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Feature: Pension Defrosted: Aerospace Corp. Unfreezes Its Pension to Attract Skilled Workers

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Aerospace Corp needed to revive its long-frozen defined benefit program to attract and retain engineers and other skilled workers. But could it make the switch without sending costs into the stratosphere?

By Joanne Sammer

It is the pension world equivalent of "Man Bites Dog." Facing cost pressures in 1993, the Aerospace Corp. closed its defined-benefit pension plan to new employees and replaced it with a defined-contribution plan. Twelve years later, it reopened the defined-benefit plan under pressure from employees and the realities of the labor market.

That action stands in stark contrast to what is happening at companies like IBM, General Motors and Hewlett-Packard, all of which have frozen their pension plans during the past few years. According to research by Watson Wyatt Worldwide, the number of Fortune 1,000 companies that have frozen or terminated a defined-benefit pension plan more than doubled from 34 to 71 between 2001 and 2004.

On the surface, the Aerospace Corp., based in El Segundo, California, is an unlikely candidate for the role of pension rebel. It is a government-funded research corporation with a mandate to support the space program through research and development. As such, its employees tend to be highly educated individuals who are not necessarily motivated by money but by the learning and research opportunities the company provides.

Even so, the Aerospace Corp. recognized that it must remain competitive in the labor market if it is to compete for Ph.D.-level scientists and engineers against large corporations, like Boeing, that still offer a traditional defined-benefit pension plan. A competitive benefits package is particularly important because the company's compensation scale is more closely tied to that of the federal government than the private sector.

Employee retention was also a key issue. The defined-contribution plan that replaced the pension plan for new employees in January 1993 provided no

incentive for workers to remain with the company. As a result, turnover among those employees was higher than acceptable before the retirement plan change, says Grant Aufderhaar, principal director of the sensor signals and electronics subdivision in the company's Chantilly, Virginia, office. He says that the portable nature of the defined-contribution plan may have contributed to that. "The defined-benefit pension plan provides some golden handcuffs and an incentive for people to stay with the company," he says.

To further encourage employees to remain with the company and work longer before retiring, the company began a phased retirement program that allows employees at retirement age to structure a flexible work schedule to serve as mentors and transfer knowledge to younger employees. "We are concerned about keeping people on the job as long as possible so that we don't lose that knowledge," says Charlotte Lazar-Morrison, the company's director of HR. "That is key to the nature of our work."

The pension change was also largely driven by employees, led by Aufderhaar. He joined the company in the middle of 1993, just after the pension plan had closed to new employees and had been replaced by a defined-contribution plan. About five years ago, Aufderhaar compared his retirement benefit statement, which showed how much he had accrued in the defined-contribution plan, with that of a colleague who had joined the company in 1992 and, thus, was a participant in the defined-benefit pension plan.

Aufderhaar saw a significant disparity in the value of those benefits. Quite simply, employees participating in the pension plan had significantly more retirement benefits waiting for them than employees who could participate only in the defined-contribution plan.

Aufderhaar decided to do something about it. To better position himself as a pension reformer, he got an appointment as a fiduciary, serving on the defined-contribution plan committee. "That became a platform to bring forward my concerns about the retirement plan situation to the company," he says. As a member of the defined-contribution plan committee, Aufderhaar had greater access to corporate officers and was able to speak to them about his concerns and highlight the implications that a disparity in retirement benefits might be having on the company's ability to attract and retain a qualified workforce.

Old plan becomes new plan

Even though management was acutely aware of the need to change the pension plan, it still had to keep a lid on costs.

The original pension plan includes a variable-benefit component that accounts for two-thirds of benefit accruals. The defined-contribution plan that replaced the pension plan for new employees in 1993 provides a contribution equal to 8

percent of an employee's pay. Therefore, company management decided on a new plan that offers a bit of both: a contribution equal to 4 percent of pay to the defined-contribution plan and a benefit accrual in the defined-benefit pension plan designed to equal another 4 percent of pay. Like the original defined-benefit pension plan, the new plan also has a variable-benefit component that accounts for two-thirds of benefit accruals.

With this plan design, the company was expecting the changes to be cost-neutral. However, the company still faced some risk during the transition to the new plan because the company allowed employees to choose whether to participate in the new plan or stay in their existing retirement plan.

"We knew that employees would make the best decision for themselves, which meant that healthy employees were likely to choose the defined-benefit plan to enjoy certain benefits in retirement, while less healthy employees were more likely to stay in the defined-contribution plan because they would be unlikely to have a long retirement and want to maximize the assets they could pass on to their heirs," says Tom O'Connor, the company's assistant treasurer. "That scenario would have significant cost implications for the plan" because healthy employees tend to live longer and collect more benefits.

Fortunately, the worst-case scenario did not play out. Although the company set a goal of getting at least 25 percent of eligible employees to migrate to the new plan, in reality about half chose to move to the defined-benefit plan. However, because those employees represent an even distribution among age groups, the benefit payouts from the plan will be more spread out and the change was less costly than expected, O'Connor says.

To further control pension plan costs, the company also eliminated subsidies for early retirement. In the past, employees received 100 percent of their benefit if they retired at age 62. Now, the age for full retirement benefits is 65. This change supports the company's goal of keeping employees working longer and reducing plan costs associated with providing full benefit for early retirement.

Communicating the change

HR director Lazar-Morrison admits that the pension plan change initially was greeted with some skepticism, even though employees had pushed for it. "But once people began using the tools to make their projections, they began to see that the change was a good thing," she says.

The company provides online tools that helped employees make the initial retirement plan choice and allow them to track retirement benefit projection as often as they want. The tools allow individuals to run different retirement scenarios based on age, salary level and retirement age using the two plan options.

The communication that accompanied the retirement plan change also had to be top-notch. "There are plenty of mathematicians in company who developed their own tools to double-check company projections," Aufderhaar says. Fortunately, the company's tools held up to the scrutiny.

These changes, though still new, are starting to have an impact on the company's ability to meet its workforce goals. Lazar-Morrison reports that having the new retirement plan is making it easier to attract new midcareer employees and that the retirement plan changes are more attractive to a broad spectrum of employees.

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