Employee Compensation

January 2012 www.blr.com Issue 387

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401(k) Participation Important, Retirement Readiness Even More So

In the opinion of ERISA Risk Management Consultant Rick Unser, the traditional view of retirement planning needs to change. Plan sponsors may feel they are doing everything possible to help employees save: They offer a plan and they try get employees to join it. In many cases, a few employees save a lot—and most of them don't. That's when the old saying about horses and water takes hold.

After all, the last few decades have seen a massive shift toward self-reliance in benefits of all kinds, from health care to retirement. With a 401(k) plan, the employer provides the vehicle and the investment alternatives, and from there it's up to the employee to save or not.

Surprise! It isn't working. Not only are employees reluctant to take on what might seem like another job, they are hampered by the procrastination and inertia inherent in human nature. Even those employees who want to tackle investment strategy on their own probably shouldn't because they simply don't understand finance well enough to do the best job.

Depending on which study one reads, participation rates in a workplace retirement plan among the American workforce range from one-third to three-fourths. Even when participation is high, the average savings rate is a paltry 5% or 6% of pay—not enough to generate an amount necessary for a secure retirement. That's especially true considering expert recommendations that retirees accumulate $200,000 to pay for the cost of retirement healthcare expenses alone.

Readiness Assessment Starts the Process

Recognizing the dismal state of retirement savings, Unser, of Lockton Financial Advisors, LLC, wants to start a new dialogue, one that shifts from raw participation figures to retirement outcomes. On his website, www.erisariskmanagement.com, Lockton covers a series of ideas that, implemented properly, will get employees much further down the road to retirement security.

The first step is for the employer to understand the employee population's current state of retirement readiness by conducting a retirement readiness assessment. The assessment is much more than benchmarking against other plans, he says. "A look at participation and deferral rates should not be the entire process. That really won't help employers make great observations about what their plan can do differently to improve those numbers. It's more important to focus on the outcomes and what they will be as a result of current employee behaviors.

"We like to start with participation and deferral rates, then factor in social security, future appreciation on assets, future contributions, the amount of time left to accumulate assets. Then we make projections that tell the plan sponsor what percentage of income employees are on track to replace. That's the key figure in the discussion."

Unser takes it a step further, too. "We like to break the figures down into age groups," he says. "In one case, a client saw that employees in the 45–55 age bracket—those who should be most concerned about retirement savings—had abnormally low replacement ratios. The employer realized they had to change the shape of the conversation for those people; that's the conversation we like to have."

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Plan Design Elements Bolster Savings

Once you understand how your overall population is doing (as well as subgroups within the population), you can use plan design elements to shore up those areas that are weak, Unser says. "There are a lot of tools available to plan sponsors to help encourage the readiness of their participants, many of them very simple. Over the last several years, we've seen plans getting away from the 6-month or 12-month waits to join the plan; now it may be immediate eligibility or a 30-day wait. Plan sponsors are realizing that it's better to have more people in the plan and starting to defer. I think that trend will continue.

"Other plan design elements include automatic enrollment and auto escalation. Some sponsors are uneasy about automatic enrollment. They are concerned about the cultural impact, the level of resistance or the legality of it, and they don't have a clear understanding of how it can really help their employees," Unser continues. Not only does he strenuously believe in the effectiveness of automatic features, he recommends jumping in with both feet.

"I'm a big believer that if you're going to pursue automatic enrollment, you should roll it out in a way that will have a meaningful impact on retirement outcomes. Enroll them at 6% of pay, with 1% automatic increases until they reach 10%. They really need to be adding between 10% and 15% of their pay each year, between their own and their employer's contributions, in order to accumulate enough for retirement. What we've seen is that the opt-out rates are very similar when you're aggressive with the percentages as they are if you start low and stay low. Why not encourage as much saving as you can?"

Communications Should Be Simple, Targeted Toward Behavior Change

"Once you've analyzed the strengths and weaknesses of your group, and you've looked at how you can use plan design to augment the strengths or fix the weaknesses, then you need to effectively communicate with employees," Unser continues. "We want employers to focus on the behavior outcomes they're looking for. Make sure that communication is specific to the various demographics of your workforce, and also geared around changing behaviors."

For example, Unser favors using a Take Action card in employee meetings. "It's very simple; it says that by checking this box and signing at the bottom, you are going to be enrolled in the plan at a 6% deferral rate and your money will be placed in a target date fund. It's much more effective than telling people, 'When you leave here, log onto the Internet, put in this code, enter this password, follow these 10 steps, and once you're done, you'll be enrolled in the plan.' People don't want to go through a bunch of machinations just to join the plan.

"Everyone is busy, so make it easy for them. We suggest to our clients that they select three deferral rate options to put on the cards, say 4%, 6%, and 10%. We find that 80% of employees will check the box in the middle, so making that option a strategic choice is important."

Unser recommends that plan sponsors take a fresh look at their employer contributions. "Not everyone is making employer contributions, but if you are, we recommend using them strategically," he says. "Let's say an employer gives a 100% match on the first 2% of pay contributed by the employee. Most employees have heard the advice about contributing up to the amount of the match. Sometimes the message is to take any extra money and contribute it outside the plan. But we know that, typically, people don't get around to it.

"When you have such a low hurdle to get the match, the vast majority of the population only meets that hurdle, and that won't result in enough accumulation. But if you match 50% on the first 4% of pay, or 25% on the first 8%, it won't change what the company is paying out of pocket, but it might produce better results for your employees.

"What I'm trying to do is to move the conversation away from the areas that are not going to have as big of an impact on retirement outcomes and move it toward the things that will have a big impact," Unser says. "Of course you need to have a good foundation of fiduciary governance, of quality investments, a good recordkeeping partner that is offering services at competitive fees. But those things alone are not going to help employees get to a point where they have the financial confidence to transition into retirement." So start talking.

2012 Hot Topic: Compensation Audits

Compensation Resources' Managing Director Paul R. Dorf believes you when you say you're having to do all the work with a fraction of the staff you had before the recession. A recent phone call confirmed it. "It was from someone who wanted me to put together a proposal for his company. He made the point at least twice during our conversation that he and one other person are the only ones left working in compensation. The company has 11,000 employees. This is not an exaggeration; this is what we're seeing," he says.

You thought you had it tough—and you probably do. But Dorf believes that now is the right time to add one more thing to your to-do list, and at the same time he suggests that you get some help with it. One of the hot topics in compensation for 2012, it seems, is the compensation program audit. And yes, in spite of what could be construed as a self-serving suggestion, he wants you to hire someone else to do it. We'll get into the reasons in a moment. For now, Dorf explains why this is a good time to do it.

Why a Compensation Audit Now? Several Factors

"One of the things I don't think people understand is how our demographics

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fit with this recession," Dorf says. "The number of people who are going to be retiring soon is dramatic. Because of the recession, a lot of people put off retirement. So in 5 years or so, there will be a huge number of retirements, and a mad scramble to hire whoever is out there will follow. This situation requires that people take a hard look at how they are paying their people."

Without sounding cold, Dorf compares employees to commodities. "It's all about supply and demand. You have to figure out which of your people are the most critical and how to pay them so they want to stay. For most companies, their assets go home every night. You'd better make it attractive enough for them that they want to come back in the morning.

"There is an awful lot of uncertainty right now," Dorf continues. "But it looks like things might be stabilizing a bit, and companies are starting to think about doing something for the employees they have left. Companies have been freezing compensation, or giving very small increases, or even taking away. But it looks like compensation budgets will be up a little over 3% for 2012 (without considering cost-of-living adjustments built into many union contracts)."

Using Small Increase Budgets Strategically

And while that is a small increase in the budget, Dorf wants you to give a lot of thought to how you can use what you have to meet the company's goals. "For years we have espoused the idea that you should stay away from automatic increases, opting instead for increases based on performance," he says. "In fact, I have stopped using the term 'pay for performance' and started using 'pay for results,' because results are what you want. You're looking for improvements in performance, improvements in profitability, improvements in customer service." The pay program, then, should target the specific areas you want to encourage.

"We like to tell clients that a good way to handle performance evaluations is by exception. There are many people whose performance is in the middle, and that's fine. I want to know which people are at the top of the pile, and why. I want to know which people are at the bottom of the pile, and what we can do to help them—or maybe we should get rid of them.

"The people in the middle are hard to rank, but I can tell you clearly which ones are the most valuable, the most dependable, the most flexible, whatever it is you value. I can also tell you the ones I find to be more problematic, the ones I can't count on, the ones who make more mistakes. Figuring that out is the first step in the process, and it has to be internal, because someone from the outside is not going to know these things."

This inventory will help you decide which employees you can't afford to lose, says Dorf. "Those are the people you'd better do something about hanging onto." And simply because unemployment is high right now doesn't mean that the available workforce has the skills you require. In sales, for example, some are more skilled than others. "My entire career I've been told a variation of this statement: '80% of our business comes from 20% of our sales people.' What that really means is that you'd better make sure that 20% is locked in and never leaves you."

How? "In this environment of limited compensation budgets, you can't make major inroads because you don't have the cash," Dorf explains. "But you can differentiate. The people who are not producing are not going to get increases, and the people who are producing at a nominal rate get a small increase, and the people who are producing at a high level get a bigger increase. After a few years, you'll really start to see the difference."

Incentivizing the Right Things

Review your compensation system to make sure it is incentivizing your company's goals. "One generalization is that sales people tend to work within their comfort zones," Dorf explains. "They sell the product or service they feel most comfortable with, to the customer they feel most comfortable with, and sometimes at a price that may not be what the company wants it to be. Maybe the company wants them to be selling something different, something with higher margins, something with a time/life that is ticking away. So adapting your compensation plan to account for that would be smart."

And the plan should not be overly complicated. "How can you use the compensation plan to motivate someone if nobody knows how it works, what they will be making, and why?"

Using an example to illustrate his point, Dorf discusses the cost of a poorly designed compensation plan. One of the consequences is often increased turnover. And the cost is high: for a nonsalesperson, he explains, turnover costs 1.5 times annual pay; for salespeople, it's about 2.5 times pay. "So if you lose a $50,000-a-year person, it will cost you $75,000 in hard money," he says.

To illustrate: "A few years ago, a company called us in to examine their compensation plan. They wanted to know why they were experiencing so much turnover. This was a billion-dollar firm, and they said they had lost about $1.5 million to turnover in the last year. I reviewed the numbers and found that they had actually lost $87 million that year because of turnover—and that was only the hard dollar piece. The soft dollar piece is things like managers out recruiting rather than doing their jobs, lower morale, the things that are hard to quantify. They were losing an unbelievable number of employees. That is the kind of thing an audit can pick up."

Now you're convinced that you should conduct an audit of your comp plans, and you think that, in spite of all the work in your in-box, you will tackle it yourself. Don't, advises Dorf. "Bringing somebody in from the outside not only gives an unbiased perspective, it also allows staff to concentrate on their normal work. An outsider may step on a few toes that an employee might be reluctant to. But I think an outside perspective provides a level of objectivity that is really important."

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This Month's Statistics

	Latest Period	Current	Prior Report	A Year Ago	12 Month % Change
CPI-U	Oct/11	226.4	226.9	218.7	3.5%
CPI-W	Oct/11	223.0	223.7	214.6	3.9%
ECI EMPLOYMENT COST INDEX					
Total Compensation	3Q/11	114.6	114.3	111.2	2.1%
Wages and Salaries—Private Industry	3Q/11	113.9	114.4	112.6	1.6%
Wages and Salaries—Civilian Workers	3Q/11	114.3	113.8	112.4	1.7%
Benefits—Private Industry	3Q/11	117.2	116.8	113.6	3.2%
Average Weekly Gross Wages*	Oct/11	$658.16	$655.20	$644.21	2.2%

*seasonally adjusted

(Source: Bureau of Labor Statistics, Washington, D.C.)

All figures are national.

KEY TO STATISTICS

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 relate 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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Issued monthly. Subscription price: $395.00 annually for complete service. Periodicals mail postage paid at Old Saybrook, CT 06475-9998, Standard Mail enclosed. POSTMASTER: Send address changes to *Employee Compensation,* 141 Mill Rock Road East, P.O. Box 6001, Old Saybrook, CT 06475-6001.

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