in the core purpose of the plans – from providing a reason for employees to stay with the company to enhancing the reason for new recruits to join. In a tight labor market, the account-based approach seems appropriate. Yet, as researchers study the link between loyal employees and satisfied customers, human resource thought leaders need to be asking, “What are we doing to back up what we say about the importance of employee loyalty?” The account-based plans say, “Thanks for last year.” Traditional pension plans say, “Thanks for your career.” What should your plan say to employees?



A version of this article first appeared in the November/December 1998 edition of *Compensation & Benefits Review*

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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.

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How Difficult Can It Be?

Let's say you are going to re-invent your pension plan. A key step is to determine how to allocate the money your organization will put away each year for employees' future income. Here's the challenge. You have enough money to fill all the boxes – except ten. If you want to provide some extra money to the employees over age 45, you'll need to cross out ten boxes for employees age 45 and younger. If you want to provide the same amount to all employees, cross out the ten extra boxes for employees older than age 45. Or, come up with another approach. (See examples)

**Put an "X" through
the ten boxes you would NOT fill.**

								\$
							\$	\$
						\$	\$	\$
					\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
20-25	26-30	31-35	36-40	41-45	46-50	51-55	56-60	61-65

Age of employees (assume older employees have longer service)

Examples of crossing out ten boxes:

								X
							X	X
						X	X	X
					X	X	X	X
\$	\$	\$	\$	\$	\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
20-25	26-30	31-35	36-40	41-45	46-50	51-55	56-60	61-65

**All Employees Get the Same
(Typical Account-Based Plan)**

								\$
							\$	\$
						\$	\$	\$
					\$	\$	\$	\$
X	X	X	X	X	\$	\$	\$	\$
X	X	X	X	\$	\$	\$	\$	\$
X	\$	\$	\$	\$	\$	\$	\$	\$
20-25	26-30	31-35	36-40	41-45	46-50	51-55	56-60	61-65

**Older Employees Get a Lot More
(Typical Traditional Pension Plan)**

								X
							X	X
						X	\$	\$
					X	\$	\$	\$
X	X	X	X	X	\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
\$	\$	\$	\$	\$	\$	\$	\$	\$
20-25	26-30	31-35	36-40	41-45	46-50	51-55	56-60	61-65

**Older Employees Get a Little More
(A Variation on an Account-Based or Traditional Plan)**