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## Session 70PD

### Plan Design Issues: The Employee Perspective

**Track:** Pension  
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*Summary: Panelists discuss the retirement needs of today's workforce and how the various sources of retirement income combine to meet those needs. They also look at how retirement income needs change throughout retirement. Discussion focuses on the role of employer-sponsored retirement plans in meeting those needs and the effect of these plans on employee behavior. Panelists cover issues associated with communicating various types of plan designs and changes in plan design to employees, as well as the risks assumed by employees and the role employers play in educating employees about those risks.*

**Ms. Rebecca A. Sielman:** We're going to be talking about plan design from the employee's perspective. I have with me James Kenney from Coates Kenney and Bill Torrie from PricewaterhouseCoopers. I'm from Milliman & Robertson.

Bill will start us off by talking a little bit about what goes into employees' retirement decisions. Then Kenney is going to talk a bit about the employee's perspective on plan changes, and I'm going to wrap things up by talking a bit about broader communication issues.

**Mr. William Torrie:** This session is on plan design issues from an employee's perspective. As a result of changing priorities many employers have kind of stepped away from the retirement issue; retirement has really become much more of a matter of individual planning and decision making. I'd just like to emphasize again these opinions are my own, and they're really based upon my experience in terms of the benefit side. As my employer company is currently redesigning their retirement plan I think it does point out that employers are perhaps reconsidering some of the design decisions they've made over the last decades. I've been working as an actuary for the last 25 years. I really started working back in 1970, and I'm about to retire in the year 2000, so I've had an opportunity to watch things change. I'd like to just discuss my observations, and if anybody has any different observations, I'd sure like to hear about them. Number one will be the employer involvement; number two will be nature of work.

Life expectancy. I don't mean just how long you're going to live, but what kind of health you are going to have while you're living. Family status. That's changed quite a bit. Personal expectations. I think that drives a lot of retirement decisions, and, of course, the governmental decisions affect a lot of what we do.

Employer involvement. I think the general observation, and probably all will agree, is that there's been a reduced reliance on defined benefit (DB) plans, both on the pension and the retiree

medical benefits. On the pension side, I guess, it is because of the complications and the lack of appreciation by most employees. Retiree medical benefits. Most employees didn't know about them until they finally got them, or maybe they were near retirement, but that wasn't the reason that employers cut back on them. It's just that they finally were forced to realize how much they really cost, and it wasn't a bad idea. I remember in early 1980 when I was involved in some union negotiations. Neither side had any idea of what they were promising employees, and they tried to redirect some of the negotiations away from retirement medical benefits. There's a much greater reliance on individual account plans. Yes, the employees now know how much they have to work with or have some expectations about how much they're going to have to work before they actually retire.

And I think for many employees the DB plan helped determine when retirement occurred. A target age of 60, or maybe even earlier, was of value as a significant subsidy. Frankly, one of the things that's driving my decision to retire is while we have a cash-balance plan, there's a leftover Social Security supplement from the old plan that kicks in at 55. Essentially, for each year I work after that I'm kind of losing some value. There are a lot of other decisions, but that's a factor driving my decision. I think with the going away of all those subsidies people now have to look at their own individual account, think about what it's going to be at a particular age or what they'd like it to be, and figure out what they need and make their decision on that. I guess there are lots of variables. As a matter of fact, I think one of the driving factors is, when am I going to retire? I have to accumulate enough, and then once I've accumulated enough, I have to have enough to live or survive for a specific period of time.

Nature of work has changed quite a bit. If you happen to be, and it wasn't me, in a physically demanding job, a lot of that's gone away. Jobs are less and less physically demanding. However, they have become more and more intellectually demanding. I mean, among E-mail, reading the papers, checking the global and local notices from our firm, and reading all the stuff that comes from our technical people in Washington, I spend the first two hours of the day just bringing myself up-to-date on what happened the day before. And there are other issues that are changing, such as involvement with computers. It hasn't bothered me, but I know there are other retiring partners who are still staying away from them. Things are changing. Computers make life either more difficult or easier, but it's different for different people. I don't plan to do telecommuting, but I think it will enable some people to maybe work a little bit longer. They don't have to travel every day. A lot of people have chosen to live a great distance from their work. I live 200 miles from where I work, so I end up living away from my family for 4 days a week, and that's probably one of the driving forces in my decision. But the opportunity for telecommuting, should it arise, might make some other people's decisions change.

Life expectancy. I think we all observe that it's continuing to increase. People are expected to live longer. I think people are expecting to live longer periods of healthy, active retirement, either by retiring early or simply being healthier in the first years of their retirement. And that drives some of their expectations of what they think they're going to do. I think there are also longer periods of what's called frailty.

Let me get into that a little bit further. It's a period where you're really not completely independent, but you're not completely dependent. This is being driven by people being healthier and by finally reaching a point where they're starting to break down. Then there are other things that help them survive, but it's not quite complete disability. Greater reliance on drugs as people age. Once you start focusing on this, your eyes catch a lot of things. I won't read this whole letter in *The New York Times* written by a retired advertising executive who was talking about closing in on frailty. He starts off this little letter describing how he's sitting in church, looks down, and sees he has two different colored socks on. He realizes he's starting to not be

completely with it, and he starts talking later on about his doctors. He has only one God, but he has a special doctor for his eyes, a special doctor for his ears, and a special doctor for his skin. He goes on for five more. And he says, "I spend most of my time sitting in waiting rooms waiting for doctors." Just to show you how up-to-date this talk is, this is an advertisement in this morning's *Wall Street Journal*. It essentially says, imagine being in your 90s and still being able to recite each of your favorite songs. Now, who's selling that? A drug company. There's a greater reliance on drugs as people age. That is because physically doctors and surgery become less and less of an option, and drugs, as pharmaceutical companies become more and more creative, are giving people opportunities to have healthier, happier, and longer lives at some expense.

Financial planning. IRAs just started when I had my second job. My first job was in 1968. I stayed there for five or six years. They had a retirement plan that I probably could have participated in, but, of course, you choose the mortgage first. The intellectual judgment is the house is my retirement plan, I'll sell it some day when its value has appreciated. By the time my second job came around IRAs were available, and their role had greatly expanded over the last 25 years. Some people at least have been contributing to them. They should have substantial accounts. If they've moved from job to job and were able to get distributions, they roll those into it. It becomes more and more of an individual account, and that clearly means an individual-decision-type plan. Going along with that, of course, is the entire financial industry with the mutual funds and the financial planners. More retirement plans are individual-account-type plans, whether they be savings and profit-sharing plans or even a trend towards cash-balance or the other lump-sum-type plans. I mean, when I started in the pension field, lump-sum plans were popular, at least the ones that clients at my firm had, but they weren't communicated that way. They were communicated as pensions, and when you reached retirement, they converted that benefit to a lump sum. When I started they were using 5%; not long after I started interest rates rose. They got the great idea maybe we should raise the interest rates on these conversions. What happened was that people might work an extra year, and the account value or the lump-sum value would actually go down as interest rates went up. That, as a little bit of background, is one of the thoughts in redesigning pension plans to be cash-balance plans. They said if 90% of our people are taking lump sums, let's communicate it as a lump sum throughout their career instead of having this thing bounce around. Bottom line, most people now are having their retirement benefits communicated as lump-sum accounts.

Many living expenses are low. That may sound a little contradictory, but I'm talking about basic expenses. By lower I mean as a percentage of your income or your actual required living expenses: housing, food, clothing, and transportation. I think it generally becomes a smaller portion of most retiree's income. I can't say it's true for everybody. I don't intend it to be a blanket statement. I think for a larger portion of the population that part of their planned expenditures has gone down. But new expenses are being introduced. Some are voluntary. Entertainment. Atlantic City. Who's going to Atlantic City? Atlantic City is our gambling Mecca in the New York City area; they have buses going down each day and there are a lot of retirees on those buses. But there are other real expenses, some elective, like long-term-care (LTC) insurance. Every retiree I've spoken to, and people have some comfort talking to me about it, has bought LTC insurance. By the way, there was a session here on LTC insurance, and it was really very interesting. The fellow who gave part of the talk who I spoke to had a lot of interesting thoughts about the aging process, what LTC insurance could provide, and some of their thoughts on what kind of changes the insurance companies could make to the contracts to make them more attractive. He also mentioned, of course, prescriptions drugs, one of the largest expenses. I have a couple of multiemployer plans. Eight years ago, during some negotiations, the prescription drug cost for their retirees was 10-15% of their total expenditure to retirees. Now it's well over one-third. I told them, "Look, you have the regular cost of living for

drugs going up 15% or so a year, but what's not seen is the rating; that is, which drugs are used." In other words, as people get older, that's about the only alternative that the doctor has.

More work available. When people retire it doesn't mean that there isn't a job out there for them. At the high end you'll see some people being offered some sort of consulting arrangements with their former employers. At the low end they offer medical insurance. In one multiemployer plan for a retail operation, they have employees who work 40 hours a month. They get very low wages, \$6-7 an hour, and they use it to buy their medical insurance from the employer. In other words, they're essentially working about 40 hours a month to buy medical insurance. They work and get the paycheck with deductions for the medical insurance. They go home with essentially no cash, but they have their medical insurance. Sometimes that can be quite important, especially if you have a spouse, an adult child, or somebody who needs medical insurance. If you get it on a group basis, you're getting a rate.

Family status has changed quite a bit. The old model of retirement was when you get old enough, you eventually move in with your kids. That doesn't happen much anymore, probably for some good reasons. But now you find, at least I found from talking to people, that some are actually ending up supporting their children to some degree because they had children as a result of a second marriage or they had children later in life. Either they got married later or it's a second marriage. In any case, their children are older or it may take longer to educate them. They may now even be supporting the grandchildren financially because of a family breakup. The grandparents become involved and end up taking them on, not just financially. This is their daily activity, watching the grandchildren while their kids go to work. I think you have more people determining their retirement based on their disabled adult children. I have one particular situation in mind. This fellow is 72 years old and has no plans to retire. Why? He has an adult disabled child. He needs the medical insurance, and that's what he's getting from the company right now. If he terminates, he has no medical insurance. And it's not unheard of for people to retire in their mid-50s or 60s to care for an adult parent for whom they have to provide some sort of maintenance or care. Family status has changed, I think, quite a bit.

Personal expectations. I don't want to get into this too much, but it depends on financial status, and by financial status I really don't mean a single income you have to retire on. As actuaries, you probably need to think of this as: What's the present value of my future expenditures? What's the present value of my future income? And the net of that really is, what is my financial status? Some people have a fairly low-level DB plan sponsored by a company or a union in the old style. It didn't cost the company money, and everybody is happy with it, so they just let it go. Maybe retirement is determined by their personal health, their financial status, or their family status. They actually have situations where they have children living with them. The extreme wealthy have been doing what they want to do right along. They'll continue to do it as long as they want, and it's really not a consideration going into a retirement phase. Hopefully, for the majority of us, this is open for discussion. It's a planning situation. You have to think about what various retirement phases you're going to want to participate in.

The government seems to have had a mixed policy over the last several decades. Even right now, I looked at this and said, "Bill, you've left out ERISA." There is a 30-year gap just because it's been there for most of the time, but if you went back 30 years, retirement plans were probably different. Many of you may not realize it, but before ERISA you could have a pension plan where, if you showed up for work at age 65, you got a pension. If you didn't, you didn't get anything, even after 30 or 40 years. Those are pre-ERISA plans, which did exist.

But generally, since ERISA, the availability of qualified plan benefits has limited the amount of compensation that can be recognized and limited benefits, it generally has cut back on tax-

favored retirement benefits. Social Security. They've chosen to increase the Social Security normal retirement age. I don't think they did it for Medicare, which is what will be the driving force when people eventually retire. An extra 10–15% of this maximum \$16,000 a year isn't going to make a whole lot of difference, but Medicare will drive it.

Then, of course, tax changes. It wasn't long ago when all your Social Security benefits were not taxed. There have been other tax changes. One notable one that I've seen raised is taking your distributions out of qualified plans. For some plans there are tax penalties if you take too much out or leave your money in too long. The distribution that the government has set up really doesn't follow people's needs. People need to be higher in the early years and lower in the later years, and it doesn't quite match what the government has done.

What we're talking about now is really my perspective. Retirement planning is now an individual issue. You have to make your own plans, and it really requires a financial planner and a retirement plan. A financial planner usually is somebody who tells you: "You have to put more in equities." I am thinking of somebody who actually helps you lay out your expenses on a year-by-year basis. What do you want to do? What do you think it's going to cost? They help people actually plan their retirement, which might be for a very long time. Should employers provide this as a benefit? That might be interesting if it's a tax-saving benefit. You wonder what benefit that particular advisor might be to the individual employee. And what is required by the employee? He owns the whole thing. He has to get out there and really prepare a budget for his retirement and plan what he wants. He needs to think about what he wants to do, get that budget together, and see if he can actually manage it. By the way, I've left out of this all of the finance side. If you get a lump sum, what are you going to do? Buy an annuity or invest it? What is the balance going to be? That's another consideration to discuss right now.

That raises the question, what is retirement? It's muddy at this point. Does retirement mean you stop going to work every day and sit on the porch or get in a Winnebago? For some it's just a reduced workload. That seems to make many people happy in the sense that they kind of stay involved with their business for a while but gradually get out of it. It might mean increased leisure, but just because you stop working doesn't mean that you're not going to take on more charitable works or volunteer work. Why is this important? Well, leisure may require some increased expenses when you're traveling or when you're doing some other things that generate additional expense. There are other opportunities that don't generate income. Is retirement just a pure disability? I did a little bit of reading about retirement and had something confirmed the other day. I used to think that the age 65 cutoff came from Otto von Bismarck. I mentioned that to Arnold Shapiro one night, and he said, "Oh, no, Bismarck started at age 70." Bismarck's retirement system set the normal retirement age at 70, and I actually happened to see something on the Web site yesterday that actually confirmed that. Later on, about 20- or 30-odd years after the program was first put in, they reduced it to age 65. So many people I think at least initially considered retirement, by fact of age, as a form of disability. Does retirement increase family obligations? I think in my personal case that may have been the driving force.

Retirement phases. Typically there's a reduced or a changed work activity, but then you may go into a period where you're more active, where you're finally catching up on some of the things you've been deferring because you were working and you couldn't travel for six months or just picking up on some old hobbies that you enjoyed. Eventually, though, it has to catch up with you. For most of us, I'm sure there are some exceptions out there, this phase involves a less active but still healthier lifestyle with some reduced expense combined with reduced activity. Some actuaries are starting to model this and are now looking for ways to come up with statistics to generate rates to help both the insurers model their insurance products and individuals help develop some of their own expectations. When you become frail, there are actually some legal

definitions of frailty. It's done for the government programs and other corporate insurance programs where people are provided with benefits based on their level of disability. The term used is limitations on activities of daily living (ADL); ADL being something as simple as washing yourself or maybe going shopping. They have a whole list of these, and depending on how many of these limitations you have, that determines your "level of frailty." At that point you may have a significant increased maintenance expense. Simply because you can't drive around anymore, you need somebody else to help you get around, or maybe you'll have to move into some sort of scenario where there's less need for travel. And then finally perhaps the last stage of retirement might be when you are actually disabled where there's increased maintenance and medical expense.

Fundamentally, what you have to do is actually think about developing a goals analysis and a cash-flow analysis. It may not be a discreet, predictable one—maybe you have to have variations on it—but you have to expose yourself or the retiree has to expose himself or herself to what the variabilities and what the expectations are. Some liabilities can be managed by the individual. If you're accustomed to traveling and you think of your extensive traveling as a liability, something you really want to do, you can cut back on that. Some, however, are insurable risks, LTC being one in particular. And you have to make decisions as to which ones you're going to leave for yourself to manage or leave to a professional.

In closing, I'd like to plug a field that I haven't appreciated. It came to me from reading one of the articles in the *Investment Section's* newsletter. It's something I noted a long time ago. While actuaries and economists have come up with mathematical models, it turns out that people really don't operate in as efficient a mode as they really should. This grand field of psychological economics measures these variables. They have these typical psychological tests. They bring in groups of people and test them to see how they respond. There's a book called *The Winner's Curse* written by Richard Taylor. The point of this book is that individuals do not make economic decisions in the most efficient fashion. It might be right to do it the way we do it, but we should be at least aware of it. I think exposing yourselves to some of the concepts that I found in this book would be a good experience. The one that they mentioned which comes very close to what we're discussing is called the life cycle theory. Some of you who are younger actuaries who had different economics courses than I had, may be familiar with the name Franco Modigliani. He won the Nobel Prize for what's called the life cycle theory, and basically what he argued is that you actually do a present value—this is a theory now—of what your expected future incomes are and what your future expected expenses are and adjust your current expenditures to meet that. Now, some kids in college are doing that right now. Some people act just the opposite. They point out that the doctors tend to discount their future income. That might be the right way to go. This might be more conservative, but if they actually look at what their expected future income is, they could actually take on the debt and still be able to live a better lifestyle earlier in their lives. He does essentially what I mentioned earlier; that is, he calculates a present value of your expected expenses and expected future incomes. What Richard Taylor points out in his book is while this is a very good theory, when they actually go through and test these economic theories they don't work very well, and that's the area where he is exploring. He begins to explain how some of us handle our own mental accounting. He has what he calls current income (current assets would probably be a better term—assets meaning our big assets, our set-aside for retirement, our 401(k) account, our house, a second house, as well as future income) and he brings in the concept that these should all be transferable from one to the other. You should look at it as a big block, but we all know that we don't treat it that way. He also gets into the concept of marginal propensity to consume, which is, "How much will I spend this year and what is it all tied to?" Current income would apply, and not just the amount but the form of payment, as well as the economic environment. Form of payment is an interesting example. Let's say somebody has just won \$300 in a football pool, and he's trying to decide, "With \$300 will I take my wife to

New York to the theater or should we buy a case of champagne and have a party?” Then his son walks in and says, “Gee whiz, Dad, that means you have an extra \$20 that you could spend for the rest of your life.” It doesn’t work that way. That \$300 is going to get spent immediately somehow. However, if you get larger lump sums, then you’re more inclined to stick it into something that’s an investment set aside for the future.

Retirement planning is much more, I think, complex than it was 30–40 years ago, where you planned on getting a pension from your employer and lived on Social Security for the rest of your life. It’s tied to greater life expectancy, new expenses, and new expectations.

**Mr. James A. Kenney:** I believe that there is often a disconnect between actuaries and employees, and that actuaries have a great deal of difficulty understanding employees and vice versa. Employees don’t usually interact with the actuaries directly. However, the decisions and advice by actuaries ought to have a great deal of impact on employees, and eventually the employee response to those decisions or that advice filters back to the actuary often in a very distorted and vague way. I think that if we start from the position that plan design is often an attempt to influence employees to behave in certain ways, we can begin to understand employee responses to changes in plan design. Most people resent being manipulated.

The reality is, however, that all of us who are involved in plan design are either consciously or unconsciously attempting to influence employee behavior through the advice that we give. Typically the plan sponsor wishes to achieve a certain goal:

- “We need to attract and retain employees. We’d like to use a pension plan as a means of attracting people. A cash-balance plan or a 401(k) plan is much more attractive to this segment of the population, and in order to keep up with the competition and attract employees we need to emphasize that.”
- “We would like to reduce our workforce and we need some sort of incentive program to encourage people to retire.”

Often plan design changes are consciously driven by a desire to influence the workforce of the employer. Some of the techniques that are used to accomplish this include:

- Cliff features such as
- Five-year vesting or what used to be ten-year vesting;
- Eligibility for early retirement subsidies such as needing 15 years of service at age 55 to be eligible to retire and receiving subsidized early retirement benefits, which often have significant present values associated with them;
- Being able to retire with unreduced benefits if, for instance, age-plus-service equals 80.
- “Use-or-lose-it” features such as windows where the employee can either retire with special benefits or terminate within a specified time period. Often those are coupled with waivers of age discrimination claims: “We’re going to give you a lot of money, but you have to agree not to sue us, and we’re going to use the pension plan as a vehicle to induce you to agree not to sue us.”
- Periodic benefit updates:
- a career plan with past service updates every four or five years;
- a union negotiated plan where the benefit is a flat dollar amount per year of service, but every 3 or 4 years it gets updated so that it changes from \$20 for service to a certain point in time to \$22 for the same period of service. What these can do is to either reduce turnover as you approach the point where people are expecting an update or make it a lot cheaper to run with essentially a final pay plan.

- “Points-based” allocation schedules in defined contribution plans, cash-balance plans, and pension equity plans where if an employee has five years of service or less, he or she gets a certain percentage. If service is more than five years but less than ten years, he or she gets a higher percentage—more than ten years of service, an even higher percentage. Sometimes this type of allocation is coupled with age as well as service. This can be a means of offering people an incentive to remain in the workforce and thereby control how the employee population makes its decisions on their employment.
- Service caps in DB plans such as 25- or 30-year service caps, where once an employee reaches those caps additional service does not count for additional benefits. This is a means of inducing people to retire because once they no longer accrue any service, they can’t really get much more of a benefit except through salary increases, and often those are relatively modest at those ages.

I’m not really telling you anything new. Many times we don’t take the mental step of putting ourselves in the shoes of the people who are subject to these kinds of influences. I think that actuaries tend to believe that employees don’t understand and don’t really care. That’s something that I’ve heard a lot, particularly that employees don’t really care about a DB plan. They don’t understand it. It’s not important to them. Another phrase I’ve heard is, “Employees should be grateful that we’re giving them these benefits,” and, finally, I’ve often heard people say, “Well, really it’s in their (the employees) own best interest, for instance, to have this subsidized early retirement feature, but we can’t give it to everybody, so we have a split-phase thing, and it really worked out for the best for the employees.” The employees don’t necessarily see it that way.

I think the reasons that actuaries don’t get it are pretty straightforward. In the first case, fundamentally every actuary I’ve ever talked to believes that it is appropriate to use plan design to influence employment decisions. We take that as a given, and we base our advice to the employers and plan sponsors on the assumption that it is OK to influence employees through plan design. The second reason we don’t get it is that we work for the plan sponsor. We’re trying to help the sponsor accomplish their goals with respect to their employee population. Ultimately, you can rationalize this through many techniques. If the sponsor is able to accomplish their goals in controlling their employee population, they will be better able to deliver the kind of benefits that will help that population and so forth. But the bottom line is that we see it from the sponsor’s point of view, and, of course, the sponsor wants to be able to influence their employee population.

Another reason why we tend not to see it the way the employees do is that we believe that the rules are too complicated to explain to employees. They’re even, in many cases, too complicated to explain to the plan sponsor or to our own employees who have to administer the plans. Now, the rules are complicated. I also subscribe to the idea that it is legitimate to use plan design to influence employment decisions, and I work for plan sponsors. I’m subject to these same beliefs and points of view. I try to balance that with an understanding and awareness of the fact that employees often resent the application of these points of view.

I think you should look at what employees really feel. How many of you have been aware of all of the recent *Wall Street Journal* articles about the cash-balance plans? Quite a few of you. Now, *The Wall Street Journal* is not a populist publication. It’s a pretty conservative employer-point-of-view journal, yet the campaign that it is now undertaking with respect to cash-balance plans is a very populist campaign. It represents the employee’s point of view against the employer’s point of view. There was a *Wall Street Journal* article slamming IBM for switching to a cash-balance



plan and using the pension plan to derive income as opposed to expense through the accounting rules and avoiding plan terminations and reversions of excess assets to the employer.

Employees clearly are confused by what's going on. In fact they don't really understand many design features in their current plan, particularly with respect to what the costs of the design features are and what the economic realities behind those features are. They're somewhat confused, particularly when they're looking at the conversion of a typical DB plan in the traditional form into a cash-balance plan.

One of the responses to not knowing what's going on in a pension plan is to be suspicious. It's particularly true of people who are close to the end of their careers, when suddenly things get switched on them. It's as if when you walk through the park and there's this guy in the park with three cards, and he's doing that three-card Monte game, and you realize that somehow you're being tricked but you can't quite figure out how you're being tricked. There's a lot of that suspicion and confusion and a great deal of anxiety. They know they're close to retirement. They know that the pension plan's very important to that retirement. They know that the cash-balance plan will also be important to their retirement, but they don't quite get exactly what it's going to cost them or whether it's better or not better, and they're anxious about it.

You can liken this situation to playing laser tag. How many of you have ever played laser tag? Laser tag is played in a dark room. It's a pretty big room. It has a lot of barricades that people hide behind and dodge around. There are often flashing lights and loud music. There's often white smoke drifting around in the air and laser beams going everywhere. And, finally, there are a lot of people who are out there trying to shoot you. It's a very confusing, anxiety-provoking situation in which the possibility of loss is very real but extremely difficult to anticipate. I think that's what employees are feeling in these situations.

I'd like to talk about how the employees feel things should be, and I think it can be summed up in one phrase—fair play. I think that fair play can be rolled down into three basic doctrines. The first doctrine is the doctrine of implied contract. The second doctrine is the doctrine of informed consent. And the third doctrine is the doctrine of fair warning.

The doctrine of implied contract goes like this: In many traditional DB plans you have a long wait for a big reward. Changing the deal is unfair to people who have almost completed that long wait. Their attitude is, "I made the decision to stay in your employ because of this climate, and now I can't get a job anywhere else. I'm 52. What are my chances of going out and getting a comparable level job now? I'm locked in. If I was going to leave, I should have left five or ten years ago when I could still be mobile and get another comparable job, but I didn't do that because of this arrangement. Now, when I can't do it you're taking away the carrot that kept me here, and that's not fair. Now, if the employer's going to go bankrupt, I can understand that. If the employer understands the doctrine of implied contract to provide decent and favorable basic benefits, I can understand that, too. But if the rug is just yanked out from under me, and I'm dumped, that's not fair." And that's the doctrine of implied contract.

The doctrine of informed consent is pretty straightforward: "I need sufficient information to make decisions. If you're offering me choices, I need to know what those choices are, and I need help understanding my choices because often they're very complex. I need information, and I need all relevant facts including the company's future plans. If the company is planning a big cutback in its workforce, that has implications for me especially if I am deciding whether or not to take some sort of offer that's being made now. I need to know about the planned cutback when I'm thinking about the offer. Don't let me spend time thinking about the offer, and then find out that something else was going to happen that I didn't understand was coming while I was considering the offer.

And I need a reasonable time to decide.” I watched the University of California go through four different early retirement window offers. Each time one of them didn’t work, they sweetened the deal. As the deals got better and better, the people who had accepted the previous offers really felt like they were being cheated. This is part of what informed consent’s all about.

And, finally, the doctrine of fair warning. “I want advance notice that changes are being considered. If you’re thinking of turning the DB plan into a cash-balance plan, I want to be told that is up for consideration. I want this warning to allow me to assess my alternatives while I still have some. If I’m 47, and I can still get a job somewhere else, and you’re thinking of turning the DB plan into a cash-balance plan, that might have a big bearing on whether or not I accept the job offer with somebody else that you don’t even know I’m thinking about. Isn’t it fair to me that I get all the relevant facts when I’m making my decisions?” There have been many court cases in which employees went to their employer and said, “Gee, I heard this rumor that we’re going to be having an early retirement window. Is that true?” and the HR people say, “Oh, no, no, no, no, no. There’s no early retirement window being planned now.” The employee goes ahead and retires. Two to three months later the window opens, and there are all kinds of special deals, but, “Gee, you’re not eligible, sorry.” In fact, a recent court decision ruled in favor of plan participants in this situation and maintained that the employer should have informed the participants that such a concept was in the works.

What I’ve tried to do today is get us to see not that we should change how we approach plan design, but that we should understand the emotional response of the people who are being influenced by the plan design issues under consideration. If we can understand that, we can give better advice to our clients and help them avoid problems with their own employees who are affected by these decisions. In many cases the decisions that are being considered, such as switching from a traditional DB to a cash-balance plan, will have a very powerful impact, if not a potentially negative impact, on the employee population.

**Ms. Sielman:** The day before the handouts for this session were due I happened to notice a press release that came out of the AAA. It was entitled, “Give employees meaningful information when pensions are changed to cash-balance plans.” Ron Gephardsbauer wrote that employees should be given meaningful information about their pension plans when employers switch from one type of plan to another. This was in response to the recent press articles about cash-balance plans and the movement afoot in Congress to require greater disclosures. I thought this would be a very good starting point for talking about communication issues and how we can do a better job of communicating with employees about their retirement programs.

I found a Towers Perrin survey that looked at the extent to which employees understand their retirement programs, and the study found that over half of employees significantly undervalue their benefit packages. Let’s consider the bottom line for having a retirement program—to attract and retain and reward employees. If employees are not properly understanding the value of those benefits, then a lot of the money that plan sponsors are putting into them might as well be thrown out the window. Along these same lines, can we be particularly surprised that there are not nearly as many DB plans now as there were 15 or 20 years ago?

George Bernard Shaw wrote that “the greatest problem with communication is the illusion that it has been accomplished.” With all due respect to him, I would change that around a little bit and say that the greatest problem with employee communication, at least with regard to retirement programs, is the illusion that what’s being done today is adequate. We know just within our own profession that it is becoming increasingly expensive to get new employees. The training costs, the recruiting costs, and the pay levels that are required now are significant, and it is often much less expensive to keep the good employees that we have now than to replace them when they

leave. Effective employee communications may go a long way towards capitalizing on those human assets that we already have. The cost of employee communications is often much, much lower than the value of the benefit programs being communicated, and even top-drawer, expensive communication programs are available for perhaps the same cost as replacing just a handful of key employees.

There are quite a number of places where we already have built-in opportunities for communicating with employees about their retirement programs:

- New employee orientations or information packets
- Summary plan descriptions
- Annual financial reports
- Summary annual reports
- Annual benefit statements
- Notice to interested parties
- Investment education

We can do a better job of taking advantage of those opportunities. Typically, employee communication materials are impersonal and legalistic. How many of you provide summary annual reports for your health and welfare or pension plans? How many of you receive a summary annual report (SAR) from your own employer? How many of you can spell SAR? When was the last time you saw one that deviated one iota from the boilerplate summary annual report language? This is a built-in opportunity for annual communication with plan participants about people who are in the plan, the investments of the plan, and perhaps a little bit about how the plan works. Can you imagine if you had a newsletter coming from the plan administrator? "Dear Participants, we had a great year. We had 30 people retire. We wish them well. We hope we'll see them at the next retiree day in September. A couple of them took advantage of an early retirement incentive program we had. Remember that you can get unreduced benefits when you're age 55 if you have 30 years of service with us. We had a couple more people leave. They didn't yet have five years of service with us, so they didn't get any retirement benefits, but we wish them well." And so on and so forth. Information about how the plan's investments did, how and where they were invested, what the cash flow was, and maybe a word or two about the investment performance. This sort of a newsletter approach would deliver information about the pension plan containing all of the required elements of a summary annual report but giving additional real information to plan participants on an annual basis about the benefits from the plan, how it works, and a sense of the value of that program.

Where do we get started? The first step is to evaluate the communications that are already in place. An important evaluation tool is obtaining feedback. How many times have you had a human resource (HR) person confess that nobody understands the DB plan? How many of you have had an HR person confess that he or she does not understand the DB plan? Another important step is to determine the status quo. There are some basic components of any benefit communication program that you need to think about before you blindly embark on "better communications." It needs to have organizational backing at the higher levels. There has to be buy-in to improve communications at all levels. It can't just be a one-shot deal. It has to look at who the audience is. It has to have some variety and some flexibility. You can't just design a glossy brochure, put it on the shelf, and stop there. There has to be a way to get feedback, to measure the success, and to assign accountability for the success.

It is also important to think up front about the functions of a communication program:

- Increase employee awareness

- Increase employee appreciation
- Communicate the long-term value of the employee to the company
- Capitalize on the investment that has already been made in the employee
- Rebuild employee relationships
- Provide reference materials
- Help meet legal requirements

You'll notice that the very last item is "help meet legal requirements." This has traditionally been our first priority. When we need to send out a plan termination notice or a PBGC notice for underfunded plans, we typically look for the boilerplate language or the model notice and send that out. I'd suggest reversing that and keeping the goals of increasing employee awareness and appreciation at the top of our list so that we use language that emphasizes the value of the employee to the employer and helps to build and rebuild relationships with the employees.

This is particularly important when you are communicating major changes, whether they are changes to an existing plan or a plan termination. Determine at the start what the message to the employees will be. What is the bigger context of this significant change? Use sensitivity in giving out all of the required notices to the employees. Even if the notices that you give the employees are boilerplate, at least have a cover memo saying, "This is what we're giving you. This is a required notice. This is a this. This is a that. Here's what you need to do right now. Here's what's going to be happening down the road. Here's when you can expect to make a decision. Do you need to make any decisions now? What decision will you have to be making later? When can you expect to get your money?"

In this fashion, the employees know at the beginning what to expect throughout the process. Be very explicit about when you expect the benefits to be paid so that the HR staff does not get monthly phone calls from everyone wanting to know when they're going to get their money. Manage that expectation by communicating clearly and honestly up-front what the expectations are.

When you're designing communications you need to solicit information from the employer if you don't have a good feel for the makeup of the employee group. Particularly if the employee audience is varied, you may need to structure your communication effort into separate communications for separate groups of employees targeted to their own particular education levels or language needs. Talk with the HR staff about who the real audience is. For instance, with employees contemplating retirement, is the real audience the employee or is it perhaps the employee's spouse who is the real decision maker? Perhaps there's an adult child who is going to be serving as the employee's chief advisor, or perhaps there's a financial planner. Keep that decision maker in mind when you're sorting through the communications.

You need to have a common thread, a philosophical mission statement that connects the various pieces of the communication program. These are called "anchor messages." For instance:

- "Our benefits are competitive. They help protect you and your family."
- "We offer a wide range of benefits. You are responsible for knowing and using them effectively."
- "We have an effective benefit program change process. There's a rationale for every change."
- "We will do what is right for both the company and the employees. We must be able to achieve a balance."

- “We have a set pool of benefit resources. We will commit to the appropriate use of those resources.”

Once the anchor message has been developed, variations on that theme need to be repeated again and again through the communications.

Another important aspect of communication packages is content. It is our natural inclination to feel that having a lot of data is good, but I think most of the world does not process information in the same way that actuaries do. Some people feel more comfortable when they have lots of concrete facts, but other people are overwhelmed by a lot of numbers, data, and details and need to have things presented in a different way. How many of you have ever been through a Myers Briggs personality assessment or are familiar with it? I went to a seminar once that went through different personality types. One of the exercises involved being in a room with a variety of objects on the floor. We had to write down what we saw. I wrote down things such as, “There is a three-inch, metallic, blue-painted figure that is roughly pyramidal in shape, and then four inches to its left there is a this and a that”—very specific, concrete descriptions. Somebody else wrote down that they saw a Pacific Island that was the site of a coming-of-age ceremony. Complete opposite extremes. We each thought the other was from outer space. But the people like me (and like most actuaries) that saw in terms of detail and concrete description are the minority. The majority of the population does not process information in the same way that actuaries do, and our communication efforts need to be sensitive to that.

Top-drawer, extravagant video communication packages may backfire because employees may resent having a lot of money spent on communication, especially if that communication is regarding benefit cutbacks. Be sensitive to the feel and style of the communication. Avoid a condescending tone and inappropriate assumptions and biases. For instance, if you are talking to a group of employees nearing retirement and explaining the different optional forms of annuity, don’t make jokes about trophy wives. Stay away from legalese. Stay away from jargon. I was working in this profession for about six months before I figured out what vesting meant, and I don’t think that “nonforfeitable” is an improvement on “vesting.” Don’t say “terminate,” say “end.” “Accrue” is another word. We understand what that means, but the average employee may be unclear about what “accrue” means. Avoid acronyms. We use them all over the place. They help us immensely, but take acronyms such as NRD, FAE, and SPD out of the communications. It is not OK to define it once and put the acronym in parentheses and then use the acronym throughout the rest of the document. Pay for the extra couple of lines of type and spell it out every time. Do not use a glossary where terms are defined so that the reader has to refer back and forth to the glossary. That really interrupts the flow of comprehension of the materials. Long, complicated, passive-voiced, weak-verb superfluously worded, abstract, unnecessarily detailed sentences such as the one I am reading should be scrupulously avoided. There is a wonderful document created by the SEC for purposes of creating prospectuses that is called the *Plain English Handbook*. It is free and it is not copyrighted. You can download it from [www.sec.gov](http://www.sec.gov). It is a superb discussion of how to write materials in an easily understood way, and I highly recommend it.

Finally, don’t stop the communication process. Don’t spend time and effort to create a wonderful Summary Plan Description and then have it sit on the shelf. Communication is an ongoing process. You have to get feedback. Don’t get scared away by something that sounds like a focus group. A focus group could be getting together with the staff in the HR department. Next time you go visit the HR director, make time to talk with the HR staff to see what their feedback is. They can be a focus group who can give you valuable insight into how well the program is understood and how well the communication effort is working. Monitor how well it is doing

through available statistics such as 401(k) plan rates of participation or changes in investment patterns.