One Bad Apple

Are all hybrid plans as bad as the negative publicity says they are? Not for three employers that made successful launches

It frustrates Rita Metras that cash balance plans have a negative reputation. At Eastman Kodak Co., where she is director of worldwide benefits, she says the plan the company started in 2000 has not stirred any controversy.

“Because of a couple of situations, cash balance plans have the reputation as something that is not as desirable as traditional plans,” Metras says. “[Yet,] more than 1,200 companies have converted, and only a few have gotten any kind of negative press. That means that we are not hearing anything about 99% of them.”

This story is about three hybrid plans from that 99%—three companies that say their plans have succeeded. They point to a couple of main factors: offering existing employees a choice between the cash balance plan and traditional defined benefit plan, and conducting a communications campaign that provides plenty of individualized and objective information and help to employees.

Amid all the publicity about hybrid plans that shortchanged some workers, “We are trying to say, ‘There is also a good reputation out there,’” says Paul Zurawski, Honeywell International Inc.’s Washington-based director, tax and benefits policy.

“Honeywell is proud of all its benefit plans. We are also proud of the conversion process that we went through. We are happy to discuss it. We have nothing to hide.”

Fairly or unfairly, cash balance plans have received a lot of negative publicity. Critics say some companies have done conversions that force older workers into plans that leave them with lower benefits than they expected, while others have not explained complex rules and formulas enough so that employees can make an informed choice between a traditional defined benefit plan and a cash balance plan.

Ask some of cash balance plans’ traditional critics whether a good cash balance plan can exist, and you hear a lot about the problems they see with existing plans. Yet, they also allow that some cash balance plans may have good elements.

“If you deal with the age discrimination issues, we do not think it is a bad plan design,” says Karen Friedman, policy director at the Washington-based Pension Rights Center.

“Certain parts are good: They are employer-paid, and there are guarantees through the PBGC (Pension Benefit Guaranty Corp.). Some workers like them because they are easy to understand, and they can carry the money with them.”

Janet Krueger, the former IBM Corp. employee who helped expose problems with Big Blue’s cash balance conversion, puts it even more cautiously. “Some do seem to be in the best interests of employees, and some do not,” she says, “but nobody has sat down and said what makes a conversion fair and what makes it unfair. What is being done is ad hoc.”
“It Is Your Decision”

Saving money was not what motivated Kodak when the company started working on its new cash balance plan in the late 1990s, Metras says. Rather, a mobile workforce needed something different. “When we went out to recruit employees, we felt that we wanted to look more like the companies we compete against for talent,” she adds, “[and employees these days] are not really interested in, ‘What can you do for me at age 65 or later?’ They want to know, ‘What can you do for me now?’”

The plan started up in January 2000, and new employees as of March 1999 automatically went into the cash balance plan. The company makes a contribution equal to 4% of an employee’s pay, which grows at the 30-year Treasury rate. Each employee gets the same contribution, regardless of service. The cash balance formula differs from the traditional defined benefit formula in that the latter builds up benefits more at the end of an employee’s career.

Kodak’s current employees could pick between the old and new plans. “We offered a choice to everybody. If people had any concerns about the plan, they did not have to go with it,” Metras says. “Choice was pretty uncommon when we did ours. We thought this would be the cleanest thing to do.”

Metras declines to say how many employees stayed and how many switched when they were given the one-time choice. However, the company did offer them an incentive: Kodak also has a 401(k) plan, and those who went with the new plan receive a match, while those who stayed with the traditional plan do not. The match is dollar-for-dollar up to an employee’s 1%-of-pay contribution, then 50 cents on the dollar for the employee’s next 4%-of-pay contribution.

Beyond giving employees the right to choose, Metras says, the other thing that made Kodak’s new plan work was the educational materials and resources it provided: “If you are offering a choice, you need to give people enough information to make a solid decision. We also did not rush it. They had plenty of time to make their decision.”

Kodak gave every employee a “detailed” decision guide, Metras says, with a personalized fact sheet with numbers and graphics that projected their benefits in the old versus the new plan. If an employee could possibly get less money under the new plan versus the old, the numbers and graphics reflected that. The company also offered employees modeling software they could use to change assumptions, such as the interest rate. Other elements included employee meetings, a help line staffed by financial experts, and a Web site.

The communications campaign’s main theme was, “This is our plan for new hires. Some of you might want to be in it,” Metras says. “We tried very hard to make it completely objective. We said, ‘It is your decision. We will give you the resources to help you decide, but we are not going to decide for you.’”

Choice Means Understanding

Kodak's conversion caught the attention of Honeywell, which introduced its pension-equity plan in October 2000. “[The Kodak conversion] was widely praised,” Zurawski says. “We took the lessons learned from that and added onto it. The primary
concept was choice. [Kodak] gave employees a choice to stay in the traditional defined benefit plan or switch,” he says. Honeywell did, too.

“[However, choice] is only really a true choice if the employee understands the options,” Zurawski adds. “One of the things that we realized was a tremendous benefit was the personalized comparison of the traditional defined benefit plan and the new plan.” Honeywell also created a 24-hour, toll-free telephone line that the 46,000 employees then eligible to make the choice could call to access their personalized comparison and talk through it with an operator.

Anywhere the company had a significant concentration of workers, Honeywell conducted on-site training during workdays. “We wanted them to understand it at a macro level and also have the personalized information,” Zurawski says.

The pension-equity design is what he calls “a hybrid hybrid plan.” “Our plan continues to use a function of final average pay, as opposed to a cash balance plan. The ultimate benefit will not be determined until the employee leaves Honeywell with his or her final pay.” Honeywell has a “fairly straightforward” formula, Zurawski adds: final average earnings multiplied by years of service and then multiplied by 6%. That differs from the formulas of the company’s traditional defined benefit plans, which have “much higher accrual in an employee’s later years of service,” he says. The company does not expect to save money on the cash balance plan in the near future.

“[The communications effort] was always about making sure they understood that they had a choice [between the new and old plans],” Zurawski says. A personalized statement comparing the old and new plans made clear if employees could get more money from the old plan, based on their expectations of how long they would stay with Honeywell. It indicated the year in the employee’s tenure at which the old plan’s benefits would exceed the new plan’s benefits.

Workers had six months to make a choice. Ultimately, 86% made a decision and the others defaulted into the old plan. When the pension-equity plan started, 34% of employees went into it and 66% stayed in the old plan. New hires automatically go into the pension-equity plan. The results tracked with the company’s expectations, although Zurawski stresses that Honeywell was objective and did not have specific goals for how many employees would switch.

Honeywell has surveyed employees about the conversion since it happened, and about 98% “said they were very satisfied,” Zurawski says. “We have not had any pushback whatsoever. They realize that the benefit they now earn was fairly communicated. Because they had a choice to stay in the old plan, there is a sense of fairness.”

Many actually prefer the new plan, Zurawski says. “Workers understand and like to see a growing lump-sum benefit on an annual basis,” he says. At a time when careerlong jobs are rare, he adds, “For workers who have shorter tenures, the plan is simply more lucrative for them. The benefit curve of the traditional defined benefit plan becomes much more valuable to workers in later years.”

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Distinctively Branded

Choice also loomed large as a factor in the 2003 introduction of Federal Express Corp.’s cash balance plan. “Our objective was to have employees make an election—not which election they made, but that they made an election,” says Beth Ewing, staff director, retirement plans. The company says it does not anticipate any
significant savings in the short term but that, in the long term, the new plan will have a positive impact on the company and enable it to make a more consistent, level contribution.

When FedEx announced the new plan to employees in mid-February, it kicked off a multifaceted communications campaign that was “absolutely not” aimed at getting FedEx’s 129,000 employees eligible to make a choice into the new plan, Ewing says. “[The goal was] to give information for them to make the right choice,” she says. “We would not be giving them a choice if we had some other objective.” New employees as of June 1, 2003, automatically go into the new plan.

“At an employer the size of FedEx, people learn in different ways,” Ewing says. “To be successful, we had to communicate often, in different ways, and in different mediums.” After mailing an announcement to employees’ homes about the new plan, the company immediately set up a pension hotline for employees to call in with questions.

FedEx also made internal broadcasts from its in-house television studio and trained internal staffers to have meetings with other employees.

The communications campaign did not have a slogan, but Ewing says it was distinctively “branded.” The signature elements included very bright colors: orange, yellow, and blues. “Everything had these bright colors and employees’ faces and the FedEx corporate logo,” she says. “Employees said that they liked that, because they get so much mail, and a lot of it is junk mail.”

Twenty-five percent of employees opted for the new plan. The two plans’ formulas differ in that, under the traditional defined benefit option, most employees accrued a larger portion of their total benefit later in their careers, while benefits accrue in the portable pension plan at a more uniform rate throughout employees’ careers.

Employees had 90 days to choose between the two plans. Early on, they received a “choice kit” with a personalized statement comparing their options, a guide to the two plans, and a comprehensive set of questions and answers. They also could use a Web tool to change assumptions such as their future salary increases and interest rates, then create adjusted scenarios to see how the new plan would affect them in subsequent years. Those uncomfortable with using the Web tool could do customized modeling with a voice-response system or via the pension help line.

FedEx also did plenty of employee focus groups and surveys. “We were constantly taking the pulse of our employees as we were rolling out the new plan,” Ewing says. “For instance, the company had a sample of employees test the Web tool before rollout and made it simpler based on their reactions. In focus groups, employees identified the three elements that had been most helpful to them in making a choice: the personalized statements, the Web site, and employee meetings. Since FedEx gave employees a choice and a personalized comparison statement, the company says that the focus groups did not reveal an employee concern that they might get less money under the new plan.”

Uncertainty Continues

Despite their new plans’ apparent success, FedEx, Honeywell, and Kodak feel the uncertainty that still surrounds hybrid plans. A big part of their unease has to do with the regulatory environment. “Here it is 2004, and we still do not have conversion rules,” Zurawski notes. “There are seven million workers in hybrid plans right now—plans that are in some sort of legal limbo in terms of whether they are legitimate.”

William Sweetnam, benefits tax counsel at the US Department of the Treasury,
understands the feeling. “You have got one court that says they are inherently age-discriminatory, and you have Congress not letting us finalize the regs and saying this is not age-discriminatory,” he says. “It is not surprising if plan sponsors look at that and say, ‘I am uncomfortable because it is an open issue out there.’”

Treasury had put out proposed regulations stating that cash balance plans are not inherently age-discriminatory, but it cannot finalize those rules until Congress blesses hybrid plans. So, in June, the agency announced that it was withdrawing the proposed regulations to give Congress a chance to review the Bush administration’s cash balance proposals and come up with legislation. “At this point,” Metras says, “we would have to have Congress pass something.”

Moreover, while some in Congress and elsewhere may question Treasury’s authority to deem the plans not age-discriminatory, “We do have the authority to say that,” Sweetnam contends, “because we interpret the age-discrimination laws for defined benefit plans. They just do not like our interpretation.”

Honeywell is working with other companies to help get legislation introduced in the fall, Zurawski says, along with lobbying groups like the American Benefits Council and The ERISA Industry Committee. “This year or next year is the timeframe [for passage],” he says.

Asked what she wants legislation to include, Metras says, “I would like to see a validation of the hybrid design—that there is no presumption that a conversion from a traditional plan is age-discriminatory. Perhaps there could be some safe harbors, like choice.”

The Pension Rights Center’s Friedman says, “Any legislation would have to, at minimum, ban wearaway, protect the legitimate benefit expectations of older workers, and set appropriate standards for hybrid plans in the future.” She declines to comment further for now about what standards she would like to see.

Metras believes “it is not really likely” that legislation can pass in 2004. However, Sweetnam is more optimistic, pointing to recent Congressional hearings as an indicator that lawmakers may be willing to move forward. “Some people are realizing that plan sponsors can terminate their plans to freeze their plans,” he says.

While the Kodak plan continues as usual, Metras wants to move beyond the ambiguity. “Kodak was held up as a model company, even by critics of cash balance plans,” she says. “So, the model company should have some certainty.”

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