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Plan Design Issues: The Employer Perspective

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Summary: Panelists discuss the issues considered by corporate sponsors in designing or redesigning retirement programs, including:

- *How corporate goals influence plan design decisions*
- *The costs and risks associated with various types of plan designs*
- *Competitive concerns*
- *The effect of corporate transactions on plan design*

Panelists also discuss the issues faced by smaller employers and how these issues will affect design decisions.

Mr. David L. Jakes: I am with William M. Mercer, Incorporated in Columbus, Ohio. My copanelists are Gary Habegger, vice president of human resources (HR) at B.F. Goodrich in Akron, Ohio, and Evan Inglis with Watson Wyatt Worldwide in Seattle.

Since this session is to be from the employer's perspective, Evan and I are going to give a couple of our thoughts on what we think the employer's perspective is and then we're going to ask an employer what his perspective is.

Mr. R. Evan Inglis: Here are a few thoughts about plan design through the ages and how we design the type of programs. In the beginning, there were defined benefits (DBs). Employers were paternal, actuaries thrived, and it was good. But employers sinned. For they did not always communicate their DB plans well, they did not always fund their DB plans properly, and they desired to transfer investment risk to their employees. And, thus, were born the defined contribution (DC) plans. It was not good, for actuaries were not required in the administration of DC plans, but still employers lusted for more. They still desired funding flexibility, low cost, and investment control. Thus were born the hybrid plans, the target benefit, the cash balance, the floor plan, and the pension equity plan (PEP).

That's about where we are with plan design today. We have these different types of pension plans with their different characteristics. Often the plan design process is to look at an employer's objectives and their business objectives and boil that down to their HR objectives and retirement objectives, and then try to take that set of objectives and match that up to a type of benefit or a pension plan. You kind of take this set of objectives and match it to a type of plan.

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Does that sound like a pretty typical approach to plan design? There are some problems with this approach. What do I have here? A strawberry. If I were to ask you, "Is this a strawberry?" would your answer be yes?

From the Floor: It would be if I weren't around a bunch of pension actuaries.

Mr. Inglis: Is this a strawberry?

From the Floor: I would say yes.

Mr. Inglis (takes a bite of strawberry): Now, is this a strawberry?

From the Floor: It's still a strawberry.

Mr. Inglis (takes another bite): It's still a strawberry.

From the Floor: A very good strawberry.

Mr. Inglis (takes another bite): Is this a strawberry?

From the Floor: It's still a strawberry, but less appetizing.

Mr. Inglis (takes a bite so there's nothing left but the stem): How many of you would agree at this point that this is a strawberry? About half of you. Now, is this a strawberry?

Well, people, pension plans are like strawberries. Let's think about a DB plan. If most of us envision a DB plan, we'd probably think about a plan that pays annuity benefits. The employer controls the investments. It has a pretty low value for young employees and most of the value accrues at later ages. It probably has early retirement subsidies once you get to a certain age, say age 55 and 10 years of service.

But what if we add lump sums to this DB plan? It's still a DB plan. Most of us would probably still call it a DB plan. We're probably at the first bite of the strawberry there. Most of us would still call it a DB plan, but this plan's going to meet a slightly different set of objectives.

What if we index the benefits for vested terminated employees? What if once a person terminates and they have an accrued benefit, their benefit is increased each year with inflation or some other index? Then we're going to be allocating much more of the benefits to younger employees. This is not a characteristic of a traditional DB plan, but we're still using a DB plan. My point here is that the advantages in retirement plans aren't inherent in the type of plan. The objectives that you're going to meet with your retirement program won't be met just because you're using a certain type of plan.

We can see the same thing if we talk about cash-balance plans. A typical or standard cash-balance plan might have a constant percentage of pay contribution. But if we weight those contributions, we're going to meet a different set of objectives. PEP plans usually communicate their benefits as lump sums and usually pay benefits as lump sums. But we can set up a PEP plan that doesn't pay lump sums.

It's very difficult to take these objectives and try to match them up with a certain type of plan because each type of plan can be changed, like the strawberry, into something that is different even though we might call it the same thing. I think that's a very fundamental problem with how we have designed plans with employers in the past. Another problem is that people have preconceived ideas about these different types of plans. A DB plan is old and traditional. How could our new, modern company—we're setting up a Web site—possibly have that old kind of traditional DB plan? Of course, we don't want a cash-balance plan. We don't want our older employees losing out on benefits. People come to the table with these preconceived ideas about these different types of plans and that affects the decisions that they make in designing plans. Another problem is that setting objectives is difficult. What objectives do we choose from? Is there a list of objectives somewhere that we can pull from to decide what our objectives are for the retirement program? Which of these objectives might be difficult to achieve at the same time?

Here's a solution to those problems. We've broken retirement plans down into ten components that we call building blocks. Table 1 lists them. The building blocks are basically scales from left to right, and they're the essential components of retirement plans. Obviously, if you choose one or the other, your program is going to be meeting different objectives. Target retirement ages refers to ages such as 55 with 10 years of service, where employees are going to hang on until that age and then retire soon thereafter on average. An unreduced benefit at age 60 or 62 would also be a target retirement age. This building block has to do with whether we want these kind of stopping points in our plan.

TABLE 1
RETIREMENT PLAN BUILDING BLOCKS

Benefit Formula	<=>	Account Balance
Annuity Benefit	<=>	Lump-Sum Benefit
Target Retirement Ages	<=>	No Target Retirement Ages
Low Value for Younger Employees	<=>	High Value for Younger Employees
High Value for Older Employees	<=>	Low Value for Older Employees
Ind. Performance-Related	<=>	Non Ind. Performance-Related
Employer Invests Funds	<=>	Employee Invests Funds
Employer Investment Risk	<=>	Employee Investment Risk
No Employee Contributions	<=>	Employee Contributions
Comp. Performance-Related	<=>	Not Comp. Performance-Related

There are two building blocks that fine-tune the value that we're providing to employees at the different ages. We break that up into the younger employees and older employees and decide how much value we want to provide to those different groups of employees. We can have a plan that's related to individual performance or not related. The last four building blocks have to do with the financing of the plan.

But the idea here is that we've broken down pension plans into these ten essential components so that we can go through a discussion with an employer about each of these different components. We can talk about the advantages of annuity benefits versus the advantages of lump-sum benefits, and the advantages of the employer investing the funds rather than the employee investing the funds. The advantages that are associated with each side of the scale on the building blocks are the objectives that you can meet through a retirement program.

For example, if we talked about who invests the funds, an advantage of the employer investing the funds might be that we expect to achieve a higher rate of return and, thus, we expect to get higher benefits per dollar of contribution. On the other hand, an advantage of the employee investing the funds might be that they've become more involved in the process. They participate in the planning process. Maybe they even appreciate the plan more because they have this flexibility to invest the funds.

We have these two objectives that we might want to achieve in our plan that we can see right away, now that we've boiled this down to the essential components listed in Table 1, we're going to have difficulty achieving both of those to the fullest extent in the same plan. We talk through the advantages of each side of the scale, and once we've done that we put them all together into the type of plan that matches those objectives and those building blocks that we've selected, whether it be the cash-balance plan, the traditional DB plan, or what have you.

This approach has some advantages, which I've mentioned, such as no preconceived ideas. We're not going to talk about DB plans, DC plans, or cash-balance plans. We're going to talk through these different components and these different plans. Where people may have preconceived ideas about it, they won't enter into the discussion at all.

I think there's going to be a clearer connection between objectives and the plan design that we end up with. We can see immediately where the objectives are manifested in the plan. We wanted employees to be involved in the process to participate in planning for retirement; thus, we have employee investing in the funds. I'm not trying to take this big set of objectives and match it up to a bigger plan to meet the objectives. It's easier to make these small decisions. It's easier to talk about lump sums versus annuity benefits and compare the five or six advantages on each side and make that decision than it is trying to look at this whole big set of objectives and match it up to different types of plans.

Finally, I think once you go through this process and you have this very solid kind of ideal pension plan, the rest of the process, which is usually much longer and more challenging, is easier because you know why you have this ideal plan and what you are aiming for.

Just to summarize, building a retirement program usually involves the following four steps. Set the retirement program objectives and design the ideal plan, hopefully, using building blocks. Then modify the plan. Usually, this ideal plan isn't something that some company can go out and put in place. There are lots of things to consider: Cost constraints, tax law issues, transition concerns, administrative issues, and so on. Grandfathering, of course, will take up a lot of time and energy. Finally, we need to implement and communicate the plan. The last two steps, which take so much time and energy, will be easier when they're built on the foundation of an ideal plan that the employer is familiar with.

From the Floor: Did you consider the level of employer contributions as one of your building blocks or objectives?

Mr. Inglis: No, that's not a building block. The employer contributions or discussion about the cost constraints is something that will come later. I guess the building block for employee contributions includes that inherently; that is, if we're just talking about whether we're going to have employer contributions or not. I mean, if an employer really wants to go whole hog on the employee contributions, maybe they don't want any employer contributions in their plan. But in terms of the level of cost, that's something that would modify the cost level of the ideal plan that we design.

From the Floor: But there are legal constraints. You may build everything the way you want it there, but if you can't hit that objective because you've been pigeonholed into DB versus DC, you may not be able to meet that objective.

Mr. Inglis: That's right. It's possible to come up with an ideal plan that isn't achievable because of tax law constraints or administrative issues. Even though you've decided on this ideal plan, you're going to have to talk through what administrative issues there are—whether this is really achievable with the tax law that we have and so on—so it is a great point. It's very theoretical. It's an exercise to bring out the employer's objectives and for them to see how their objectives will be manifested in a plan. You're not going to go through this exercise and be done with the plan design process because there definitely are other considerations.

Mr. Jakes: There are four issues that I want to cover. The first one is a very brief discussion of the plan design steps. Evan has already talked about this, but I wanted to review it only to give you some background for the other items I want to talk about. Second, I'll spend a lot of time on the various different stakeholders. We've talked about an employer, but who is the employer? Who in the organization needs to be involved and has an interest in this type of discussion? The third issue is a real brief discussion on some of the recent press and how that affects the whole process, and the fourth issue covers some of the implementation issues that have to be worked out by the employer.

The first of the plan design steps is to assemble a team. The team generally includes several people from the employer. It probably will also include a consulting actuary, maybe a communication consultant, and an attorney. From the employer's perspective, various people could be involved. Chances are once this team is assembled, its members will have different backgrounds and knowledge about retirement programs, ranging from a very thorough knowledge to little or no knowledge. There needs to be a basic set of education to bring the team up to speed before the process can start.

The next step is what Evan just talked about—setting the objectives of the program. Next, the group will consider alternatives that meet most, if not all of the objectives within the cost constraints and other constraints that he talked about. And then there is the transition issue and, finally, the implementation of the program. It is my experience that the second-to-last step, the transition, is where most of the time is spent. More time will be spent on transition than will be spent on the basic plan design because of all of the conflicting issues.

Who should be on this team from the employer? There are various possibilities. Obviously, human resources and finance are logical members. They are the first ones you think about. Legal and executives have a stake in this since they are the ones who are going to give the approval in the end. The managers and the employees have a stake in this since it is going to affect their benefits. And, finally, we will talk about how this will impact the shareholders as well.

How much are each of these different groups involved? This is one of the very first decisions that needs to be made as the team is being assembled for this type of project. The major stakeholders are, HR and finance. Sometimes, especially when you get to transition, you get one side versus the other. HR is worried about the fact that they are going to have to administer the plan. They are worried about the HR side of the plan, and the impact on the employee workforce. Finance is worried about this from the cost perspective. Retirement programs can be a very significant cost, especially if your discussion includes retiree medical.

Usually, there is a legal representative involved as well. I see the legal people having two roles. One is to make sure the end result is compliant with the code and regulations and the second is lawsuit avoidance—to make sure we don't do anything to make too many people too unhappy.

I have seen very different involvement from the legal side. I had one situation where they put together a team that did not include any legal counsel. The plan design was finalized in early November for a January 1 implementation. As was discussed before, this means you have to have a 204(h) notice issued by December 15. This notice can't be provided until the plan is written. The attorney was told she had four weeks to write the plan and she didn't even know this discussion was going on. Needless to say, that is one extreme but not necessarily the recommended extreme.

In some situations, I have seen plan sponsors include an inside ERISA counsel from day one as a part of the team that is responsible for designing the program. Alternatively, you can use outside ERISA counsel. At least keep the counsel involved throughout. They may not be involved in every step of the way, but they should be involved in the discussions.

In HR, depending on how you are setup, it should include your corporate HR. There may be HR people from various locations around the country or different divisions who will need to be involved if there are different workforce issues in each of those divisions. The same thing with the finance people.

The next group of people to talk about are the executives. Clearly, they are going to be involved at some point because they have to give the final approval of the new plan. There will be a plan amendment that probably requires board approval.

The real issue is how much do you get the executives involved early on? One alternative is to get them involved very early on through surveys or interviews, asking them what their objectives of the retirement program are, what would they like to see, and what their goals are for the program. If their goals are very different from the objectives, goals, and building blocks that the committee came up with, then my guess is they are not going to be very happy with the committee's final design recommendation. Before a lot of time is wasted coming up with a design, it is better to agree on the objectives up front than at the end. After this, keep the executives periodically informed.

Once you have a basic plan design and you are going to start talking about transition, one of the first steps of discussing transition is coming up with some transition objectives. This is another point where it is a good idea to have the executives agree with the transition objectives before a lot of time is spent coming up with a detailed transition. Getting executives involved in the various different steps along the way makes it much more likely that they will provide the approval that you want once the design has been completed.

I keep this very generic on purpose. Managers are the people who are on the front line. This could include middle managers, higher managers, and lower managers. They know if there are attraction and retention issues in their particular area and how the retirement programs impact those issues. You may want to involve them (or a group of them) in the plan design committee. I was involved in a design study once at a hospital where they included the head of each department. This included the head of ambulatory services, the head of rehab, the head of nursing, the head of the janitorial services, etc. That is a little extreme. There were 20 people in the room trying to come up with objectives. Several of them were thinking about objectives for themselves and not for their people, so that was a little bit much. I would consider whether there are a couple key managers in key areas who can be involved and who you would want input from—maybe not total involvement of the plan design committee, just checking in with them periodically.

One alternative is to have a group of managers that serve as a sounding board. Anytime the committee has a decision, they go to the managers and make sure they agree before they go to the next step. The more buy-in you get, the better off you are going to be in the decision and implementation stages. However, the more buy-in you get, the longer it takes and the more complicated it gets, and you can get tied up. There is balance there, and it is going to be very different for each organization.

What about the employees? They are the ones who are eventually going to feel the impact of this change. You can have a whole spectrum of involvement here as well. You can have it where this new plan design appears out of nowhere on their desk 15 days before it's implemented. That is one end of the extreme. The other end of the extreme is to keep the employees involved from the beginning either through surveys or focus groups. You can get a small group of employees involved in a focus group and ask them what they think about their retirement benefits.

We recently had a case where the client reduced the benefit formula in the DB plan and communicated it as such. They did not hide it. An employee called and asked, "How much money are you taking out of my account?" at which point in time the head HR person said, "Maybe we need to talk to you about cash balance since, obviously, our employees don't have any idea what we are providing to them."

The question is, how often and in how much detail do you get the employees involved? It is similar to the question about the executives and the managers. Do you get them involved up front? Do you get them involved looking at the objectives? I have seen situations where an employer got a small group of employees together. They spent some time educating them about the retirement program and keep them involved as a sounding board throughout the whole process rather than just using them as a focus group or an up-front survey and then as an announcement at the end. There is a whole spectrum here and that depends, again, on the organization. If it is a very paternalistic organization, they may be far less likely to get their employees involved. If it is not that paternalistic, they may be a lot more interested in employee involvement.

Clearly, the shareholders are not going to be involved in the design discussions. They are not going to discuss this at a shareholder meeting. But it can have an effect on the share price, either through the cost, the employee perception, the employee reaction if you experience mass turnover because of it, or the unfavorable press that we have seen in some cases.

As you can see, there is a wide range of people who are affected by a changing plan design. One of the real issues up-front is, how many of these people are going to get involved and to what degree?

I just wanted to briefly mention *The Wall Street Journal* articles. I think they have been mentioned in every session I have been to, so I am not going to spend a lot of time on these. These are quotes out of the articles:

- "A way to save money" (they called cash-balance plans a profit center)
- "A way to hide benefit cuts"
- "Legally questionable"

- “No accruals for several years after transition"

There was a rumor going around one of my largest clients that they were going to go to a cash-balance plan. The HR people received several phone calls from people around age 50 saying, “Maybe I should start looking for a job where I can earn a retirement benefit now that I’m 50, and I’m starting to think about these kinds of things.” This was just because of a rumor that the employer was thinking about going to a cash-balance plan. So the articles clearly have an impact on what people are thinking.

One result of this is going to be increased employee information. There will have to be more detailed communication to avoid some of those preconceived thoughts. There are probably going to have to be old plan and new plan comparisons. In some cases, some employers have gone to the point of offering the employees the choice between the old plan and the new plan. If you provide this choice, you are going to need to provide projections, maybe even software, so that the employees can do “what if” analysis under various different scenarios.

I don’t know if you saw the recent article in *The Wall Street Journal* when IBM announced its cash-balance plan to its employees. They provided a calculator. I do not know if it was on a Web site or where it was, but it was some place to go and calculate benefits under both the old plan and the new plan. IBM then proceeded to take the old plan projections out of the calculator after a couple of weeks, which made the employees mad. It really makes you wonder why they did that.

What are some of the issues we will have to worry about in implementing a new plan? One of the key implementation issues is going to be employee communication. You are obviously going to have specific descriptions of the plan. In some cases there will be participant elections. This is true whether the employees are electing into the old plan or the new plan, whether they are electing for the first time to have 401(k) contributions, or whether they are electing from various investment options in their cash-balance plan. These communications may include benefit illustrations and/or statements, especially if the Moynihan Bill passes. This bill would require various different benefit projections as part of the basic communication. Other tools could include computer simulations, depending on your workforce.

Another implementation issue that will need to be addressed is administration. If you are changing from a plan that is not based on lump sums to a plan that offers a lump sum, there may be some very different looking forms and letters that you are going to produce for the retirees and the vested terminated participants. You are going to need a new computer system, and that takes time to develop. You are going to need to determine the availability of data. Do you have the data necessary to do whatever it is that you have designed? And, finally, the legal documents. These include the plan documents, the summary plan description, and anything else that might be necessary.

As you have seen, the implementation can be a significant, time-consuming project. There are two ways to handle this. One is to have the design completed six months in advance of the effective date so that there is time for the implementation. The other alternative is to not be ready that far in advance. In that case the plan administration and some of the other things may be on hold for the first couple of months while the administration systems get caught up with the new design.

Some other issues to think about include the impact on executive benefits. If you have a nonqualified plan that offsets the potential qualified pension benefit and you have just changed the qualified pension benefit, that may have an impact on your nonqualified plans, which you also will need to look into.

Mr. Gary L. Habegger: Now, as Paul Harvey would say, "You're going to hear the rest of the story." As I look over the participants and the presenters of this conference, I seem to be in a somewhat unique position in that I'm a corporate plan sponsor and an employer. Many of you are consultants, so I'm in a different position than many of you. I'm going to try to keep my results relatively brief and, hopefully, the points that I'll make will stimulate some discussion and some questions on your part.

When considering plan design, I consider a couple of important questions and issues that both consultants and employers must address. You can boil all the issues down to one fundamental principle that certainly applies at my company, and that fundamental principle is: Plan design must support the achievement of the strategic business goals of the sponsoring firm. Everything that we do has to be supported by or supportive of our business goals. We must explain to employees not just in isolated cases, but in totality, how all of the benefits packages that we provide support those business goals and those business objectives. Ultimately, that's the responsibility of the firm's CEO. That's why at B.F. Goodrich our CEO has become involved in understanding how everything we do must support the overall business objectives of the company. We're charged with designing benefit plans and aligning everything with our strategic business objectives.

Now, this is probably a change from the traditional way that we've done things in the past. In my experience, benefits changes often have been driven by the benefits department. The benefits department lists certain perceived inequities or certain perceived reasons why we must change. Things such as, "We must manage our cost in this area," or "We must be competitive in that area." We run out and conduct a survey of all the pension plans in the area, or in the country, and we need to be competitive in our pension plans. Or maybe we're trying to attract a certain group of employees, or we're trying to settle a union contract. In any case, the benefit staff and, perhaps, the consultants who work with us typically would design some type of modified program that ultimately would be approved and implemented. That's the way we've done things in our company for many years. We're trying to change that. And it's always done basically in isolation on a plan-to-plan basis. We look at the pension plan over the next six months, and then we look at the health care plan. Later we look at the DC plan and at other plans on a plan-by-plan basis. When we do that, we run into various problems.

That process doesn't happen anymore today. Today, benefits changes, including retirement plans, are increasingly being driven from top-down instead of bottom-up to support our broad business goals. At B.F. Goodrich, we can no longer support the narrow task of redesigning the retirement plan or redesigning any other plan without regard to the context in which that plan exists. To avoid this pitfall, we need to insure that as we go through this process, the entire context of our business strategy will be considered both from the plan sponsor's standpoint and from the employee's standpoint. The designers and consultants all have to be involved in that process. There are certain questions that we must ask during the process.

The first question is, what is the role of our total rewards package and what role does it play in the achievement of our business goals? Is it well-understood at the executive level in the first place? Let me give you an example. We have a vision statement at B.F. Goodrich. We have a business strategy that's been communicated to our employees. Our employees have heard that business strategy and our vision. All the packages and all the programs that we come up with must support that business strategy.

We have defined what types of employees that we want. We want the traditional things. We want people with integrity, to be intelligent, things of that nature. We want them to be quick learners. We want them to take risk. We want them to take responsibility. We ask them to make all kinds of decisions in their job. But when it comes to our benefits package we say, “It’s too complicated for you. You can’t make decisions. We’re going to make them for you.” We then have an immediate disconnect with our employees.

We say we want to change to a high-performance growth culture. That by itself indicates that we’re going to hire certain types of employees. We want an ownership mentality. We want people who are going to take ownership of the business. When you have an ownership mentality that defines, in many cases, the type of package you’re going to put together, you don’t look at things in isolation. You don’t look at a pension plan in isolation.

The second question. We have this total package. When you look at it, how does the retirement piece of that total package fit in? Is it a major part, is it a minor part, or is it somewhere in between?

I’ll give you an example. We say we want to focus on quality, not quantity, in terms of how people accrue things in the various compensation and benefit plans that we have. We want quality of service, not quantity of service. We immediately look at all the plans that we have; in our case, we have a lot of service-based plans. All you have to do is hang around for a long time and you’ll have a very nice benefit. But we communicate constantly to our employees that we want quality, not quantity. That will determine what type of a plan and what type of a combination of plans we’re going to have. We want people to stay around as long as they perform. The moment they don’t perform, then we’ll ask them to move on to somewhere else. We’re not interested in plans that are going to support the idea that all I have to do is hang around here until I reach age 55 and I have it made. That by definition will determine how we look at our plans.

Then, when you look at changes—we’ve had many, many changes in our benefit plan—how do you expect those changes in your total rewards program, including the retirement plan, to support the business goals? Do you know what are our business goals? Have we communicated them to our employees?

I think it’s very important for a plan sponsor to step back, look at their total rewards, and get away from looking at plans on a one-on-one basis. What is our total rewards philosophy? What are the guiding principles that we measure every plan by? If you don’t do that first, you’re going to find yourself, as we found ourselves throughout the years, in a situation where things just don’t make sense. We do one thing in one area and do the exact opposite somewhere else, none of which supports our business goals.

Here’s an example. We say we want to promote pay for performance. That’s a philosophy that’s linked to results. We say that we want to recognize the reward of a mutual commitment. If I do something as an employee, then the employer is going to do something.

Another example. We’re a very decentralized company, but we still have the philosophy that we’re going to somehow support a one-company culture because we have one common stock that covers the whole company. By its very nature, that type of a philosophy is going to drive you to different things. We say we’re going to promote a total rewards package that’s going to have certain core benefits. Those core benefits will be your reward for doing a good job. You get to keep your job. That’s your core benefit. We’re then going to have extra benefits that will be linked to results. That's a very different philosophy from a number of years ago within B.F. Goodrich. We're going to focus on quality, not quantity of service.

When we make a change, are the changes that we're making supporting that philosophy? When you make a change in one area of your program, how do those changes affect the rest of the total rewards program? One of the things that we've learned over the years is that when we go in and make a change to our DB pension plan or our DC plan, we have to ask, will it throw other things out of balance? Are there other things we have to consider? Should other changes be made or should we be planning for other changes? Certain elements of our programs have pieces at risk. If we change something in one portion of the program, does that change that piece at risk in the other portion of the program? We need to think about it in the retirement area when we say we want pay for performance. Does that drive us to a certain retirement plan design? Do we have all DC plans? Do we have an additional match for excellent performance? Do we have additional matches for various business units? Forget about the legalities of all that for the time being. What is it that we're trying to accomplish? Our challenge always is to step back and return to the guiding principles that we've established. Does it meet or align with the guiding principles? If so, then we'll move ahead. If not, we will not do that.

Do our employees understand and support our business goals? Do they understand the role that our total rewards program plays in the achievement of those goals? That's very difficult for us. We're constantly coming back trying to say, "We have this great benefits package for you people. Here's how it supports the achievement of our business goals." If we can't explain that, we probably have the wrong package sitting there.
Do we understand what employees value most or least about their total rewards programs? Now, you're not always going to design things on what people would like to have, but you'd better understand what they would like to have so that you can start discussing with them why it is that you can't get there from here. If we understand that, then we can proceed with a total rewards package, and a part of that is the retirement plan.

How do we gain employee acceptance for any changes that we would have? Are we prepared to relate the changes that we make to our business strategy and our business objectives? We step back now every time we make a change and say, "If we make this change in this plan, how are we going to relate the change that we're making to our business strategy and our business objectives?" If we can't do that, we're not going to make the change. We can't just say, "Well, we thought it was a good idea. We think you'll like this." We have to step back and ask, "How does that support the business objectives and will employees understand and accept that?" If we can't do that, then we're not going to make the change.

The point is, before we make any changes in our plans we have to look at them broadly in the entire context of our total rewards philosophy. It's a very different process at B.F. Goodrich that we're into right now than what we were into maybe 10–15 years ago. We did things on a plan-by-plan basis. We're just not going to do that any longer. We're going to look at it very broadly in the total context.

Fundamental changes in retirement, welfare, and compensation plans have the potential to change the entire organization and its cultures and attitudes for better or for worse. One of the things that I have the stripes on my back to bear this out is that if you make changes you are going to have employees who are going to react to those changes. And if you can't explain them in your business context, then don't make them.

First of all, is change needed? We're no longer going to change just for change's sake. We're not going to change because a lot of companies are moving to this type of a plan design. We're only going to change if this supports the business strategy. Is the type of change that we're making the type that is really wanted by us and one that we can understand, explain, and have employees understand?

Over the years, we've seen our benefit plans change and evolve. As recently as 10 or 15 years ago, our benefit, health, welfare, and retirement plans were often viewed by employees as entitlements from a paternalistic employer: "B.F. Goodrich is going to take care of me until I die. I've seen plus-ups in the pension over the years. B.F. Goodrich is going do an ad hoc increase in my pension and take care of me. This is an entitlement. This is what I've earned. I've been able to hang on long enough to get this." And I have to say that many of our plans were designed just for that purpose. They were designed to reward service and loyalty without any thought for what the contribution has been by employees.

Change has been resisted in the past. It was unwelcome. Employees didn't want it. I've heard over the years when are these changes going to end? Change, change, change. Can't you put something in place and leave it there? We'd like to have something that we can count on. Many of those people are still in our workforce, and they're nearing retirement age at this point in time.

On the other hand, we have a lot of younger employees. And today's younger generation finds that the notion of paternalism and reward for long service absolutely abhorrent; it's amusing to them. They don't expect to be with B.F. Goodrich for 35 years. They are looking at maybe five to ten years with the company and then they'll move on. They want portability, the ability to move on. They think that's the norm today. They get to B.F. Goodrich and they say, "Oh, that's not the norm at B.F. Goodrich? It's the norm at a lot of other companies." And so the question is, what types of plans support our business philosophy and our business strategy?

We need plans that are going to be adaptable to changing personal and business strategies. Our desire is to have something that is acquisition-ready and change-ready; something that we can change over time without going through a lot of the things that we've had to go through in the past, which is looking at each plan on a single, isolated basis. We just don't want to do that. We're going to look at all plans as we go through the process.

The blending of generations within B.F. Goodrich is a big challenge to us. We have different fundamental philosophies among employees. But the fundamental process that we have to go through and that we have to be committed to is designing plans and programs and linking them to our overall business strategies and objectives. There are a couple of things that we're trying to do. First of all, we want to have a business case for any changes that we make. If we can't come up with a business case, we're not going to make the change. Second, we have come up with philosophical underpinnings that are going to guide us in any changes that we make along the way. And, third, we do get our top executives involved in high-level design up-front. We talk with them about that. Not the nitty-gritty stuff, but high-level design, directional, whatever it is that we're trying to accomplish. When we do that we encompass all the plans that we have. We'll say, "Yes, we're talking about the pension plan, but if you make that type of a change here's how it's going to affect all the other plans that we have in place." It's very, very important to us to get our high-level executives involved in that.
We need to motivate, we need to reward, and we need to measure our people to execute successfully on our business strategies. Over the last 18 months our focus has been to look at our entire total rewards program: compensation, benefits plans, retirement plan, health and welfare plans, and rewards programs just for management, and so forth. We're trying to have a

philosophy that works that we can point to and say there's a business reason for why we have this plan in place. It's a very different process than looking only at a DB plan and saying, "Oh, we have to make changes so that we can keep up to date." We come back at it and say, "Why is any change necessary in the first place and why would we do this? What is the business case that we can build with our employees if we make this change?" If we can't build that business case, we won't do it.

From The Floor: I just wanted to ask how deeply you bring bonuses and long-term incentives into your employee organization as far as your pay for performance philosophy and, on the further side of that, how is that carried down into your retirement plans?

Mr. Habegger: That's a good question. We have approximately 20,000 employees in all of B.F. Goodrich. We're in the process of looking at driving incentive plans, or you can call it variable pay of some type, down through the entire organization. It's not there yet. We probably have 5,000 employees who are on bonus-type plans out of the 20,000 today.

Second, how do we drive that in our compensation and benefit plans? As I said before, it has been only about 18 months since we stepped back and looked at the philosophical underpinnings that are guiding us, so we're into what we call a total rewards project. In our retirement plans we intend to reflect the fact that there's some measure of performance in those retirement plans. We haven't figured out yet exactly how we're going to do that and tie it all together. This is a huge undertaking and a huge project, but we intend to do it. I don't know what form it will take yet, but we intend to get there. And we're going to support that with our business reason that we want pay and we define our benefits packages as pay. We want it linked to performance. We'll probably have a core level of benefits and a variable piece of benefits.

From the Floor: I was wondering whether or not your core objectives might be different for different lines of business and, if so, how do you reflect that?

Mr. Habegger: We have an overall philosophy, and then we can have additional pieces to that philosophy that will drive down into individual business units. Now, everybody's going to operate according to the overall philosophy, but it can be modified somewhat from a geographical standpoint or from a workforce standpoint. For example, if we do incentive pay or if we have incentive pieces to some benefit plans, they won't all be necessarily on the same measures. We may have different measures for different business units, so we will adjust and adapt to what's needed. But, overall, everybody's going to live with the six or seven philosophical underpinnings that we develop.

From the Floor: Do you apply those underpinnings globally?

Mr. Habegger: Yes. We're not there yet, but, yes, we intend to do that.

From the Floor: Have you considered going toward a cash-balance plan arrangement and, if not, what are the major reasons to date that you might not have done that?

Mr. Habegger: We're in the process. Everything's open at this point in time. We're looking to accomplish what we want whether we will use a cash-balance plan or eliminate the DB plans altogether. The cash-balance plan is a form of the DB plan and goes to DC plans. We don't know the answer to that, but I suspect we'll have some type of cash balance or DC weighted on that side more than what we would call the traditional DB plan. But we haven't rejected that at this point in time and we're not far enough along to say, yes, we're going to have a cash-balance plan or, no, we're not and here are the reasons. We're looking at it right now.

From the Floor: What is the relative value of your retirement program vis-à-vis the health program? And do you think that the corporate perspective is consistent with the value that the employees would place on those two programs?

Mr. Habegger: First of all, we have health plans for active employees and we also provide retiree medical, so if I lump those two together as the health plans the health plans are quite a bit more valuable than the retirement plan if you look at it from a cost or a liability standpoint.

Now, from an employee perspective, if you go over and change the pension plan and make some minor changes, you hear a little grumbling. If you change that health care plan or, technically, the retiree health care plan that people are counting on (those people at age 50 or above anyway), we'll hear lots of comments about making a change there and taking some of the value and putting it over into the retirement area. We did that a number of years ago. We had a DC retiree medical plan. The company pays so much towards the premium and everything above that amount the employee picks up. We put that cap on in 1990. We haven't raised the cap. We're above the cap now.

I get lots of letters from retirees asking, when are you going to adjust the cap? We write back and say we're not planning to adjust the cap. When we did that, we had all kinds of consternation and anxiety on the part of people, but our employees were smart enough, especially those who were younger in ages. They said, "When I get there that retiree medical plan is not going to be worth much because I'm going to be paying in 80% or 90% of the cost."

At the same time, we went to our DC plan, our 401(k) plan, and we increased the match from 50 cents on the dollar of the first 6% of pay to a $1.00-per-$1.00 match on the first 6% of pay. And our communications to people back in 1990 was, "We're going to have a much higher shared arrangement as we go forward. The company's going to put some money in your 401(k) plan. You have to contribute money too, but we're going to give you extra money and, hopefully, you'll be able to use some of that money to buy your medical care from the company when you retire." That was a tough sell. But today with the way the markets have performed since 1990, we don't hear much about that retiree medical plan anymore from our active employees. They have great 401(k) balances today, and they're not all that concerned about purchasing retiree medical today. Now, that could switch once they retire. We may hear grumbling at that point because they have other uses for that money, so we've had a little flavor of that. But that was done sort of in isolation and we were trying to get away from the *Financial Accounting Standard 106* issues—liability issues—and all of that. We looked at the 401(k) in isolation. We wouldn't do that again. We'd look at the whole package instead.

From the Floor: Do you think that part of the reason that your workforce isn't entirely concerned about the postretirement medical benefits is because none of them plan to retire with B.F. Goodrich. If you have a much younger workforce, don't they plan on not being there anyway?

Mr. Habegger: Yes. For a lot of our younger employees that's correct. Also, most of our employees think by the time they retire the government will have solved the medical problem. They think that we'll have socialized medicine. They really think that the government is either going to mandate that employers do it or they will fix it somehow themselves. They're not worried about it. They think the government will come up with a scheme somehow to do it. They really believe that. They're not concerned about what B.F. Goodrich might do.

Mr. Jakes: They probably also don't expect that Social Security will be around, so that's an interesting combination.

Mr. Habegger: That's right.

From the Floor: Have they done a government survey like that or is this just an informal process?

Mr. Habegger: It's not a statistically valid survey. Have we done a survey? The answer is, no, we haven't. But we have done it this way. Our HR managers in all of our businesses are telling us that's what people are telling them. They think that somehow Congress is going to solve this.

From the Floor: On your pay-for-performance philosophy, to what extent is that by individual versus by group? And if it is by individual, are you trying to carry that into the benefit plan?

Mr. Habegger: The pay-for-performance philosophy—to what extent is it individual versus group? And if it was individual, to what extent will we carry that over into the benefit plan? It's both. It's individual and it's group. We'll probably have a tough time on an individual basis to carry it over into some of our plans, particularly in the qualified plans. There will probably be more group issues, and we'll leave the individual piece to be a part of the actual bonus plans that we have. But we'll make sure that in combination we have a good fit and we have things working in tandem.

Mr. Lane B. West: Is stock compensation in the variable pay piece? Are you considering doing that, and, if so, what do the employees think about stock options?

Mr. Habegger: We use some stock compensation, but it's at higher executive levels. Not just the top executives, but it goes down into group vice presidents and some directors. We've driven our stock options down low. Our employees tell us they would like to have stock options. We know that from surveys that we've taken. They also tell us they don't understand how stock options work, but they'd like to have them. They read about it in the papers and they see the millions of dollars that various executives have received through stock options, so they think it should be good. They also tell us I don't understand how the stock options work, but I'd like to have them. So that's something we'll look at.

We have to get over some issues that we have. We're a New York-incorporated organization, so anything that we do has to be approved by our shareholders, unlike companies that are incorporated elsewhere who have stock-option programs for executives and can do other things for their lower level employees. We have some things that we have to do or we'd have to incorporate in another state to solve the issues.

From the Floor: David talked a little bit about involving employees in the plan design process. You do not seem to be in the later stages of thinking about this redesign of total compensation. Up to this point how have you involved employees or do you plan to involve employees in the process?

Mr. Habegger: How will we involve employees? First of all, we did a major survey of all of our employees trying to gather information. We communicated to them that in no way are we accomplishing anything through this survey. We wanted their feedback. We told them, "We're going to go through this project, and there will be changes." We wanted to know what they think, so we constructed a major survey.

Second, we have teams of people that include people out in business units, HR managers, and other types of managers. But part of the process, also, is going to be once we come up with a few alternatives, we're going to go back to employees and test things out on them before we make any final decisions. We're going to involve them in giving us feedback. We'll choose samples of employees throughout the organization, and we'll test things out with them and get feedback through focus groups, so, yes, we're going to involve employees. To date, we have in place employees on many of the design teams so we do have people out in the businesses who are participating in those.

From the Floor: Are we involving unions or the heads or presidents of unions in these changes to make sure that they're involved, that they understand it, and that we don't have to negotiate or whatever?

Mr. Habegger: First of all, this project is taking place with a nonunion workforce. In B.F. Goodrich of the 20,000 employees, we probably only have 2,000–3,000 that are unionized, so we have a small union population. We have to be concerned about them, but we carve that out and we plan to deal with that at a later point in time. Just as an aside, we, a number of years ago, put in a cafeteria-type program and we, also, as I said, have had a DC retiree medical plan since 1990. We've been able to negotiate those same arrangements with all of our unions. We put it in for all the nonunion workforce first and then worked towards trying to get agreements with our unions. In order to do that, we gave a lot of our unions 401(k) plans and kept them happy, so we've been able to get them on the same program. Whether that will hold true as we go through this, who knows, but we've carved that out. That's a separate issue.

From The Floor: David, you mentioned that employee direction was becoming more popular in cash-balance plans. My question is, how do you reconcile that with definitely determinable benefits?

Mr. Jakes: I am saying it is becoming more popular, meaning that there are a handful of organizations who have started to do it, which is a handful more than there were a year or two ago. I still would not consider it at all mainstream. The key is that no matter what the employee selects as their index, the assets of the fund are not invested in that index necessarily. The employer still has that choice. For example, if the employee chooses to invest their assets in a Standard & Poor's (S&P) 500 index, that doesn't mean the real assets are invested in an S&P 500 index. The employer still has the investment risk. The return that has been promised to the employee through this theoretical account balance is based on a fixed outside index that has nothing to do with the actual asset performance of the underlying assets. I have not been involved with one of these, so I have not looked at all the details, but that is my understanding of the theory behind it.

Mr. Bruce C. Cable: What about the discrimination issues that are involved in those employee-directed cash-balance plans?

Mr. Jakes: As I said, I have not put one in, so I have not thought about the specifics of this. But any cash-balance plan is going to have to go through a general test. One thing I have heard is that in some organizations they will only allow a portion of the asset pool to be under employee discretion which would help. I would think the assumed rate of interest for the general test would have to be different based on the employee election, which could, theoretically, cause some problems. As you know, under a 401(k) plan the only thing you have to test is the contributions.

But in a cash-balance plan you are testing a benefit that is the contribution, plus interest to age 65. If the highly-compensated employees tend to be riskier people than the nonhighly-compensated employees, I would think that that could create an issue.