

BEST PRACTICES IN Compensation & Benefits

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Incentive Compensation—Still Viable In Today's Economy

In the last year, you may have developed a strategy for increasing productivity. Maybe you decided to expand incentive compensation to employees other than sales staff and executives; after all, the trend is toward more incentive compensation, rather than less. You set up measures and performance standards, told people about the program, and waited.

But now, the economy has tanked. Goals and expectations have changed, and there is no way your employees can meet the challenges you set out at the beginning of the period. How do you deal with the kind of massive shift we've been experiencing?

Vishrut Parikh, director of product marketing at compensation software development company Callidus (www.callidussoftware.com), wants you to understand that the principles of incentive compensation are sound, and can apply as easily to your rank and file workers as they do to your sales staff and executives. Along with Public Relations and Analyst Relations Director Jock Breitwieser, Parikh recently spoke to us on the topic.

BLR: Is incentive compensation for nonsales, nonexecutive staff done at large companies?

Parikh: No. It doesn't matter what size the organization is. When you have instituted an incentive compensation program, the complexity is about the same as it is for a large organization. There are no overriding standards for creating these plans: People are free to create whatever plan they like in whatever way they want to create it. There are standards to follow when reporting

the compensation, but when you create it, there are no standards. That's why the complexity from a 10-person sales organization to a 100,000-employee company is about the same.

BLR: What trends are you seeing with regard to compensating employees with variable pay?

Parikh: Historically, two constituents have used incentive compensation: sales and executives. What we have seen is our customers asking for solutions that will allow them to extend pay for performance to all of their employees. The second thing we're seeing is that, while budgets are being cut, and bonuses are lower, the use of bonuses to motivate people is increasing, and companies are trying to make them available to a much larger percentage of their employees.

BLR: So there is less money being spread to more people? How does that motivate them?

Parikh: It is counterintuitive, but that's what's happening. Companies are not doing away with incentive programs, but they have reduced the pool of available money. They also are mixing cash and noncash rewards. Not everyone is paying huge incentive compensation dollars, but many companies are paying out a lot more in the form of gift cards or other noncash awards. This has been a very common practice in some industries, such as banks. Now it is becoming more and more prominent for other types of employees.

Breitwieser: Companies are using non-cash incentives as motivation for their employees. If you're a smaller company,

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and you really want to motivate your employees, you give them a bigger upside from the incentives. So if employees overfulfill on their quotas, or whatever metrics they're working against, they don't get 100% of what their original salary would be; they get 110%, for example.

Parikh: It's a win/win situation. Companies are getting higher performance, and the employees recognize that their efforts are paying off because they get more than what they were signed up for.

BLR: In this economy, when the pool of available workers is large, why pay incentives at all?

Parikh: Companies can think like that, and they may be able to hire people at first. But that won't last too long. Psychologically, we are motivated by rewards and recognition. That's not new. If an employer takes a short-sighted stand, they will be able to hire people, but will they get the best out of those people? That's a question leading companies are asking because making sure they retain talent is a challenge, even in this environment.

You want to keep your talent, make sure they perform properly, make sure you're getting the best out of those employees. Retaining people is still a problem. Yes, there are more applicants out there (so you could get away with paying them less), but if you compare the little less you're going to be able to pay them to the cost of hiring and training, is it worth it? Do you want high turnover, or do you want to minimize turnover? And when the economy turns around, how are you going to find and keep talented employees if you have not treated people properly?

BLR: How well do companies really link pay with performance?

Parikh: Companies basically end up spending about 8% to 10% of their gross revenue on variable compensation. That could be a very large amount of money. If you ask them whether they are getting a return on that investment, they may not know.

Companies will lay out strategies at the beginning of the year, decide how many people to incentivize, how much money they will spend on it, etc. Then at the end of the year they might ask themselves whether they have achieved the goals they set. Did they get the performance they were hoping for? A lot of times companies have no way to measure that.

That's why the next year, when they're going through the process again, the company just says they plan to grow by 10% or something, so they tack 10% onto the quota. They really need to make sure they have a way to measure the return on investment.

Companies should make sure that the solution they use can make corrections throughout the year, as well. Look at what has happened in the last 18 months! You cannot say strategies haven't changed; they have changed significantly. How do you accommodate those changes in your incentive program?

Is your solution flexible enough to allow you to make changes midyear, or whenever you need to so the program is in line with business needs? You don't want to be limited by what the technical application is allowing you to do; make sure you're actually doing what the business needs you to do.

BLR: What are some things to keep in mind about communicating an incentive program to a group of employees who never had one before?

Parikh: Make sure you have a consistent performance management

program throughout the company, and that you're communicating in a collaborative manner. Managers need to speak to their subordinates, making sure they understand why the objectives are set the way they are set, and that there is two-way communication. There needs to be buy-in and transparency.

If you don't provide that to your employees, especially in a downturn like this, the new program could have a negative effect on employees. Building trust is equally important as paying out money. Employees need to understand and have a say in how their objectives are set, and that must be at the beginning of the process, not when it's time to pay out the bonuses.

Point to Remember

While incentive compensation has traditionally been used in large organizations and for two specific categories of employees, the situation is changing. Maybe now is your time to find out why.

Workers Worried

Over half of U.S. workers said they felt concern in their workplace due to the economy, according to a Tell It Now^(SM) survey released by ComPsych (www.compsych.com), a provider of employee assistance programs.

When asked: "What is your work atmosphere in light of the economy?"

16% said "panicky"

39% said "somewhat worried"

23% said "business as usual"

14% said "cautiously optimistic"

8% said "very hopeful"

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Energy Company ‘Walks the Talk’ In Taking Care of Its Top Asset

Many companies say that their employees are their number one asset, but they don’t necessarily do much to demonstrate that belief. NuStar Energy L.P. is an exception.

“If you take care of your employees, then they’re going to take care of you,” says Kim Rash, director of benefits and compensation for the San Antonio-based company. That’s a management philosophy that permeates everything the company does. NuStar offers company-paid health and wellness benefits, provides both a pension and a 401(k) plan, listens to employee concerns and suggestions, pays bonuses—and hasn’t laid off anyone since the company’s inception in 2001. And the list goes on.

“They really do put employees first here. It comes from the top, and it’s pushed down to the bottom,” says Rash. The company employs about 400 employees in San Antonio and another 1,300 in offices across the United States and abroad.

Award-Winning Benefits

NuStar provides employees with “NuStarbucks”—flex dollars provided above and beyond their base salary to cover the costs of providing basic benefits, such as medical and dental coverage (and for their family when applicable), term life insurance with a benefit equal to four times their base salary, and accidental death and dismemberment insurance, Rash explains. “We take away the worries of employees paying for their health insurance.”

Based on their needs, employees also have the option of selecting a variety of other benefits, which can be paid for with any remaining flex dollars or out of pocket. Those benefits include vision, additional life insurance, survivor income insurance, a legal plan, critical illness coverage, and long-term care. NuStar also offers flexible spending accounts and provides a \$300 per-child

subsidy for dependent-care expenses for up to four children, Rash says.

In addition, the company offers both a traditional defined benefit pension plan and a 401(k) plan. Vice President of Human Resources Bob Grimes says the pension plan is completely funded by the company. The plan provides a benefit that is equal to 1.6 percent x final average pay (i.e., average of the highest 3 consecutive calendar years, including base pay, overtime, and bonus) x years of credited service, according to the company. So, for example, an employee, age 62, who had a final average pay of \$65,000 and 30 years of service would have a benefit of \$31,200 (.016 x \$65,000 x 30).

NuStar also offers a dollar-for-dollar 401(k) match of up to 6 percent of pay, says Joanna Weidman, vice president of corporate communications.

The overall benefits provided to employees are valued at 47 percent of employees’ salaries, Weidman says. For the last couple of years, NuStar has issued a benefits statement to each employee so they understand the full scope of their compensation and benefits. “I think it opens a lot of employees’ eyes,” she says.

Grimes notes that the company mails these benefits statements to employees’ homes, so spouses can see them, and also makes the statements accessible through the company intranet.

New-hires are “just amazed” with the benefits package provided by the company, Rash says, adding that the benefits have helped keep turnover low at NuStar. The voluntary turnover rate is 3 percent.

NuStar’s employee benefits plan has been ranked the best in its industry by Hewitt Associates and was one of the reasons that the company was named this year to *Fortune*’s “100

Who: NuStar Energy L.P.

What: Provides company-paid health and welfare benefits, and offers both a pension plan and a 401(k)—with a match of 100 percent up to 6 percent of pay.

Results: Voluntary turnover rate is 3 percent.

Best Companies to Work For” list (ranked 44th) and named the top large company on *Texas Monthly* magazine’s “Best Companies to Work for in Texas” list. Last year, NuStar received accolades from the *San Antonio Business Journal*, which ranked it the number one large company to work for in the city.

This is the first year that NuStar participated in the *Fortune* and *Texas Monthly* rankings. “It is very exciting to earn a place on *both* of these prestigious lists in our *first year* of participation,” says NuStar president and CEO Curt Anastasio. “What makes this recognition particularly noteworthy is that both honors are primarily based on employees’ responses to confidential surveys. So these awards truly reflect the positive spirit of our employees.”

What to Do

Here are a few tips to consider when offering a comprehensive benefits package:

Gain support from the top. “You need to have management buy-in,” says Rash.

Communicate. “It’s really important to communicate what you have—frequently,” she adds. Use a variety of ways to reach out to employees about the benefits available to them.

Provide reminders. “Remind them, especially today, we’re very fortunate to have jobs and not only benefits, but great benefits,” she says.

Issue benefits statements. This articulates the value of the benefits you’re providing to employees—above and beyond their salary.

WASHINGTON ALERT

Law Includes HR Provisions

The American Recovery and Reinvestment Act of 2009 includes several provisions related to compensation and benefits, in addition to the COBRA and transit-related provisions covered last month in *Best Practices in Compensation & Benefits*.

The legislation provides unemployment compensation to workers who leave an employer for “compelling family reasons,” such as domestic violence, illness or disability of an immediate family member, or the need to accompany a spouse to a place, due to a change in location of the spouse’s employment, from where it is impractical to commute.

According to a congressional summary of the new law, other provisions include:

- Extension through December 31, 2009, of the Emergency Unemployment Compensation program, which provides a maximum of 33 weeks of extended unemployment benefits to those who have exhausted their regular benefits
- A \$25 increase in weekly unemployment benefits through this year
- Extension of unemployment compensation for 13 weeks to railroad workers, who are not part of the federal/state unemployment system
- Incentives to hire unemployed veterans and disconnected youth

The new law also imposes additional executive compensation restrictions on companies that receive so-called federal “bailout” funds, although the \$500,000 cap on executive compensation that was part of recent U.S. Treasury guidelines is not included in the legislation.

COBRA Guidance Available

In related news, two federal agencies have published guidance related to the COBRA stimulus provisions included in the new law. The legislation provides for a 65 percent subsidy for COBRA

continuation premiums for up to 9 months for workers who have been involuntarily terminated.

The U.S. Department of Labor has posted related information at www.dol.gov/cobra, including an overview of the law, fact sheets, and frequently asked questions.

In addition, the Internal Revenue Service has released information to help employers claim credit for the COBRA medical premiums they pay for their former employees, as well as a revised version of Form 941, *Employer’s Quarterly Federal Tax Return*, which will be used to claim credit. To access the information, visit IRS.gov and enter “COBRA Health Insurance Continuation Premium Subsidy” in the search box.

Comp Time Law Proposed

Private sector employees would be entitled to receive compensatory time off in lieu of overtime pay under HR 933, the Family-Friendly Workplace Act, which was recently reintroduced by Rep. Cathy McMorris Rodgers (R-Washington).

Under the proposed law, an employee may receive comp time at a rate of at least 1½ hours for each hour of work that would otherwise qualify for overtime pay.

Employers would be permitted to offer comp time, as long as they comply with the provisions of applicable collective bargaining agreements and, in the case of nonunion workforces, as long as they reach an agreement with employees about such an arrangement before the work is performed, give employees the option of comp time or overtime pay, and not make the agreement a condition of employment.

The proposal was referred to the House Committee on Education and Labor.

Workplace Flexibility Bill

Employers with 15 or more employees would be required to consider employee requests for flexible work terms and conditions under HR 1274, the

IRS Update

Withholding Tables Released

Following enactment of the American Recovery and Reinvestment Act of 2009, the Internal Revenue Service (IRS) released new wage withholding tables that incorporate the Making Work Pay credit.

Available for tax years 2009 and 2010, the maximum credit is \$800 for married couples filing joint federal income tax returns and \$400 for other taxpayers. Unlike last year’s economic stimulus payment, taxpayers will not receive a check from the government for the credit. Instead, employers must adjust withholdings from employees’ paychecks, resulting in more take-home pay for most employees.

There’s no need to have employees complete a new W-4. However, those with multiple jobs may want to do so to ensure that enough withholding is held to cover the tax for the combined income, according to the IRS.

The new withholding tables are available on IRS.gov in Publication 15-T, *New Wage Withholding and Advance Earned Income Credit Payment Tables*.

Working Families Flexibility Act, which was reintroduced by Rep. Carolyn B. Maloney (D-New York).

The bill would allow employees to request a modification to their hours, schedule, or work location; require employers to engage in an interactive process to discuss the employees’ needs and potential ways to address them; require employers to explain the grounds for any denials; and prohibit retaliation against employees making such requests, according to Maloney.

The proposed legislation was referred to four House committees, including Education and Labor.

Experts' Forum

Behavioral Finance Lessons and Defined Contribution Plans: *Automatic Enrollment and Beyond—Part II*

by Patricia Advaney, Senior Vice President, Participant Solutions Diversified Investment Advisors

In last month's issue, we discussed how automatic enrollment—which uses inertia to an investor's advantage—has been a successful and widely adopted application of what many behavioral economists have known for years.

But even while automatic enrollment helps increase total plan participation, its implementation at relatively low default rates, say 3%, will be insufficient to help most people realize their retirement income goals. Whenever possible, sponsors should consider higher default rates and incorporate automatic escalation features to establish implicit “anchors” of more appropriate savings rates.

This month, we explore how other behavioral finance lessons may be applied to increase retirement plan saving.

Offering Better Choices

As an alternative to automatic enrollment, plan sponsors might consider implementing a rapid enrollment card that simplifies the decision-making process, providing individuals with limited choices. This is a compromise between automatic enrollment and open-ended election forms with so much choice as to leave the investor paralyzed. As an example, with respect to the investment vehicle, participants can elect a target date solution.

The choices of contribution rates might employ “smarter default” technology to nudge investors closer to a more optimal decision. For instance, still keeping it simple, the card might ask the individual to choose from rates of 5%, 8%, and 10% (rather than what is often displayed: 1%, 2%, 3%, 4%, and 5%). And borrowing from the target fund concept, perhaps there should be different sets of rates for different age groups.

In his book *Predictably Irrational*, Dan Ariely, one of the nation's foremost behavioral economists, demonstrates just how important a role choice architecture plays. For instance, consider the following three newspaper subscription arrangements: 1. online only: \$59; 2. print only: \$125; 3. online and print: \$125

When offered these three choices, of 100 people surveyed, the vast majority (84) chose to pay \$125 to receive the newspaper online and in print. A few people (14) chose the cheapest alternative (online only), but no one chose the \$125 option of print only. However, if you think the “print only” alternative is unimportant to the outcome, consider the result when this option is removed. When given the choice between options 1 and 3 only, most people (68) chose option 1 over option 3 (32).

Ariely argues there is no apparent “rational” reason why people would behave so differently in the two scenarios, but that we, as humans, repeat this pattern over and over and hence are “predictably irrational.”

His explanation for this seemingly irrational behavior? People evaluate available choices relative to each other. In the first scenario, option 3 costs the same as option 2 but provides two media formats—clearly a better choice.

But in scenario 2, the choices are much different, and there isn't a “close second,” hence, a different conclusion is reached. This idea of providing a “decoy” to affect an outcome is not a new concept, but it is one that offers an important lesson when trying to change human behavior: The choices offered, and how they are presented really *do* matter.

The Role of Education

Automatic or simpler enrollment methods mean that the initial engagement

with participants will be more limited than in the past, making a detailed education kit much less relevant going forward. This does not mean that there is no place for education, but rather, future communications must be personalized, targeted, and relevant. Engagement will depend on motivation, which is likely to increase as retirement nears.

Feedback will be critical to helping participants gauge success, and plan sponsors should start to expand their success measures beyond participation rates and average contribution rates to include, for example, percentage of participants on track to replace 80% of their preretirement income.

What else can we do to change—really change—the traditional behaviors associated with retirement saving? Consider one or more of these strategies to encourage people to participate in the plan:

- **Engage mentors and peers to personalize the message.** Research has shown that within organizations, departments with managers who voice strong support for the savings plan have higher participation than those where the managers are not active supporters.
- **Communicate organizational participation goals.** Organizations typically communicate organizationwide goals for charitable drives: Why not do the same for retirement savings?
- **Establish open enrollment windows with deadlines.** Deadlines can be effective in getting individuals to take action.
- **Use interoffice mail to generate “buzz.”** As long as communications do not contain personal information, using interoffice communications can be more effective than sending to homes.

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From the Courthouse

Court Upholds Mandatory Arbitration Of Benefit Claim

A federal appeals court has held that a health plan's mandatory arbitration procedure for appealing benefit denials must be utilized before an employee can file suit, even though the procedure included requirements that are illegal under ERISA.

The court said that in light of the public policy in favor of arbitration, it was possible to sever the illegal provisions and go forward with the arbitration as if those provisions did not exist (*Franke v. Poly-America Medical and Dental Benefits Plan*, U.S. Court of Appeals for the 8th Circuit, No. 08-1637 (2/5/2009)).

Facts. "Johan" was employed by Poly-America, L.P., since 2001 and was covered by the Poly-America Medical and Dental Benefits Plan.

Each year of his employment, Johan acknowledged in writing his agreement to arbitrate any claims associated with his enrollment in the plan.

After suffering a heart attack in November 2006, Johan submitted his medical bills to the plan for payment. Payment was denied, and Johan appealed to the plan administrator, who upheld the original decision. Johan was informed that he could file a written request for "final and binding arbitration."

Johan chose instead to file suit in federal district court. The plan asked the court to compel arbitration although it admitted that provisions in the arbitration agreement, which asserted that arbitration would be binding and that arbitration costs would be shared, were unlawful under ERISA.

The plan argued that those provisions could be severed from the arbitration agreement so that the agreement could be enforced. The district court concluded, however, that "the mere existence of the illegal provision unduly inhibits or hampers the

processing of appeals and therefore makes the arbitration agreement unenforceable."

Ruling. When reviewing whether to enforce an arbitration agreement, the 8th Circuit court (covering AR, IA, MN, MO, NE, ND, and SD) said that it needs to determine if there was a valid arbitration agreement and whether the dispute at issue fell within the terms of that agreement. Johan admitted that the dispute was covered by the arbitration requirement, but argued that the illegal provisions made the agreement invalid.

Johan cited a case where the 4th Circuit (covering MD, NC, SC, VA, and WV) ruled that an arbitration agreement was invalid.

But the 8th Circuit Court noted that the arbitration agreement in that case was riddled with biased provisions that allowed the employer, among other things, to choose the arbitrators and unilaterally modify the arbitration rules without notice, presumably even during arbitration.

The court concluded that the Poly-America arbitration clause did not approach the "sham system unworthy even of the name arbitration" at issue in *Hooters of America, Inc. v. Phillips* (4th Cir., 1999).

The court asserted that Johan's situation was more like the facts in *Gannon v. Circuit City Stores, Inc.* (8th Cir., 2001). In that case, the severability clause in the arbitration agreements showed that in the event a provision within the agreement was invalid, the intent of the parties was to proceed to arbitration once any invalid term had been eliminated.

The court rejected the concern raised by Johan and the district court that plan participants could not be expected to know that the provisions at issue were unlawful.

The LAW

Employee Retirement Income Security Act (ERISA)

The Federal Arbitration Act (FAA) (9 U.S.C. Sec. 2) requires that "[a] written provision in any ... contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The U.S. Supreme Court has ruled that the FAA was intended "to reverse the longstanding judicial hostility to arbitration agreements ... and to place arbitration agreements upon the same footing as other contracts" (*Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991)). Therefore, arbitration agreements are to be enforced unless a party can show that it will not be able to vindicate its rights through the required arbitration process. This policy applies equally to claims based on statutory rights, so there is no "compelling basis to treat agreements to arbitrate ERISA claims differently" (*Arnulfo P. Sulit, Inc. v. Dean Witter Reynolds, Inc.*, 8th Cir., 1988).

ERISA Sec. 503 requires that every employee benefit plan must include a claims procedure that provides adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied. The notice should set forth the specific reasons for such denial and afford a reasonable opportunity to any participant whose claim for benefits has been denied to have a full and fair

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That possible problem was not a sufficient basis upon which to deny the request to compel arbitration.

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If You Provide It, They Will Ride

Pocketbooks will benefit from the increase, but the TransitCenter expects the cap increase to have other positive results, such as improvements in air quality and reductions in traffic congestion as well. "We conducted surveys last summer of employers in very large cities like New York, San Francisco, and Chicago," says business officer Nathalie Vanheusden.

"And 40% percent of the employers in those areas offered transportation benefits. Of those who did not offer them, 30% said that if there was a significant increase in the cap, like the one we have now experienced, they would be likely to offer a program. So we are anticipating greater awareness and probably growth of the benefit," she says.

When companies put a commuter program in place, she points out, employees ride. "We interviewed commuters, and for those whose employers did not offer the program, 53% said they would enroll if their employer were to offer it.

"Our studies found that the use of mass transit for employees who joined the program increased 41% on average, and 46% during the weekends. We also found out that 18% of employees who joined the program had been driving alone to work and now use mass transit."

ABOUT THIS NEWSLETTER

This newsletter is devoted to sharing compensation and benefits ideas that have worked for HR professionals striving to make a strategic difference in their companies. If you have a story you'd like to share, send us a fax at 860-510-7224.

If you have a question about one of the newsletter stories or want more information, call 800-727-5257, ext. 2194, or e-mail equayle@blr.com.

Benefits Corner

Higher Limit on Commuter Benefits Puts More Money into *Everyone's* Pockets

When the 2009 stimulus package was signed into law on February 17, a celebration was happening in another city somewhat north of the White House. The offices of the TransitCenter were buzzing because the package contained something for which they had spent more than 7 years lobbying.

Buried within the American Recovery and Reinvestment Act is the provision that is causing so much excitement in New York City—the long-hoped-for increase in the cap on commuter benefits. When we reported in these pages the advantages of using commuter benefits to attract and retain employees, not to mention as a way to save taxes for your company and your employees, the limit on pretax income enrolled commuters can use to pay for mass transit was \$120 per month.

With a sweep of his pen, President Obama raised the limit to \$230 per month, on par with the cap on pretax parking expenses.

"The concrete impact of raising the cap is that employees can potentially save up to \$1,000 per year and maybe even more," says Nathalie Vanheusden, TransitCenter's business officer. "It really is significant, especially in the current economic context."

If your company already offers transportation benefits, and you want to take advantage of the increase in the cap, contact your service provider to find out what you need to do. If you don't currently offer the benefit, now might be the time to start a program.

Vanheusden says commuter benefits can help you attract and retain employees: "We hear from potential customers fairly frequently that they have to put this program in place because they aren't able to hire people without it. Employees' commuting costs are getting so high, they tell us, that people won't make a long trip without the employer helping them with the costs."

When employees can deduct the cost of their commute from their gross income, their payroll taxes are lower, resulting in more take-home pay. Employers, too, pay less in payroll costs and, as a result, the program is very inexpensive to offer.

The TransitCenter expects commuters in the New York City metropolitan area alone to save an additional estimated \$37.5 million a year because of the increase, and their employers to save about \$16.4 million in payroll taxes annually.

Whether you start a new transportation benefit program or you increase the cap on your existing program, be sure to take advantage of the communication opportunity. Employees will be excited at the prospect of seeing more money in their paychecks. Be sure your communications point out that the net impact is similar to an increase in salary—certainly a welcome idea in the midst of this difficult economy

McGregor says his company paid \$13,000 for the procedure undergone by that first employee. "That included the surgery, travel for two people, a 2-week stay at the Intercontinental Hotel, all the follow-up care, and hospital charges. We got a bid locally, because we wanted to know the price difference; the local bid was \$51,000."

However, money may not be the main issue for employees. McGregor reports that his employee had a very positive experience using an international hospital. "When talking about the experience, the statement the employee gave me was that he felt like he got better care than he would have in the U.S. When I asked why, he said, 'The physician spent more time with me than any physician in the U.S. ever has.' That translated into better care."

Employees see Satori as just another option from which they can choose. "Let's say somebody needs a hip replacement," says Lash. "He or she may be able to choose from Hospital A, B, C, or D. We become a fifth choice. However, if the employee selects Satori, not only will the deductible and co-pay be waived, but the employee will share in some of the savings, if the employer sets up the program that way. So maybe \$7,500 or \$10,000 gets

deposited into his or her healthcare reimbursement account (HRA); it can be used to pay for healthcare expenses for the next several years. Employers like it, too, because anything they put into an HRA is tax deductible to them, so they still get 100 percent of the savings."

What You Need to Do First

McGregor says that if you decide to pursue adding a medical tourism component to your health plan, you should strive to engage employees in the decisions from the beginning. "If employees are really involved in the decisions, to see how this improves quality and enhances their healthcare program, then you'll have much better participation in the program. If you don't involve them, then you'll get resistance. They'll think it's just an effort to cut back benefits and reduce care."

Your choice of vendors is important, too. McGregor suggests two things to keep in mind when choosing one. First, make sure physicians in the networks at home are willing to care for patients who return from an overseas procedure. "Some physicians embrace it, and other physicians will fight the concept of exporting care. Make sure when you evaluate providers that have foreign networks that they have an effective follow-up system locally."

Second, your vendor should be able to communicate with employees with all levels of education and experience within your organization. You may have employees who don't have a passport and don't travel, says McGregor. If the vendor offers a travel concierge who can answer the questions of these inexperienced travelers, it will do a lot to assuage their fears and encourage them to try the new program.

The Law (continued from page 6)

review of the decision denying the claim. DOL was authorized by ERISA to provide the details for this requirement.

DOL regulations provide that claims procedures may not contain any provision for the mandatory arbitration of adverse benefit determinations that precludes the claimant from suing for benefits (29 CFR 2560.503-1 (c)(4)).

In addition, a claims procedure must not contain any provision and not be administered in a way that would unduly inhibit or hamper the initiation or processing of claims for benefits. The regulations state that an example of such a provision is a requirement of the payment of a fee or costs as a condition to making a claim or to appealing a benefit denial (29 CFR 2560.503-1(b)(3)).



Q: In order to increase contributions to our 401(k) plan, we are thinking about adding an automatic enrollment feature. Would this complicate our nondiscrimination testing?

A: Thanks to recently released—and eagerly anticipated—final regulations, the answer is no. At the

end of February 2009, the Internal Revenue Service (IRS) issued final regulations that address two types of automatic enrollment programs: qualified automatic contribution arrangements (QACA) and eligible automatic contribution arrangements. These final rules had been anxiously awaited since the auto enroll feature was introduced under the Pension Protection Act in 2006.

If you decide to add a QACA and design it properly, your plan will be considered to have met the average deferral percentage and average contribution percentage

tests normally required for 401(k) plans.

The safe harbor exemption says that automatic contributions must begin at a minimum of 3 percent of salary, increasing by 1 percent a year to a maximum of 6 percent of salary. The employer must also provide a company match or nonelective contribution with 2-year vesting. More information on QACAs can be found in the IRS publication *Automatic Enrollment 401(k) Plans for Small Businesses*.

It is available online at www.dol.gov/ebsa/pdf/automatic_enrollment401kplans.pdf.

INDUSTRY TRENDS

Pensions' Funded Status Impacting Businesses

It's no secret that the last quarter of 2008 saw sharp declines in 401(k) accounts. Pension funds also saw large declines in value despite the best efforts of actuaries to accurately predict interest and discount rates in their calculations. Not only did the drop in pension fund assets impact the funds themselves, the funded status of the plans also impacted business goals and operations.

"Changes in funded status are wreaking havoc with the projections companies have made," said Alan Glickstein, senior retirement consultant at Watson Wyatt. "Large and unexpected pension contributions will require companies to divert funds they had earmarked for other business activities into their pension plans precisely when they can least afford it."

Watson Wyatt analyzed pension data for 450 *Fortune* 1000 companies and projected their pension funding status for 2008. The results indicate that, on an aggregate level, funded status will decline an average of 32 percentage points, from 106% in 2007 to 74% in 2008.

This represents a total loss of \$445 billion, wiping out a 2007 surplus of \$78 billion and leaving the analyzed companies with a combined \$366 billion deficit on their year-end 2008 financial statements. Some companies did not have complete data available when the analysis was done, so actual figures, available later this spring, may vary.

"Plan sponsors are feeling the effects of a pension-funding crisis with both asset values and interest rates dropping," said Jim Shaddy, North American retirement practice leader for Watson Wyatt. "We urge Congress to respond with the appropriate temporary relief for plan sponsors."

SEI, a global provider of outsourced asset management, reached similar conclusions based on its own polling. SEI found that companies are feeling the impact of significant pension fund shortfalls in their overall business operations. Many plan sponsors are reevaluating their investment management in an effort to avoid further declines.

According to the *Global Quick Poll*, released in February 2009, nearly 64% of the global poll participants made asset allocation policy changes in the past year, and 48% said they are moving assets away from equities. And 49% of those polled said that if their organization was required to make a cash contribution to meet their plan's funding requirement, corporate finances would be significantly impacted.

"Following the pension 'perfect storm' earlier this decade, funding levels had improved but the impact of last year has once again put pensions at the top of the agenda for corporate treasury functions," said Jon Waite, chief actuary for SEI's Institutional Group. "Increased underfunding will have a substantial impact on organizational finance and from our perspective, continuing 'as is' is not a choice. Changes will need to be more strategic and less reactive."

SEI's poll showed that 75% of U.S. participants said their organization has already moved plan assets out of equities and into bonds or alternatives; 72% said that required contributions before funding relief would have either significantly impacted corporate finances, or the company would not even have been able to make the payment.

The seriousness of the situation was emphasized when nearly half of respondents in the United States, 46%, said it is now more likely that they will take steps toward terminating their defined benefit plan.

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As defined contribution plans are now the essential retirement savings vehicle for most Americans, we need to be vigilant in designing and supporting programs that help more participants reach a fully funded retirement.

Automatic enrollment is clearly a start, but more needs to be done. We need to continue to identify and apply techniques that truly change behavior. We cannot start soon enough.

◆ *Patricia Advaney is senior vice president, Participant Strategy, Diversified Investment Advisors, and a member of the firm's Executive Committee. With nearly 20 years of experience in the investment and retirement plan industry, she is responsible for overseeing all participant-facing activities.*

continued from page 6

Thus, for the limited purpose of determining whether to compel arbitration, the court said it would not consider the relative advantages or disadvantages that might result from enforcing the agreement.

◆ **Point to remember:** *The extended litigation in this case might have been avoided if the plan's arbitration provision had been reviewed to make sure it was consistent with the U.S. Department of Labor's (DOL) claims procedure regulations.*

There must be a lot at stake in this case for the parties to spend resources on whether to arbitrate. Plans surely would rather not litigate denials of health coverage.

However, having a fair and legal claims procedure is the best way to avoid having to argue the validity of a claim before a jury.

EXECUTIVE COMPENSATION ALERT

Stimulus Act Restricts Comp Practices of Financial Institutions

The American Recovery and Reinvestment Act of 2009 (the Stimulus Act), signed into law by President Obama on February 17, 2009, restricts the executive compensation practices only of financial firms that have or will receive funds from the federal government's Troubled Asset Relief Program (TARP). But what affects only financial institutions today could affect nonfinancial companies tomorrow. Therefore, these restrictions on pay practices should be carefully examined.

The Origin of TARP

The Emergency Economic Stabilization Act of 2008 (EESA), signed into law by President Bush on October 3, 2008, granted to the Treasury Department (Treasury) the authority to spend up to \$700 billion in federal funds for the purchase of mortgage-backed securities from troubled financial institutions, with the goal of increasing the liquidity of secondary mortgage markets. To that end, Treasury established TARP, through which Treasury can acquire troubled assets by means of either direct purchases of assets or preferred stock, or auction purchases.

Once TARP was established, Treasury immediately issued regulations placing limitations on the compensation that could be paid to executives of financial institutions receiving EESA funds (see a discussion of this in Issue 750, page 1).

Restrictions on Payment Practices

Congress, in enacting the Stimulus Act, sought to provide a stimulus to the U.S. economy by such means as federal tax cuts, expansion of unemployment benefits, and massive domestic spending in education, health care, and infrastructure, including the energy sector. The public's anger at the disclosure of huge executive salaries, bonuses, and other perks inspired a last minute amendment to the \$787 billion legislation.

This amendment imposed restrictions on the payment practices of all financial firms that have or will receive funds from TARP.

The restrictions replace the Treasury's regulations pursuant to TARP, as discussed, and are much stricter than those regs. Treasury is expected to issue new regulations soon to implement and answer questions relating to the Stimulus Act's restrictions on executive compensation practices.

Specific Prohibitions

Under the Stimulus Act, TARP recipients are subject to regulations to be issued at a future time by Treasury that will:

1. Prohibit the payment of compensation to "senior executive officers" (generally, the five most highly paid officers) as an incentive for them to take unnecessary and excessive risks that threaten the value of the company;
2. Require the recovery of any bonus, retention award, or incentive compensation paid to a senior executive officer and any of the next 20 most highly compensated employees that was based on statements of earnings, revenues, gains, or other criteria that were later found to be materially inaccurate;
3. Prohibit "golden parachute" payments to departing senior executive officers or to any of the next five most highly compensated employees departing from a company (unless the payments are for services performed or benefits accrued, which presumably would include pension benefits); *and*
4. Prohibit any compensation plan that would encourage manipulation of the reported earnings in order to enhance the compensation of employees.

Luxury Expenditures

The Stimulus Act requires the board of directors of each TARP recipient to maintain a companywide policy

regarding excessive or luxury expenditures, such as special events or office and facility renovations.

Prohibition Against Payments Of Incentive Compensation

Treasury is also directed to issue regulations that will prohibit TARP recipients from paying or accruing any bonuses, retention awards, or incentive compensation during the period in which any obligation arising from financial assistance provided under TARP remains outstanding.

This prohibition on payments of incentive compensation does not apply to awards of restricted stock provided the restricted stock does not fully vest while TARP obligations are outstanding and does not have a value greater than one-third of the employee's annual compensation. The provision also does not apply to bonus payments made pursuant to a valid written employment contract executed on or before February 11, 2009.

The number of employees affected by this prohibition depends on the amount of money received from the government by the TARP recipient. For instance, this prohibition only applies to the most highly compensated employee if the company received only \$25 million in TARP assistance. If the company received \$500 million or more, the provision applies to senior executive officers and the next 20 most highly compensated employees.

Prohibitions Relating To Salaries

The prohibitions regarding payments of incentive compensation say nothing about executive salaries. However, the Stimulus Act has provisions that will tend to limit them, at least indirectly.

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For instance, each TARP recipient is required to establish a board Compensation Committee, composed entirely of independent directors, for the purpose of reviewing employee compensation plans. This committee is required to meet at least semiannually to discuss and evaluate employee compensation plans in light of an assessment of any risk posed to the TARP recipient from such plans.

Each publicly traded TARP recipient will be required to hold an annual shareholder approval vote on executive compensation. This vote will not be binding, however; it will not overrule any decision of the board of

directors and will not create or imply any additional fiduciary duties on the board.

The Stimulus Act also requires the secretary of the Treasury to review bonuses, retention awards, and other compensation of senior executive officers and the next 20 most highly compensated employees that were paid before the date of the enactment of the Stimulus Act to determine whether such payments were inconsistent with the Act, TARP, or contrary to public interest. If such determination is made, the secretary must seek to negotiate with the company and the employee for reimbursement.

What to Remember

The Stimulus Act's compensation provisions have been criticized for limiting the incentive of an executive to deliver the long-term performance that is needed to benefit the company. Another alleged wrong step is the Act's prohibition on using any form of incentive compensation other than restricted stock (see Lucian Bebchuk, Opinion; *Wall Street Journal*; February 16, 2009). One thing seems to be apparent—the spotlight put on firms receiving government assistance is going to inspire increased interest in the compensation practices of all businesses.

By the numbers...

	Latest Period	Current	Prior Report	A Year Ago	12-Month % Change
CPI-U	Feb/09	212.2	211.1	211.7	0.2%
CPI-W	Feb/09	206.7	205.7	207.2	-0.3%
ECI EMPLOYMENT COST INDEX					
Total Compensation	4Q/08	108.9	108.7	106.3	2.4%
Wages and Salaries-Private Industry	4Q/08	109.4	109.1	106.6	2.6%
Wages and Salaries- Civilian Workers	4Q/08	109.6	109.3	106.7	2.7%
Benefits	4Q/08	107.7	107.5	105.6	2.0%
Average Weekly Gross Wages*	Feb/09	\$615.05	\$614.05	\$602.65	2.1%
Average Hourly Wages					
All*	Feb/09	\$18.47	\$18.44	\$17.83	3.6%
Construction	Feb/09	\$22.20	\$22.32	\$21.35	4.0%
Manufacturing	Feb/09	\$18.11	\$18.02	\$17.57	3.1%
Trade/Transp./Utilities	Feb/09	\$16.45	\$16.38	\$16.05	2.5%
Wholesale Trade	Feb/09	\$20.58	\$20.44	\$20.04	2.7%
Retail	Feb/09	\$12.99	\$12.97	\$12.80	1.5%
Financial Activities	Feb/09	\$20.59	\$20.46	\$20.06	2.6%
Other Services	Feb/09	\$16.32	\$16.35	\$15.78	3.4%
Unemployment Rate*	Feb/09	8.1%	7.6%	4.8%	3.3%

*seasonally adjusted
(Source: Bureau of Labor Statistics, Washington, D.C.)
All figures are national.

CPI-U: Consumer Price Index for all urban consumers; the newer index representative of the buying habits of about 87% of the total U.S. population. (1982–84=100)

CPI-W: Consumer Price Index for urban wage earners and clerical workers; the older index covering only about 32% of the U.S. urban population.

ECI: Measures change in compensation per hour worked, including wages, salaries, and employer costs of benefits. (6/89=100)

Average Weekly Gross Wages and Average Hourly Wages: Data related to production workers in manufacturing and mining; construction workers; nonsupervisory workers in transportation, public utilities, and wholesale/retail trade; also finance, insurance, real estate, and other services. Accounts for approximately 80% of the total employees on private, nonfarm payrolls.

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