Thinking Differently ...

Repackaging Traditional Defined Benefit Plans

Pension Benefit Guaranty Corporation
25th Anniversary
1999

Dennis Ackley

Presentation Objectives

1. Explain why employees don't get excited about traditional DB plans.
2. Offer a "consumer-oriented" approach to explaining the cost of retirement.
3. Suggest ways to increase employees' — and employers' — perceived value of DB plans.

Thinking Differently

USA NOW

September 7, 2020

RETIREMENT CRISIS WORSENS

President signs emergency retirement bill

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No-Choice Meal

New ways to serve it hot or cold

Retirement savvy test required for high school graduation

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Test of Basic Retirement Savvy

#1 A couple accustomed to $50,000 a year in “spendable income” wants to retire at age 65. If they expect to live to 85 and keep their current lifestyle, their retirement will likely cost (in today’s $):

A. $250,000

B. $500,000

C. $750,000

D. $1,000,000

Test of Basic Retirement Savvy

#2 An employee who expects to retire at age 60 and live to 85, and who currently has $100,000 in a 401(k) (assuming inflation and investment rates are the same), should view that money as:

A. Taxable income
B. Help covering medical and long-term care expenses
C. $4,000 worth of income a year
D. All of the above

Test of Basic Retirement Savvy

#3 At age 65, a typical retiree who wants more value should choose:

A. $100,000 single lump sum
B. $1,500 a month for life
C. Trick question — both same value

Test of Basic Retirement Savvy

#4 At age 65, a typical retiree who has $100,000 and wants a monthly income that will last a lifetime should expect — **by buying a lifetime annuity** — to receive about:

A. $300
B. $700
C. $1,500
D. $3,000

Test of Basic Retirement Savvy

#5 At age 65, a typical retiree who has $100,000 and wants a monthly income that will last a lifetime should expect — **by withdrawing the same dollar amount each month from an invested account** — to receive about:

A. $300
B. $700
C. $1,500
D. $3,000

Our Secret

Our Pledge

I pledge not to tell employees

Our Secret

unless I also tell them

"Compared to What You'll Need"

so they can become retirement savvy.

Our Secret

Most baby boomers
will **NOT** have
enough money
during retirement
to maintain their
current standards of living.

How Big Is Our Secret?

A couple accustomed to spending
$50,000 a year, wanting to retire at 65,
will need 20 years of income (to age 85)

$50,000 x 20 years = $1 MILLION

to maintain their current lifestyle
during retirement.

How Big Is Our Secret?

Ackley's Super Simple
— But Not That Far Off —
Retirement Income Estimator

Current Spendable Income (Lifestyle)
X Retirement Years (Time)
= "Ballpark Estimate"

- May be off 10% - 20%
- Most employees have no idea!

Why Don't They Know the Secret?

- Employees know prices of homes, cars, and TVs.
- Why can't they come within $50,000 — even *$500,000* — of their retirement "price tags?"

Why Don’t They Know the Secret?

Retirement

is **NOT** considered

a consumer item.

Big Idea

Why Retirement Isn’t a Consumer Item

Who wants to buy or sell something that:

- Provides no immediate gratification
- Has no easy-to-understand price tag
- Cannot be attractively packaged
- Has no noticeable group of unsatisfied customers demanding improvements (Soon to change? Where’s Ralph Nader?)

The "Retirement Business" Has Changed

- Rich pension plans are becoming rare
- Long-service employees are rarer (perception?)
- Retirement gets longer as life expectancy soars:
  - At age 65: age 81 men and 84 women (half live longer)
  - From birth: nearly 20 years longer than in 1936

The "Retirement Business" Has Changed

- Baby boomers postponed buying homes and having children — still paying for both
- Americans' consumer debt soars while savings rate is low and falling
- Organizations have "quietly" transferred retirement responsibility to employees

The "Retirement Business" Has Changed

- Taxes on retirement benefits are rising (kiss 5-year averaging good-bye)
- Social Security taxes must spiral up on today's kids to cover baby boomers — or benefits must be changed

Messages Having Little Impact

Employees say
they know a lot
about retirement…
but they don't
act like it.

Big Idea

Messages Having Little Impact

95% say they know to start saving early
(Money Magazine)

However…

- 31% of eligible employees do not save regularly for retirement (EBRI 1997)
- "Free money" isn't enough — modest communication of $1 employer match gets no better participation than an aggressively communicated $.25 match (Watson Wyatt 1996)

Messages Having Little Impact

86% say they know they need
60-80 PERCENT of preretirement income
(EBRI 1996)

However…

- 64% of baby boomers have no idea of the **DOLLARS** (Scudder 1998)
- 16% in 401(k) set contributions by target (EBRI 1996)
- Employees who have tried to calculate their retirement cost have 5 times more saved (EBRI 1999)

Messages Having Little Impact

70% say they are confident about their prospects for retirement income (EBRI 1999)

However…

- 33% of baby boomers have $100,000 in 401(k) — less than two years' average pay (Scudder 1998)
- 46% of baby boomers now tap savings to meet expenses (Scudder 1998)

Messages Having Little Impact

58% say they are "extremely" or "very" knowledgeable investors (1997 Merrill Lynch)

However, mutual fund investors *do not* know...

- 48%…bond funds can lose
- 50%…company stock is riskier than diversified stock funds (1997 Hancock)
- 57%…stocks are best protection against inflation (32% say bonds)
- 33%…aggressive growth funds would drop the most if market falls (*Money*/Vanguard 1998)

Messages Having Little Impact

What do savings plan sponsors do?

	1997	1998
Education seminars	60%	↑ 76%
Newsletters	46%	↑ 49%
One-on-one counseling	26%	↑↑ 44%
Personal planning reports	20%	↑ 26%
Hot lines	12%	↑ 18%

(Plan Sponsor 1998)

Messages Having Little Impact

Do savings plan sponsors believe efforts are working?

	1997	1998
Help employees have good retirement	50%	↓ 37%
Reduce company's liability	68%	↓ 54%
Reduce employees' stress about future finances	29%	↓ 12%

(Plan Sponsor 1998)

Messages Having Little Impact

What do savings plan sponsors say?

Will even HALF of the 401(k) participants be adequately prepared for retirement?

- 62% say NO
- 61% who have "excellent communications" also say NO (BARRA RogersCasey 1999)

Why pursue "best practices" — find new ideas!

Messages Having Little Impact

Ask employees…

"What's the estimated price of your retirement?"

These people are responsible for the most expensive and important purchase they will make.

The Cost of Ineffective Retirement Education

Ineffective retirement education
— and “nouveau pension plans”
that have lower payouts —
will not change how much
employees need…
only how much they’ll have.

Big Idea

The Cost of Ineffective Retirement Education

Because employees don’t know the “price” of their retirement, they…

- Save too little
- Choose conservative investments
- Prefer a current account vs. a promised income in the future — even 65% over age 60 take lump sum over annuity (Watson Wyatt 1997)

The Cost of Ineffective Retirement Education

What can employees do who reach retirement age with too little money?

- Keep working
- Lower their standards and expectations
- Pursue "deep pockets"
  - Vote for government benefit improvements
  - Sue previous employers

It May Not Be Too Late

Join Ackley's

"Compared to What You'll Need" Campaign

to turn employees into **retirement income consumers.**

They get better "CTWYN" information buying tires, refrigerators, or Snicker bars.

Compared to What You'll Need

Use high-impact "CTWYN" messages

- **Vivid** — easy-to-understand, dollar and cents targets — not percentages
- **Personal** — simple explanations

  How much money...

  - Do I need to retire in the lifestyle I want?
  - Will my pension and 401(k) pay?
  - Do I need to save?

Compared to What You'll Need

Use high-impact "CTWYN" messages

- Explain retirement like a purchase
- Use consumer-oriented terms
  - **Retail price** — total needed if "fast forwarded" to retirement today
  - **Discounts** — amounts already paid (current savings, projected pensions, and Social Security)
  - **Layaway payment** — amount needed to purchase "financial independence"

Compared to What You'll Need

Retail price of retirement

$30,000 (annual spendable)	X	25 (years)	=	$750,000

Discounts — amounts already paid

- Current single sums (401(k), IRAs, savings) - $100,000
- Lifetime payments (pensions and Social Security at retirement)

$20,000 (annual benefit)	X	25 (years)	=	- $500,000

Your layaway payment (savings target) $150,000

Why Retirement Education Isn't Working

Current efforts aren't bad — not good enough

- Retirement education techniques are rooted in paternalism
- Investment education techniques were adopted from Wall Street — for short-sighted "stock pickers"

Retirement totally changed — education didn't

Why Retirement Education Isn't Working

Replacement ratio target — antique concept

- Assumes everyone should keep current lifestyle
- Leaves employees clueless about dollars
- Hides key elements — how to set savings targets, what sources of income are available, how to take control of future finances

Why Retirement Education Isn't Working

Retirement jargon — not "consumer-oriented"

- Blizzard of content-free terms
  - Defined benefit/defined contribution
  - Qualified plan
  - Salary reduction
  - Actuarial reduction
  - Annuitant
  - Financial security…etc.

Improving Retirement and Investment Education

Use educational sequence

- Step 1 — make me aware
- Step 2 — motivate me to learn
- Step 3 — help me understand
- Step 4 — allow me to take action and gain appreciation

Most programs skip 1 & 2 — never reach 4

Improving Retirement and Investment Education

Use the CTWYN approach

- Get employees to think like consumers and ask questions
  - Future Social Security benefits?
  - Future health care expenses/Medicare?
  - Future taxes on sheltered income?
  - Future investment performance?
  - Future impact of inflation?
  - Future home ownership arrangements?

Improving Retirement and Investment Education

- Consider new names — not "Capital Accumulation," "Tax Deferral Plan," or "Defined Benefit" — sound like they apply to high-income or older employees
- How about "Career Reward Plan" for DB and "Financial Freedom Builder" for 401(k)?

Improving Retirement and Investment Education

WARNING LABEL

The Chairman of the Federal Reserve warns that this 401(k) plan and other "retirement plans" may cause hallucinations — a belief that you will be adequately prepared for retirement. This temporary mental state may last to about age 60. Then you'll realize you've screwed up.

Reinventing DB Plan Communication

More emphasis on what DB plans do — less on how they work

Reinventing DB Plan Communication

Get employers focused on what DB plans do

- Reward loyalty (service)
- Reflect accomplishments (pay)
- Guarantee income — insured for a lifetime
- Clearly represent an employer-paid benefit
- Allow some funding flexibility
- Provide cost-efficient way to pay for targeted amounts

Reinventing DB Plan Communication

Get employers focused on sending the right messages to employees…

- 401(k) — "thanks for a pay period"
- Cash balance — "thanks for a year"
- Pension — "thanks for a career"

What do employers want to say…and to whom?

Reinventing DB Plan Communication

Stop communicating…

Monthly projected benefit

"Your projected age-65 Qualified Defined Benefit Pension is $1,554.16 a month."

- How many employees intend to be retired one month?

Reinventing DB Plan Communication

Start communicating…

Your Career Reward Value

"By continuing your Acme Inc. career to age 65 — assuming your pay and the Plan remain unchanged — your estimated annual Career Reward Plan benefit will be **$18,650** for as long as you live. If you receive payments for 25 years (age 65 to 90), the Plan will have paid you **$466,250** (insured up to the limits protected by the PBGC, a U.S. Government agency)."

Reinventing DB Plan Communication

Stop communicating…

Accrued pension benefit

"If you would leave the company today, the plan would pay…"

- Horrible first impression
- Tiny amount for short-service employees
- Don't "disclose" unless requested

Reinventing DB Plan Communication

Start rewarding loyalty…

- Key in many high-performing companies
- Link between loyal employees, satisfied customers, and happy investors
- Old — “how long you kept your job”
- New — “employer/employee relationship built on mutual trust and mutual passion for success that continues to add value to each other”

Reinventing DB Plan Communication

Start rewarding loyalty…

“Your loyalty to Acme Inc. during 1998 added a projected **$20,400** to the amount the Career Reward Plan will pay if your benefits start at age 65 and are paid to age 90.

By continuing with Acme for another five years, you are projected to add **$102,000** to the lifetime benefits you will receive during that period.”

Reinventing DB Plan Communication

Stop segregating DB and 401(k)…

"This 401(k) Account Statement does not include the benefit you may receive from the Qualified Defined Benefit Plan."

Reinventing DB Plan Communication

Start communicating…

"Your Career Reward Benefit Plan is like a *Guaranteed Future Income Value* of **$466,250**. This is the projected amount the plan will pay you during retirement from age 65 to 90. (Actual amount depends on how long you live.) You may wish to consider this "value" in planning how to save and invest in your Financial Freedom 401(k)."

One-year value increase:

January 1, 1998		January 1, 1999
$445,850	+4.6%	$466,250

Reinventing DB Plan Communication

Stop using "faint praise" in recruiting…

"…plus Acme offers an attractive Qualified Defined Benefit Plan."

Reinventing DB Plan Communication

Start communicating to recruits…

"Acme rewards high-performing, loyal employees who make customers say "Wow!" The Career Reward Plan provides a lifetime income when your Acme career ends. Let's say you were "fast forwarded" to the end of your 25-year Acme career at age 65. Using today's value of money and $45,000 pay, your annual payout would be **$16,875** for as long as you live. If it is paid from age 65 to 90, you would receive **$421,875**. As your pay goes up, so does the payout amount."

Reinventing DB Plan Communication

Should you add the "Retirement Value Perspective" to 401(k) plans?

"If you were retiring today and expecting to live 20 years during your retirement, your 401(k) savings plan balance of $100,000 could pay $5,000 worth of income per year ($416 a month) — assuming investment performance and inflation are the same."

Summary

- Make retirement income a consumer item
- Focus on awareness and motivation
- Reinvent DB communication
  - Show the real value
  - Emphasize what DB plans do
- Keep your CTWYN pledge

Traditional Defined Benefit Plans

FREE MONEY — AND LOTS OF IT — FOR AS LONG AS YOU LIVE… GUARANTEED!

Test of Basic Retirement Savvy — Answers

#1 D. $1,000,000

#2 D. All of the above

#3 B. $1,500 a month for life — According to actuaries, at age 65 the $1,500 a month for life provides nearly 50% more value for typical retirees than $100,000 in a lump sum.

#4 B. $700 — At age 65, $100,000 used to purchase a life-only, single premium annuity from one of the major life insurance companies will provide about $700 a month. Rates vary based on sex, competitive practices, economic conditions, and other factors.

Test of Basic Retirement Savvy — Answers

#5 A. $300 — At age 65 with $100,000 in an invested fund (assuming 50% in an intermediate government bond fund and 50% in large company stocks), a retiree should expect to be able to withdraw the same dollar amount each year equal to about 4% of the initial lump sum amount. So 4% of $100,000 is $4,000 — about $333 a month. Why only 4%? This is based on research of every 25-year period of market performance beginning in 1929. The concept is the same as dollar-cost averaging — except it is in reverse. When the market goes down, a larger number of bonds/shares must be cashed in to provide the monthly payments. When the market rebounds, there are fewer bonds/stocks to participate in the market gains. This is an over simplification of the explanation provided by Scott Burns at www.scottburns.com — click on 'The Spender's Portfolio.' A key assumption is that the stock market in the future will act somewhat like it has in the past.