

# A different retirement benefit conversation:

A variation of a DB plan  
could help in the war  
for diverse talent



The ongoing need for talent is causing many companies to rethink their workforce staffing strategy and benefits models. Companies that are succeeding in this effort are looking for ways to attract and retain top talent in a way that is differentiated from other employers and meets needs often left unmet by typical benefits programs. Some employers are contemplating reintroducing a benefit once ubiquitous in corporate America but is now increasingly rare: the defined benefit pension plan.

For US companies, one of the primary ways to attract and retain workers has always been a good retirement program: traditional defined benefit (DB) and/or defined contribution (DC) plans. Both DB and DC plans have advantages and drawbacks, but for upwards of 50 years, company-sponsored retirement plans helped build financial security for millions of workers and their families.

However, some companies might consider a DB plan either a millstone, or a dinosaur. These plans fell out of favor in corporate America because they were perceived as too expensive, too complex, too unpredictable, and perhaps too generous. Innovations in plan design and risk management can now address these objections, and companies willing to consider the proverbial “path least traveled” have an opportunity to differentiate themselves in the war for talent.

Looking at the objections to DB plans, it’s not surprising that defined contribution (DC) plans have grown in favor among CFOs for nearly 30 years. That is, until the pressure to retain talent started to build following the global pandemic.

Depending on the nature of a company’s business and human capital strategies, a DC plan may not always be a perfect solution. Plan design is often the culprit. Too many 401(k) plans, in exchange for giving employees more autonomy in building their retirement savings, have proven to be inadequate at preparing employees for a secure financial future. In addition, a typical 401(k) usually lacks any management tools in terms of incentives to attract and retain top talent, and no practical “prod” to guide employees to retire on time. Furthermore, the matching formula can lead to inequities in a diverse workforce, such as a company that has a large percentage of part-time or hourly-rate employees. Such employees are rarely able to contribute the amounts necessary to qualify for the full match — even though they are the employees that may need it the most.

DC plans place the onus on employees to make appropriate investment allocation decisions that many are not adequately positioned to make. In addition, and perhaps most importantly considering the primary purpose of the plan is to deliver financial security in retirement years, employees are often left to determine how to transition from a mindset focused on wealth accumulation to one focused on income generation and spending in retirement.



Organizations that are committed to becoming the “employer of choice” are taking a fresh look at some of the more attractive incentivizing characteristics of DB plans without the cost uncertainty of a traditional pension.

## A possible DB solution for the “employer of choice”

Organizations that are committed to becoming the “employer of choice” in their industry or market are taking a fresh look at some of the more attractive incentivizing characteristics of DB plans without the cost uncertainty of a traditional DB plan.

Mercer has been reviewing pension plan concepts that might appeal to companies who fit this profile and who may be considering establishing or reopening their pension plan. We use market-based strategies to help mitigate the drawbacks of traditional DB plans outlined above.



### Useful definitions

#### Cash Balance Plan

In a cash balance plan, each participant has a hypothetical account that is credited annually with a dollar amount, usually calculated as a percentage of pay. The account earns interest based on an interest crediting rate defined by the plan document. Cash balance plans build value steadily and often at the same pace for all employees — whether they’ve worked for the company for 1 or 30 years.<sup>1</sup>

#### Variable Benefit Plan

In the context of a variable benefit plan, the plan sponsor provides a lifetime payment to the retiree (and potentially a spouse/partner), with periodic adjustments to the benefit amount based on the performance of the underlying assets.

There are a number of reasons why a market-based DB plan may appeal to an employer:

- **Supports talent attraction**  
Providing a benefit that stands out against the competition for talent and that can potentially solve one of employees’ primary concerns — future financial security and certainty — can help the company attract needed talent. Companies that rely heavily on attracting mid-career talent with specific and scarce skills — for example, hospitals, pharmaceuticals, and the like — stand to benefit the most from a differentiated benefit of this nature.
- **Supports talent retention**  
The promise of a benefit guaranteed for life can also help with retention. Additionally, market-based DB plans can be designed so that increased tenure/experience drives increased benefit value. “The longer you work here, the more your retirement benefit value increases.”
- **Supports workforce management needs**  
Unlike DC plans, DB plans provide sponsors with a workforce management tool, where sponsors are able to provide additional retirement benefits to a specific group of employees to incentivize early retirement when necessary or to defer retirement when advantageous. Providing a benefit that delivers adequate retirement financial security can also support the flow of talent — reducing “retirements in place” where long-tenured employees with inadequate retirement savings occupy critical roles in the organization that aspirational — and perhaps more diverse - employees will seek elsewhere if forced to wait too long for their opportunity.
- **Seeks to deliver financial stability for employers**  
With market-based DB plans, the investment decisions are the plan sponsor’s responsibility, but the participants ultimately share investment experience (good and bad). This experience is shared through periodic benefit adjustments (up or down), which tends to keep the plan close to full funding.
- **Aims to deliver equitable and inclusive benefits and outcomes**  
DC plans disadvantage part-time or lower-income employees who don’t qualify for the full company match. DC plans also provide different retirement outcomes for similarly situated employees (same age, service) because of individual saving and investment decisions. Market-based DB plans could provide employees more equitable and inclusive benefits. Importantly, the benefits are not based on the participant’s ability to save or their confidence and ability to manage their personal investments.
- **Provides cash flow timing flexibility to sponsors**  
Market-based DB plans offer additional funding and timing flexibility, thereby easing the burden of budgeting for future pension costs. For example, a sponsor can pre-fund the plan for three years when business conditions are good, garnering a tax write-off and improving the firm’s P & L income. Contributions can be made when the timing is most beneficial for the plan sponsor, as opposed to every payroll period with DC plans, for example. This advance funding could potentially create a surplus, which would allow the employer to forgo any additional funding in years where business conditions are poor.

<sup>1</sup> For a good background on the structure and mechanics of cash balance plans, see Kenneth R. Elliot and James H. Moore, “Cash Balance Plans: The New Wave,” *Compensation and Working Conditions (Bureau of Labor Statistics)*, Summer 2000. <https://www.bls.gov/opub/mlr/cwc/cash-balance-pension-plans-the-new-wave.pdf>

- **Optimizes cost of benefits with more sophisticated investment management of retirement assets**

Sponsors of market-based DB plans have the ability, with the help of professional advisors, to implement more sophisticated investment strategies, thus creating the possibility for higher earnings and thus better retirement outcomes for participants, potentially at a lower cost than an equivalent DC benefit.

- **Relieves participants of complex financial decisions**

DC plans require participants to make decisions about (a) how much to contribute, (b) how to invest, both before and during retirement, (c) how much to withdraw initially in retirement, and (d) how much to withdraw each subsequent year in retirement. These are complex decisions with many variables (e.g. assumed earnings, assumed age at death). Market-based DB plans eliminate all these decisions for plan participants.

- **Utilizes the financial advantages of longevity pooling**

By providing lifetime income, market-based DB plans utilize the power of longevity pooling, to the benefit of plan participants. For the same cost, more retirement income can be provided to retirees under a market-based DB plan than under a DC plan, and it can be done without taking on any additional investment risk. Similarly, the same benefit can be provided for less cost using a market-based DB plan than through a DC plan, with no additional investment risk required.

Each of the above elements aims to provide a differentiated advantage that may ultimately deliver better financial outcomes to employees, while improving an employer's talent acquisition, retention and workforce postures.

Employers often find that market-based DB plans offer additional funding and timing flexibility, thereby enabling tax and cash flow optimization.





## Market-based DB plans — a few more details

We see two primary “flavors” of market-based DB plans:

- **Market-based cash balance plans**
- **Variable benefit plans**

The plan sponsor manages the investments under both plan types, and both plan types adjust benefits based on underlying asset performance. These benefit adjustments can help to limit the financial risks to the plan sponsor. However, there are a few notable differences between these two plan types, as outlined in the table below:

	 <b>Market-based cash balance</b>	 <b>Variable benefit</b>
How is the benefit defined?	Account balance	Monthly benefit
How is the retirement benefit determined?	Accumulation of annual pay credits (usually a percentage of pay) plus earnings	Accumulation of a percentage of each year’s pay
How long will the retirement benefit be paid?	For lifetime (or joint lives of participant and a spouse/partner)  Alternatively, account balance paid as single sum	For lifetime (or joint lives of participant and a spouse/partner)
Retention ability	Service-based pay credits can aid retention (reward tenure)	Service-based benefit percentages can aid retention (reward tenure)  Additionally, these plans implicitly provide increased benefit value at each higher age (reward experience)
Any minimum benefit guarantees?	Yes. Account balance can never be less than sum of pay credits	No
Vesting of employer-provided benefit	3 years or less	5 years or less
Bequest to heirs	Possible, if account paid out as lump sum  No, if account paid out as lifetime income	Generally not available since these plans do not typically provide a lump sum option

The type of plan that is best for any particular employer will depend on that employer’s objectives, workforce characteristics and preferences. The above table shows typical features of these plans. However, significant flexibility exists in order to meet employer objectives for their specific plan.

# Discover more

To explore how a market-based DB plan may help your employees at all levels, please [visit our website](#) or contact your Mercer consultant.

## Important notices

Important notices References to Mercer shall be construed to include Mercer (US) LLC and/or its associated companies.

© 2024 Mercer (US) LLC. All rights reserved.

Past performance is no guarantee of future results. The value of investments can go down as well as up, and you may not get back the amount you have invested. Investments denominated in a foreign currency will fluctuate with the value of the currency. Certain investments, such as securities issued by small capitalization, foreign and emerging market issuers, real property, and illiquid, leveraged or high-yield funds, carry additional risks that should be considered before choosing an investment manager or making an investment decision.

Mercer does not provide tax or legal advice. You should contact your tax advisor, accountant and/or attorney before making any decisions with tax or legal implications.

This does not constitute an offer to purchase or sell any securities.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see <http://www.mercer.com/conflictsofinterest>.

This does not contain investment advice relating to your particular circumstances. No investment decision should be made based on this information without first obtaining appropriate professional advice and considering your circumstances. Mercer provides recommendations based on the particular client's circumstances, investment objectives and needs. As such, investment results will vary, and actual results may differ materially.

Information contained herein may have been obtained from a range of third-party sources. Although the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages) for any error, omission or inaccuracy in the data supplied by any third party.

Investment management and advisory services for US clients are provided by Mercer Investments LLC (Mercer Investments). Mercer Investments LLC is registered to do business as "Mercer Investment Advisers LLC" in the following states: Arizona, California, Florida, Illinois, Kentucky, New Jersey, North Carolina, Oklahoma, Pennsylvania, Texas and West Virginia; as "Mercer Investments LLC (Delaware)" in Georgia; as "Mercer Investments LLC of Delaware" in Louisiana; and "Mercer Investments LLC, a limited liability company of Delaware" in Oregon. Mercer Investments LLC is a federally registered investment adviser under the Investment Advisers Act of 1940, as amended. Registration as an investment adviser does not imply a certain level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. Mercer Investments' Form ADV Parts 2A and 2B can be obtained by written request directed to: Compliance Department, Mercer Investments, 99 High Street, Boston, MA 02110.