

Human Resource Programs Subject to "Survival of the Fittest"

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Like living creatures, Human Resources (HR) programs are growing and changing. As employee needs change, costs increase, and new regulations become law, HR programs are adjusting to help employers reach their goals. As part of the evolutionary process, service providers are working with employers to adapt products, services, and support to function most effectively as conditions and the needs of employers and their employees change. A look at some of the most recent modifications to benefits programs provides an effective overview of the benefits landscape.

Taking a more personal approach

One goal of employers for their employees participating in Defined Contribution (DC) plans is to deliver communications based on individual needs. Drawing on new communications technology and data available in strong plan administration systems, that is now possible. For example, Fidelity's first PERSON communications program provides online, print, and in-person communications that are tailored based on:

- An employee's life stage
- Personal data
- Plan specifics

Fidelity is compiling data and using it to deliver to individuals specific, personalized information. Customized retirement savings scenarios illustrate the potential impact of taking action, including increased contributions, an asset allocation adjustment, or delaying retirement.

For years now, employers and employees have focused on wealth accumulation for retirement. Now, as baby boomers prepare to retire, strategies are shifting to income distribution.

Because today's retirees are expected to live 20 to 30 years after retirement, postretirement income planning goes beyond the consideration of wealth preservation (balancing preservation with continued accumulation) to considering issues such as taxes, estate planning, and long-term care.

Tying performance to goals

To further optimize HR administration programs, employers are seeking new methods to tie employee performance to company goals.

William Arnone, a partner at Ernst & Young, LLP, says a balanced scorecard approach to performance management works at his company, because everyone's performance is linked to company goals. Under this approach, the process "flows from the top into individual lines of business," Arnone says, "then to business units and then to each individual. Alignment is formally enforced. It creates a sense of coherence." Each employee has a scorecard for the three categories recognized as drivers of the business—"people, quality, and growth."

"Offering a continuum of recruitment, development, and retention is essential for meeting business goals," notes Heather Fougner, vice president of Solutions and Services at Fidelity. "Employers want to identify that they are recruiting for the right skills and processes. Without this integration, it's difficult to give clients the business intelligence they need."

If employers recruit employees with the right business skills, it will be easier to train them. The key is to identify the gap between current skills and future needs, and create development plans

according to job family or that are customized to suggest special training for individual employees.

“If you can link each performance component to a learning component, you’ll be in a better position to drive workforce productivity and enhance employee satisfaction,” Fougner says. “In addition to providing more effective development plans, integration also presents the opportunity to help cascade organizational goals throughout the employee base.”

Managing diseases

On the health and welfare front, disease management and case management also have a new look. According to the Center for Studying Health System Change (CSHSC), these two management strategies have the potential to control the costs of treating the most expensive diseases.

About 10% of patients typically account for 70% of health care spending, according to the CSHSC. If employers can manage health care costs for these employees, they should be better able to control total costs. Disease management has been used for diseases where intervention can improve care delivery, such as cardiovascular disease, diabetes, and asthma. Now it is being used for a broader range of needs, including lower-back pain, orthopedic conditions, cancer, and obesity, says CSHSC Senior Health Researcher Glen Mays. To develop a disease management program, the employer, health plan, or third-party vendor identifies which employees have targeted diseases, then regularly communicates with them, reminding them to keep up with prescriptions, doctor’s visits, weight-loss programs, and other health care regimens.

Case management typically targets patients with multiple conditions. For example, someone who is obese may have diabetes, heart disease, or other illnesses that can be addressed simultaneously. The employee is assigned a case manager who coordinates his or her care.

While the financial impact of existing programs remains unproven, Mays says, disease management and case management have the potential to control costs by avoiding delays in care, improving coordination, eliminating redundant care, and encouraging self-management. He adds that information technology systems can do even more today. They can identify and target employees, provide online access to test results, provide employees with information about diseases, and recommend treatments. New systems also better target physicians, identify eligible patients, generate reports automatically, and provide feedback.

Those programs with a return on investment have succeeded in enrolling a significant number of employees, Mays says. But enrollment is voluntary. To boost participation, some employers are providing incentives to employees or physicians.

Expensing stock options

Another new twist in workplace benefits programs is alternatives to stock options as the incentive compensation of choice. With new proposals calling for options to be treated as expenses beginning January 1, 2005, many employers are considering alternatives.

The net effect is that all types of incentive compensation will be treated equally, explains Jack Dolmat-Connell, managing director of Pearl Meyer & Partners, an executive compensation consulting firm. As a result, employers will choose the most efficient vehicle after considering cash, granting restricted stock shares, and granting different types of stock options.

Traditional stock options are given to employees with a designated share price. If the stock increases beyond that price, the options can be exercised for a net gain. If the stock price decreases, the options may become worthless. Restricted stock grants are a real share of stock, rather than an option to buy shares at a set price. If the price of the stock goes down, employees

who receive restricted stock grants realize a loss. New types of restricted shares feature lengthy vesting schedules but with performance acceleration, rewarding executives if they stay with the company and it performs well.

It is also possible that indexed and performance-based options will become popular. Indexed options give recipients an incentive to ensure that their company outperforms its peers. For example, if a company's stock increases in value by 60% and the stock of its peers increases 75%, the options will be worthless, because the company did not outperform the index. If the company's stock increases by 75% and the peers' stock increases by 60%, the options can be exercised at a gain.

"Many new ideas are being considered that are more in line with pushing performance," Dolmat-Connell observes. "At the same time, corporate governance issues and options expensing are putting pressure on companies to link executive compensation with firm performance."

Defining DB trends

The funding of Defined Benefit (DB) pension plans drew a great deal of attention in 2003 and will continue to do so in 2004. The Wall Street Journal estimates that plans are underfunded by \$300 billion and that 44 million employees could be affected. A major reason for underfunding is that pension obligations are artificially inflated because the formula used to calculate them is based on 30-year Treasury bond rates. Lynn Dudley, vice president and senior counsel for the American Benefits Council, believes Congress is on the verge of approving a new rate.

The Pension Stability Act, recently approved by The Senate Committee on Health, Education, Labor and Pensions (HELP), would replace the 30-year Treasury rate with a rate based on longterm corporate bond rates for three years. The House of Representatives approved the Pension Funding Equity Act, which replaces the 30-year Treasury rate with a corporate bond rate for two years. A compromise rate is expected before year-end. Most companies are simply waiting for Congress to act.

Employee benefits and HR programs will continue to evolve—and to become more complex. As a result, more than ever, employers need a trusted service provider to guide them through the regulatory labyrinth and help them adapt as the business landscape changes.

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