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Hewitt Associates

on Flexible Compensation

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A roundup of flexible compensation activity by region . . .

USG Corporation is a holding company for several operating subsidiaries which are well known in the building products and industrial processes markets. The Chicago-based corporation had $2.53 billion in 1985 sales and ranked 152 on the Fortune 500 Industrials listing. The corporation has long maintained a competitive employee benefit program. Modifications made in 1983 helped bring medical costs largely under control. Workforce demographics, while changing, probably are more distinguished by the long service of employees than the diversity.

What factors prompted USG to implement a flexible compensation program? "Trends—or more precisely, the lack thereof," comments Hal Pendexter, Vice President, Human Resources. "We conducted focus meetings with groups of employees throughout the organization and discovered no pressing need for one particular type of benefit or program enhancement. In the aggregate, we found that employees valued our overall benefit package, but various employee groups placed emphasis on different components. The only consensus was that employees wanted to be able to control benefit decisions and adapt benefits to their current needs."

Separately, USG had introduced Section 401(k) salary reduction savings in July 1983, with enviable results. "We had 96% participation in the first year," notes Peter Maitland, Director, Employee Benefits. "We interpreted those results as a sign that pre-tax employee contributions and flexible spending accounts would be readily understood—even welcomed—by our employee population."

USG "SelectBenefits" went into effect July 1 of this year for 4,700 salaried employees of the USG holding company and certain subsidiaries. The credit formula provides a flat-dollar amount (unrelated to family status), plus a percentage of pay (related to age). The program offers choices in the areas of medical (with three deductible levels ranging upward from $200 single/$400 family); life insurance (up to five times pay) with AD&D (up to 2½ times pay), plus a new dependent life option; as well as time off (employees may buy or sell one week, but may not sell below a minimum vacation schedule of two weeks). The program also offers spending accounts ("SelectAccounts") for payment of health care (including dental, vision, and hearing) and dependent care expenses. Employees may take unused credits in cash—or deposit amounts in the Investment Plan.

Some highlights from the election results . . .

- 74% of employees made one or more changes from the previous program.
- 14% of employees opted for higher deductible medical ($500/$1,000 or $1,000/$2,000).
- 10% of employees increased their level of life insurance, while 6% decreased coverage.
- 49% selected the new dependent life option.
- 9% of employees bought an additional week of vacation, while 12% sold a week.
- 28% established health care spending accounts and 2% did so for dependent care expenses.
- 7% deposited leftover credits in the savings plan—more than the 4% who elected a cash option.

"Given our previous benefit package as the starting point, and the fact that employees know they can select again in six months, we didn't anticipate a groundswell of change—this time out," explains Pete Maitland. "Besides, what statistics fail to show is employee reaction. Informal feedback indicates that employees are literally delighted with the opportunity to make changes, whether or not they actually did so. We've been credited with having implemented a bold, different, and responsive program."

Contributes Hal Pendexter: "SelectBenefits suits today's USG Corporation—both in terms of responsiveness to employee needs and as an expression of management intent. Back a year or so ago, we brought a broad outline of the proposed flexible program to senior management—and received full support even in the earliest stages of development. We are an innovative employer and we wanted our benefit package to be on the leading edge of plan design—representative of the corporation."

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East

When Charles of the Ritz Group, Ltd., a major cosmetics manufacturer headquartered in New York City, explored alternatives to controlling benefit costs, one choice was to cut back the medical program for everyone. But a very different-looking workforce instead prompted Charles of the Ritz to explore a flexible compensation program.

Consider the employee demographics at Charles of the Ritz. Among the company's 1,200 employees, single employees represent half the workforce. Close to two-thirds of the employees are female. In addition, the company's employees are relatively young both in terms of average age (36 years) and service (5 years).

According to John Hawkins, Director of Compensation and Benefits, "Our 'one-size-fits-all' benefits were largely unappreciated by the majority of our employees. For our people, consumer choice is a way of life. We thought our employees would value benefits more by being able to 'shop for' the coverages suited to their individual security needs."

Effective July 1, Charles of the Ritz implemented a "classic" flexible compensation program. While the company continues to cover most of the cost of benefits, employees decide how the dollars are allocated. The program offers several options in medical, dental, disability, life insurance (employee and dependent), plus flexible spending accounts to pay for health and dependent care expenses. Also, employees entitled to less than four weeks of vacation may buy up to five additional days, in half-day increments. Employees with more than four weeks of vacation may carry forward unused days, but are ineligible to buy additional days out of concern over bumping up against the forfeiture rules.

As a means of controlling medical costs, Charles of the Ritz moved from a noncontributory first-dollar medical plan to a comprehensive approach offering choices among three different deductibles ($100 single/$200 family to $500 single/$1,000 family) and out-of-pocket limits ($1,000/$2,000 to $1,500/$3,000), plus HMOs. Two dental options also are offered. Or, employees may opt out of health coverage entirely. Interestingly, the allocation of flexible credits is tied to the health benefits employees actually choose. Depending on the type of coverage selected (not the level) employees receive from $583 to $1,159 ($2,283 family) in flexible credits, plus nearly 1% of pay, as follows:

Health Care Choices at Charles of the Ritz

	Receives FlexCredits of . . .		To buy . . .			
			Single		Family	
An employee choosing . . .	Single	Family	High Option	Low Option	High Option	Low Option
Medical and dental	$1,159	$2,283	$1,051	$ 863	$2,640	$2,162
Medical only	$1,083	$2,083	$ 859	$ 704	$2,264	$1,850
Dental only	$ 659	$ 783	$ 192	$ 159	$ 376	$ 312
No coverage	$ 583	$ 583	—	—	—	—

Under the program, a single employee choosing the richest medical and dental plan options would have leftover credits. An employee with dependents also electing the highest options would have to make contributions for the same coverage. Notes Mr. Hawkins, "We struggled long and hard over the decision to ask our employees with dependents to switch from noncontributory coverage to having to pay something. But for us, this represented a fair way to introduce cost-sharing. Employees with the greatest coverage needs are asked to help pay the cost for that coverage—but are allowed to pay with pre-tax dollars. Additionally, we wanted employees with dependents to think twice about 'doubling up' on coverage they might already have elsewhere."

What choices did employees actually make under the new program? First-year election results verify that employees indeed have a variety of needs...

- 9% bought vacation days.
- 10% of employees opted out of medical coverage.
- 39% elected to "trade" benefits for cash.
- 43% chose life insurance options greater than one times pay.
- 62% added their own money to the program on a pre-tax basis.

A note about timing . . . Once the flexible program was designed, it took Charles of the Ritz only three months to complete the work needed to administer and to communicate the program to employees. "Our enthusiasm snowballed, and we became increasingly determined to meet our July 1 target. With only 90 days left, we rolled up our sleeves and got the job done," says Mr. Hawkins.

Regarding the success of the program, he adds, "We consider the election results proof positive that employees do have different needs that are better met through flexible compensation."

South

The Georgia State Legislature amended The Official Code of Georgia Annotated, Title 45, Chapter 18, Article 3 ". . . *relating to employees' insurance and benefit plans, so as to provide for . . . a flexible employee benefit plan and to promulgate rules and regulations for its administration . . .*"

A flexible benefit program mandated by law? That was one of the unusual aspects of a flexible program implemented July 1 by the State of Georgia for 55,000+ employees of virtually all state agencies, including also state legislators. Under the new program, employees have the option of retaining current coverages—or electing participation under the new statewide flexible benefit program that offers selection of coverage levels.

Under the direction of Bobbie Jean Bennett, Assistant Commissioner, State Merit System, the State of Georgia undertook a major overhaul of public sector employee benefits to accomplish several objectives, including . . .

- Streamline administration. Under the previous system, more than 200 benefit plans were in place across 26 State of Georgia agencies. Consolidation would allow for greater efficiency in plan administration—and greater consistency in the types of benefits offered state employees.

- Capitalize on the "buying power" of the total group for insurance coverages. With the exception of medical and a special life insurance arrangement through the pension plan (which are state subsidized), insured-plan coverages are offered on an employee-pay-all basis. Through the statewide program, most employees would be able to purchase comparable (or better) coverages at substantially lower rates.

- Meet employee needs. An attitude study conducted last year indicated that employees wanted the ability to make choices in benefits. Moreover, if given the opportunity, over one-half of surveyed employees would change existing coverages in one or more benefit areas.

Employees opting for the statewide "You Decide" program can structure coverages in three basic areas: medical, including HMOs, where available; short- and long-term disability; and life insurance, including AD&D and dependent life. Few of the options are "brand new"—indeed, "standard" and "high option" medical existed in the past. But the range of coverages, coupled with the ability to select levels of protection (e.g., up to three times pay in life insurance), now are made available on a consistent basis across state agencies. In addition, employees opting into the statewide program may pay premiums in before-tax dollars.

"In terms of plan design, our program probably ranks as one of the least complicated," acknowledges Ms. Bennett, "and for good reasons." The communication materials and enrollment procedures, for example, needed to be readily understood by a large and diverse audience—"those with advanced degrees as well as employees with minimal schooling." Moreover, while legislation mandated introduction of a flexible benefit program, no new dollars were allocated for coverages under the state system. "We needed to deliver the greatest value to employees, while operating within our budgetary constraints."

"Employee response to You Decide has been very positive," notes Ms. Bennett. "We had very few problems with incorrect enrollments, or employees not getting forms in on time." And election results have been highly encouraging. "Our medical program elections remained much as before since the options were virtually identical. But 54%, which means 30,000 employees in our environment, signed up for supplemental life insurance, and enrollments about tripled in each of the disability coverage categories."

West

. . . The benefit program provides rich security coverages on a largely noncontributory basis . . . Since employees pay little for the coverage, few see benefits as a valuable part of total compensation . . . Employee demographics have changed over the years and many employees neither want nor need all the protection the company offers . . . The company prides itself on offering a leading-edge program for salaried and nonunion hourly employees—and retaining that differential relative to union groups is important.

These are some of the considerations that prompted privately held Vons Grocery Company, an 18,000-employee grocery concern headquartered near Los Angeles, to adopt a broad choicemaking program. Under the Vons "Personal Choice" program, effective July 1 for 1,200 salaried and nonunion hourly employees, benefits are presented as one element of a total compensation package which the employee may restructure to suit individual needs and circumstances.

The flexible credit formula provides a flat-dollar amount (depending on elected family status), plus almost 1% of pay. The communication materials stress to employees that ". . . Personal Choice allows you to direct a portion of the available benefit dollars to the benefits you most value. Or, if you want to change the balance between direct pay and benefits, Personal Choice gives you a way to convert benefit dollars to cash."

Within the benefit area, the program offers a wide array of choices. Included are four options in medical (including the prior "first-dollar" plan), plus HMOs; four choices in dental (each designed to encourage preventive care), plus a prepaid option; election of vision coverage; ten options each in life insurance and AD&D, plus dependent life; and purchase of additional time off—up to three personal holidays. In addition, employees may establish flexible spending accounts for payment of unreimbursed health care and child care expenses.

An unusual feature of the program, scheduled to take effect January 1, 1987, involves profit sharing. At that time, after-tax employee contributions will be converted to pre-tax salary reduction dollars. But the Personal Choice program will also be expanded to include employee control over the company's profit sharing allocation. Instead of making "regular" profit sharing contributions, Vons will allocate profit sharing amounts to employees in the form of "flexdollars." If employees elect to deposit profit-sharing-derived flexdollars in the plan, Vons will match employee savings dollar-for-dollar. (The underlying profit sharing formula will be adjusted to allow for the full matching.) Or employees may use the profit-related credits to spend on benefit options, or take these amounts in (taxable) cash. Inclusion of the profit sharing component expands the range of "choice" available under the program—and helps increase the visibility of Vons total compensation expenditure.

According to Gary Nelson, Senior Vice President, the features of the program already in place are being well received by employees. "Employee acceptance of Personal Choice has been high, although we have observed some reservation as to management's 'real' reasons for implementing the program. The program was structured so an employee could choose the benefits in effect before Personal Choice, but 18% of our employees made alternate choices of medical and dental, while average life insurance amounts were decreased 13%, and average AD&D amounts were increased 29%. We are pleased that the options we now offer better meet the needs of that many people."

Canada

Can the enthusiasm for flexible compensation translate "north of the border" to employees of Canadian operations? According to International Minerals & Chemical Corporation (IMC), a major producer of fertilizer and other agricultural products, the answer is "yes." Headquartered in Northbrook, Illinois, IMC is one of the few U.S. companies to have extended flexible compensation to employees of its Canadian operations. Effective July 1, "FlexSecurity" offers broad benefit choices to IMC's 200 salaried Canadian employees.

The Canadian unveiling of flexible compensation follows the U.S. introduction by about 18 months. "Flexible compensation was a great success with our U.S. employees," says Robert Lyter, Manager of Benefits Administration (U.S.). "So when the time came to update our Canadian benefits, our first thought was to explore the possibilities of a flexible program. Although it's still a new concept in Canada, we felt sure it would be popular with employees and would serve our corporate needs well into the future," adds Mr. Lyter.

Why has it taken so long for Canadian employers to jump on the flexible compensation bandwagon? John Gugulyn, Industrial Relations Manager (Canada) explains that like many Canadian employers, IMC initially was skeptical about the value of flexible compensation. "We weren't sure flexible compensation was necessary since we have Provincial (government-subsidized) health care, and medical cost containment is not a driving force here, as it is in the U.S.," he says. "But after some discussion and evaluation, we realized flexible compensation was an excellent way to help us meet our objectives of providing a competitive benefit package and increasing the value of benefits to employees."

Mr. Gugulyn notes that IMC also had some doubts about employee acceptance of such a program. Before proceeding with implementation, IMC tested the program with a random sample of employees. The results were highly favorable. While 82% of the group said their current benefits were "very good," 80% said that a flexible program would be "better than their current program." Over half of the employees tested said that the most appealing feature of FlexSecurity was the "ability to choose."

FlexSecurity still provides basic benefits including provincial health insurance, AD&D, and short-term disability. Choicemaking is available in seven benefit areas including supplemental medical, dental, term and dependent life, personal accident (to supplement AD&D), long-term disability, and vacation. In most areas, IMC provides a core level of coverage and gives employees flexible dollars to purchase additional coverage. The flexible dollar allowance, which varies based on pay and family status, enables employees to purchase the same level of coverage they had previously. Additional coverage may be purchased through after-tax payroll deductions. At the end of the year, any flexible dollars not used for benefits may be taken in cash, or deposited in IMC's Group Registered Retirement Savings Plan.

The new program offers an extensive range of options in all benefit areas. Preliminary enrollment results indicate that employees are taking full advantage of the opportunity to create a benefit package tailored to their needs. For example, in the area of supplemental medical, most employees (71%) upgraded their coverage by electing an option that includes hearing and vision benefits. And, a significant number of employees (22%) chose to buy or sell vacation days. According to Mr. Gugulyn, "this testifies to the fact that employees understand and welcome benefit choicemaking."

"Everyone is very pleased with the new program" says Mr. Lyter. "We're riding high because we've implemented a 'leading edge' benefit program at no additional cost to the company. And employees are highly flattered that IMC has made such a grand effort on their behalf."

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