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Hewitt Associates

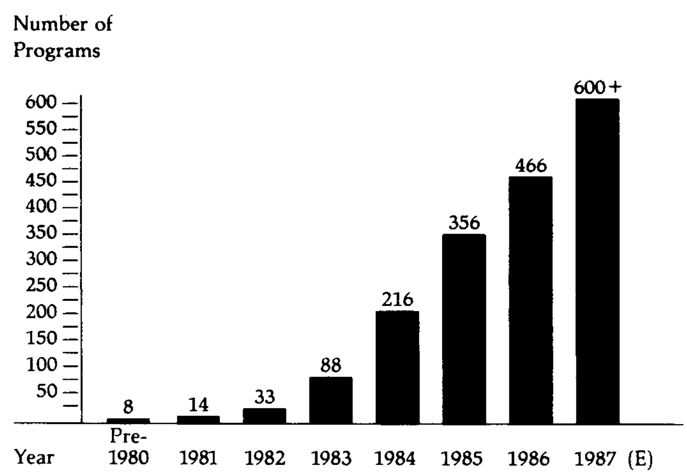
on Flexible Compensation

January 1987

Change. Last year brought plenty of it...major tax overhaul legislation...new health continuation rules...a plethora of regulations...a resurgence of early retirement window and other voluntary separation arrangements, sometimes in industries considered "immune" to workforce reductions... and mixed results on the health care cost management front. Still, against this backdrop of major change in the employee benefit field, flexible compensation continued to register healthy growth.

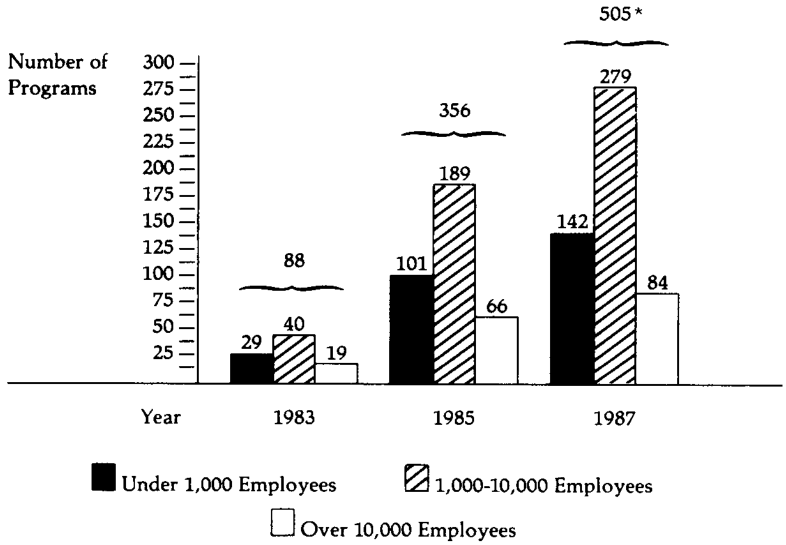
Here in words and pictures is an update on flexible program prevalence—by employer size, industry, and location. The figures are based on 466 programs on line through 1986 and another 39 with January 1 implementation dates—for a total of 505 programs currently in effect.

Flexible Compensation Programs



Flexible compensation programs have been implemented by companies in all size categories, but most of the recent growth has been fueled by the "medium" size organizations—those with 1,000 to 10,000 employees.

Flexible Compensation Programs by Size of Employer



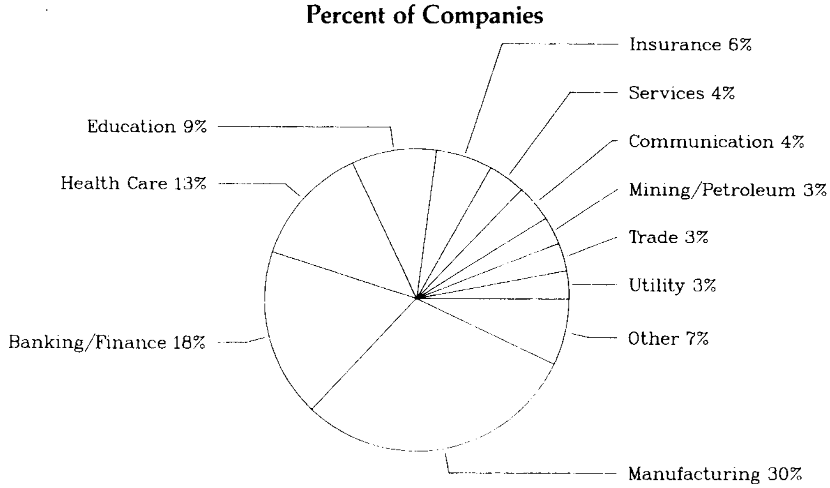
* Based on flexible compensation programs in effect by January 1.

Among the very largest companies in the country, 29% of the Fortune 100 Industrials and 16% of the Fortune 500 had flexible programs in effect by January 1. On the service side, 15% of the Fortune 500 Service companies had implemented programs by January 1, including 34% of the 100 largest commercial banks, 22% of the 50 largest life insurers, 16% of the 50 largest utilities, and 12% of the 50 largest retailers.

By industry, flexible programs are well represented across industry lines. But concentrations of flexible programs appear in the following industries ...

Flexible Compensation Programs by Industry*

Percent of Companies



*** Total—505 flexible compensation programs in effect.**

By state, the "Top 10" for flexible compensation programs include Illinois (52 programs), Minnesota (47), New York (40), California (36), Texas (31), Michigan (26), Pennsylvania (25), Ohio (24), Wisconsin (19), and Colorado (18).

Spotlight

Organizations continue to implement flexible compensation programs—driven by different objectives and surrounded by unique circumstances. Moreover, the programs take various shapes—choicemaking, spending accounts, or combination arrangements. Following is a sampling of employers who launched or expanded flexible compensation programs, effective January 1.

Mitchell Energy and Development Corporation, known for pioneering the commercial/residential planned community of The Woodlands, Texas (also the company's headquarters), needed to walk a fine line between achieving immediate cost savings and preserving benefit security for its 2,500-employee workforce. Mitchell undertook a complete overhaul of the benefit program, including replacing high-value comprehensive medical with a choice of three comprehensive options (deductibles ranging up to $1,500); introducing choice-making in other benefit areas, including allowing for vacation buying; and adding flexible spending accounts. From the medical plan restructuring (and other cost management features introduced at the same time), Mitchell expects to achieve about a 20% reduction in benefit costs by the end of the program's first year. As significant, "Our employees feel they have a better program—one that's accommodating of their broader benefit needs and still protective in terms of financial security," notes Ralph Smith, Benefits Manager.

Separately, Mitchell implemented the flexible program in near-record time—four months from start to finish. "We're used to moving swiftly once we determine a course of action, but the breakneck speed with which we implemented the flexible program outpaced even our usual performance," notes Mr. Smith. "We couldn't have accomplished what we did, as fast as we did, without the help of a committed and motivated project team."

FREEPORT-McMoRan INC., an energy and mining company based in New Orleans, implemented a flexible program for the "classic" purposes of controlling costs and meeting the diverse needs of employees. The company restructured existing medical to offer comprehensive plan choices; introduced options in other insured-plan areas; and implemented flexible spending accounts for health and dependent care. As noted in an employee announcement: "FLEXPLAN provides highly competitive benefits in a way that provides more value to each employee and—at the same time—offers the company better control of benefit costs" over the long term.

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Any unusual "snags" encountered along the way? Notes Marcy Cellos, Employee Benefits Supervisor, "Our implementation went as uneventfully as we'd hoped it would—unless, of course, other implementations include the conducting of employee meetings in remote field locations and offshore properties."

At Seattle-based **Seafirst Bank,** a leading lending institution in the northwest, a primary objective of the flexible program was to raise the perceived value of benefits. Early focus group research with employees indicated generally low levels of understanding of the prior program and the value of the bank's expenditure on benefits. Seafirst structured the flexible program to generate enough credits to keep all employees whole, but set realistic price tags on the options so employees could see the actual worth of benefits—and the impact of selecting "up," "down," or "out" of the various coverages. According to Kenneth Breen, Manager, Benefits and Payroll, "We had a program that was already well designed from a cost management perspective. But we wanted to impress upon employees the value of benefits as a part of total compensation and encourage their participation in making the benefit program 'work' to meet individual needs."

The benefit program at **Kaiser Aluminum and Chemical Corporation** went largely unappreciated by employees, even though Kaiser contributed substantially to medical benefits—including heavy subsidization (and utilization) of dependent coverage. Flexible compensation provided a vehicle through which employees could enhance the overall value of their benefit package by opting down (or out) of medical coverage. Kaiser's program allows employees to "buy back" prior medical coverage—reinforcing the company's "no takeaway" posture. But, by offering other medical plan choices (including a no coverage option if employees have coverage elsewhere), Kaiser gave employees the opportunity to take unused credits in cash or to fund a health care spending account.

American Express Travel Related Services, a New York-based subsidiary of American Express Company, introduced flexible compensation to provide a more tax-effective benefit package, and ultimately, to improve employee perception of the value of benefits. The program, which includes benefit choices and spending accounts, was extended to about 18,000 employees across the country.

Some companies "phase in" flexible compensation to "test the waters" with employees. **The Pillsbury Company,** based in Minneapolis, adopted a phased approach for a different reason.

Pillsbury was anxious to introduce a full flexible benefit program as a tool to recruit and retain employees (particularly for the company's highly competitive restaurant groups), and to manage the long-term cost of benefits. However, the payroll and human resource systems needed to administer salary-driven options posed a barrier to 1987 implementation. The solution? Pillsbury decided to move ahead with a 1987 launch of the health benefit portion of the program—including choices in medical and dental, plus a spending account—and fold disability, life insurance, and other benefits into the program at a later date.

Two companies established "stand-alone" spending accounts for employees.

Dallas-based **Mary Kay Cosmetics, Inc.** introduced health care spending accounts to expand the range of covered health care expenses, and to take the edge off an increase in the company's medical plan deductible. Mary Kay is providing an annual contribution of $100 to each account which employees may supplement with up to $400 per month on a pre-tax basis. Employees also may take advantage of a new dependent care spending account.

In an effort to expand the scope of coverage of their "traditional" benefit package, **Cullen/Frost Bankers Inc.,** a major bank holding company headquartered in San Antonio, introduced health and dependent care spending accounts to 2,100 employees throughout Texas.

Several companies used flexible compensation to combine benefit programs after a merger or acquisition.

For Northbrook, Illinois-based **International Minerals & Chemical Corporation (IMC),** extension of "FlexSecurity" to newly acquired **Mallinckrodt, Inc.,** a major chemical and health care products manufacturer in St. Louis, seemed a natural fit. IMC's flexible program (implemented in 1985) remains popular among employees and continues to help control benefit costs. While FlexSecurity helped blend the two organizations' benefit programs, Mallinckrodt "fine-tuned" their version by pricing benefits to reflect subsidies similar to levels employees received in the past, and preserving certain features—such as vision care—from the prior program.

Through a series of acquisitions, **Great Western Financial Corporation,** headquartered in Los Angeles, quickly grew into one of the nation's largest savings and loan associations. With 10,000 employees across the country, Great Western used flexible compensation to "standardize" benefits for employees nationwide. The program combines broad choicemaking with flexible spending accounts. Says Patricia Benninger, Manager, Human Resource Services, "Flexible compensation opened the door to a complete overhaul of our employee benefit program, including a move to self-funding and an updated benefit administration system."

Another acquisition posed challenges of timing. At **The Mead Corporation,** a Dayton-based paper products manufacturer, meeting employee benefit needs and heightening employee involvement in benefit decisions provided the underpinnings for the company's new flexible program. The program offers 7,000 employees a wide range of insured-plan choices, flexible spending accounts, and both the buying and selling of vacation time. Then, as details were being unveiled to employees, Mead acquired the 1,500-employee distribution group of another paper company. What to do about incorporating the new employees? According to Ronald Carzoli, Vice President of Human Resources, "Although it took some special effort at the eleventh hour and a lot of cooperation, we decided to extend choicemaking to the new operating unit. We wanted our new employees to feel part of the team from the outset."

Flexible compensation often holds appeal for start-up or spin-off operations.

Mazda Motor Manufacturing, which starts production in the United States out of Flat Rock, Michigan in September, 1987, introduced a flexible program for 200 current employees, but expects the program to cover more than 3,000 employees by 1988. Mazda implemented a broad choicemaking program with options in medical, dental, group life, and disability, plus flexible spending accounts. "We favored a choicemaking program because it offers the flexibility and versatility we'll need as we grow," says Charles E. Corbett, Director, Employee Benefits. "The flexible program also reinforces our desire to encourage employee involvement, an important component of our corporate operating philosophy."

When Kansas Gas and Electric Company established one of its operating units as an independent company this year, the result was **Wolf Creek Nuclear Operating Corporation.** The staff and day-to-day operations remained virtually unchanged at Wolf Creek, but management had the opportunity to develop a separate and distinct benefit program. "We were starting from scratch," says Sonya Wright, Compensation and Benefits Coordinator, "so we decided on a flexible program to underscore our commitment to quality and innovation. The flexible program couples broad choicemaking with spending accounts, and offers employees benefit opportunities comparable to (or better than) those received under the prior program."

Some organizations extended their flexible programs to part-time or union employees in addition to their salaried, full-time workforce.

At **St. Francis Hospital** in Colorado Springs, flexible compensation provided a way to allocate benefit dollars more equitably to all employees. Under the new flexible program, part-timers—who account for 25% of the 600-employee population— receive half the credits provided to full-time employees, and all the same benefit choices including options in medical and dental, plus health and dependent care spending accounts. Notes Sarah Butz, Vice President, Human Resources, "Through the flexible program, we are able to recognize all employees, including part-timers who are a valuable component of our workforce."

Negotiations between the International Brotherhood of Electrical Workers (IBEW), and **U S WEST Direct,** a telephone directory publisher headquartered in Denver, resulted in over 300 bargaining-unit members being included in a flexible program similar to the one implemented last year for the company's 560 management employees. Through the "ChoicePlus" program, union members can "buy back" prior coverages; or rearrange benefits in medical, dental, vision, and life insurance; plus establish spending accounts for health or dependent care expenses. According to Dennis Schroeder, Director of Employee Relations, "Positive reviews about ChoicePlus from management employees spilled over to other employee groups. In accepting the program, the IBEW reacted to the wishes of its members who wanted to be able to tailor benefits to individual needs." At the same time, U S WEST Direct also extended ChoicePlus to 100 nonrepresented hourly employees.

Some notable "firsts" in flexible compensation . . .

Northeast Utilities Service Co., a major provider of electricity and gas to Connecticut and other New England states, is the first organization to implement the Hewitt Associates Installable FlexSystem® administrative software on its IBM mainframe computer. "Our systems environment and resources permitted us to support the processing of flexible administration in-house," says Christine Snow, Senior Employee Benefits Analyst. "We're pleased with the outcome. Employees now have the flexibility to choose the benefits they need from a wide array of options, and Northeast Utilities maintains greater control over day-to-day administrative activity, as well as the system software."

Hawaiian Electric Company, headquartered in Honolulu, became the first Hawaii-based employer to implement a "full-flex"program. Hawaii is unusual in that it is the only state to mandate employer provision of medical coverage—the equivalent of base-plus-major-medical protection, at least 50% company paid. (Alternatives must satisfy a comparability of benefits test.)

Hawaiian Electric's program, covering 500 nonbargaining-unit employees out of a 2,000-employee workforce, offers flexible spending accounts (health, dependent care, and legal), plus choices in most insured-coverage areas, including within medical a comprehensive ($200 deductible) option. According to Bill Brown, Director, Compensation and Benefits, "Our primary goal was to introduce choicemaking so employees could better meet individual benefit needs. But another objective was to move closer to the principles of 'insuring' for medical—providing well for a catastrophic event, but less so for the minor ailments such as colds and flu. From a cost management perspective, we wanted to gain greater control over the incidental expenses that were driving up our medical costs."

Upcoming

On April 23-24 in our office in Lincolnshire, Illinois, Hewitt Associates will be sponsoring the sixth annual FLEXIBLE COMPENSATION FORUM. Last year, nearly 150 participants gathered to share information and discuss common concerns about flexible program operation. To maximize the benefit for FORUM participants, attendance is limited to companies who have programs in effect (or very near implementation). For details or an invitation, contact Marilynn Cooney at 312/295-5000.

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